

**ANNUAL REPORT
FOR THE YEAR ENDED JUNE 30, 2006**

MXENERGY HOLDINGS INC.

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Pursuant to Section 4.03 of the Indenture, dated as of August 4, 2006 (the “Indenture”), by and among MxEnergy Holdings Inc. (“MXenergy”), certain of its subsidiaries named therein, as Guarantors, Law Debenture Trust Company of New York, as Trustee (the “Trustee”), and Deutsche Bank Trust Company Americas, as Paying Agent and Registrar, relating to the Floating Rate Senior Notes due 2011 issued by MXenergy (the “Notes”), MXenergy is furnishing the information contained herein to the holders of the Notes.

**MXENERGY HOLDINGS INC. ANNUAL REPORT
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some statements in this Annual Report are known as “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, or the Exchange Act. Forward-looking statements may relate to, among other things:

- future performance generally;
- our business goals, strategy, plans, objectives and intentions;
- our integration of the assets of Shell Energy Services Company, L.L.C. post-acquisition;
- expectations concerning future operations, margins, profitability, attrition, bad debt, interest rates, liquidity and capital resources; and
- expectations regarding the effectiveness of our hedging practices and the performance of suppliers, pipelines and transmission companies, storage operators, independent system operators, and other counterparties supplying, transporting, and storing physical commodity.

These forward-looking statements include, but are not limited to, statements about our plans, objectives, expectations and intentions and other statements contained in this Annual Report that are not historical facts. When used in this Annual Report, the words “expects,” “anticipates,” “intends,” “plans,” “believes,” “seeks,” “estimates” and similar expressions are generally intended to identify forward-looking statements. Because these forward-looking statements involve known and unknown risks and uncertainties, there are important factors that could cause actual results, events or developments to differ materially from those expressed or implied by these forward-looking statements, including our plans, objectives, expectations and intentions and other factors discussed under “Risk Factors” and other parts of this Annual Report. You should not place undue reliance on such forward-looking statements, which are based on the information currently available to us and speak only as of the date on which this Annual Report was furnished to the Trustee. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

NON-GAAP FINANCIAL MEASURES

EBITDA and Adjusted EBITDA are measures commonly used by financial analysts in evaluating performance of companies, including energy companies. Accordingly, management believes that EBITDA and Adjusted EBITDA may be useful for potential purchasers of notes in assessing our operating performance. Management also believes that these measures allow a standardized comparison between companies in the energy industry, while minimizing the differences from depreciation policies, financial leverage and tax strategies. EBITDA and Adjusted EBITDA, as used herein, are not necessarily comparable to similarly titled measures of other companies. The items excluded from EBITDA and Adjusted EBITDA are significant in assessing the economic operating results of the business.

EBITDA and Adjusted EBITDA (including pro forma presentations thereof) have limitations as analytical tools and should not be considered in isolation from, or as an alternative to, operating income, cash flow or other combined income or cash flow data prepared in accordance with generally accepted accounting principles, or GAAP. Some of these limitations are:

- they do not reflect cash outlays for capital expenditures or contractual commitments;

- they do not reflect changes in or cash requirements for, working capital;
- they do not reflect the interest expense or the cash requirements necessary to service interest of principal payments, on indebtedness;
- they do not reflect income tax expense or the cash necessary to pay income taxes;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and EBITDA and Adjusted EBITDA (including pro forma presentations thereof) do not reflect cash requirements for such replacements;
- Adjusted EBITDA does not reflect the impact of earnings or charges resulting from matters we consider not to be indicative of our ongoing operations; and
- other companies, including other companies in our industry, may calculate these measures differently than as presented in this Annual Report, limiting their usefulness as a comparative measure.

Because of these limitations, EBITDA and Adjusted EBITDA (including pro forma presentations thereof) and the related ratios should not be considered as measures of discretionary cash available to invest in business growth or reduce indebtedness. We compensate for these limitations by relying primarily on our GAAP results using EBITDA and Adjusted EBITDA (including pro forma presentations thereof) only supplementally. For more information, see the consolidated financial statements and related notes included elsewhere in this Annual Report.

The SEC has adopted rules to regulate the use in filings with the SEC and public disclosures and press releases of non-GAAP financial measures, such as EBITDA and Adjusted EBITDA, that are derived on the basis of methodologies other than in accordance with GAAP. These rules require, among other things:

- a presentation with equal or greater prominence of the most comparable financial measure or measures calculated and presented in accordance with GAAP; and
- a statement disclosing the purposes for which the registrant's management uses the non-GAAP financial measure.

The rules prohibit, among other things:

- exclusion of charges or liabilities that require cash settlement or would have required cash settlement absent an ability to settle in another manner from non-GAAP liquidity measures;
- adjustment of a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual, when the nature of the charge or gain is such that it is reasonably likely to recur; and
- presentation of non-GAAP financial measures on the face of any pro forma financial information.

The non-GAAP financial measures presented in this Annual Report may not comply with these rules and may be excluded from the registration statement we have agreed to file with the SEC with respect to our Floating Rate Senior Notes due 2011.

BUSINESS

In this Annual Report, the term “Issuer” refers to MxEnergy Holdings Inc., a Delaware corporation, the term “MXenergy” refers to the Issuer and its subsidiaries before giving effect to the acquisition of the assets of Shell Energy Services Company, L.L.C., a Delaware limited liability company which is referred to herein as “SESCo,” which acquisition took place on August 1, 2006. Unless the context requires otherwise, the terms “Company,” “we,” “us,” “our,” or similar terms, refer to MXenergy after giving effect to the acquisition of the SESCO assets as if it had occurred on June 30, 2006.

Our Business

Overview

We are an independent energy provider of retail natural gas and electric power to residential and commercial customers in deregulated markets in the U.S. and Canada. We serve natural gas customers located in 28 market areas across 11 states and Ontario, Canada, and electricity customers in six market areas in Massachusetts and New York.

We provide customers a choice in natural gas and electricity supply with alternative price structures. We principally market two products: (i) fixed price contracts with terms of up to three years that provide consumers with price protection against fluctuations in natural gas and electricity prices and (ii) variable price contracts that are usually priced competitively with the price offered by the region’s incumbent utility. We derive margin or gross profit from the difference between the price at which we are able to sell natural gas or electricity to customers and the price at which we purchase the offsetting volumes. Both natural gas and electricity are supplied to the consumer using the distribution infrastructure of the respective local distribution company, or LDC.

It is our policy to match the estimated requirements of fixed price customers by purchasing or hedging offsetting volumes of natural gas and electricity in advance of entering into a fixed price contract with our customers. Due to the price volatility of natural gas and electricity, we believe it more prudent to purchase anticipatory hedges in line with short term marketing estimates for sales of fixed price contracts to residential and small commercial customers instead of purchasing hedges after such sales are made. Any unused anticipatory hedges are typically sold within a short period of time or the volumes are applied toward fixed price customers whose contracts come up for renewal. In addition, our forward hedged volumes are reduced by the amount of attrition we expect to realize over the customers’ contract terms. By following a policy of purchasing or hedging all estimated fixed price customer supply obligations in advance, we are able to achieve more stable and predictable cash flows.

We have grown both organically and through acquisitions, having completed six acquisitions since 1999 not including the acquisition of SESCO’s assets (to be discussed below).

Recent Developments

On August 1, 2006, MXenergy acquired substantially all of the assets of SESCO, a wholly owned subsidiary of Shell Oil Company, serving primarily residential and small commercial markets. As of August 1, 2006, SESCO supplied natural gas to approximately 315,000 residential and small commercial residential customer equivalents, or RCEs (each reflecting 100 MMBtus of annual consumption), in the deregulated markets of Georgia and Ohio. Such transaction is referred to herein as the SESCO acquisition. In addition to expanding MXenergy’s relationships with customers in two LDC markets it already serves in Ohio, the SESCO acquisition also expanded MXenergy’s operations in Ohio to include customers in the service territory of Vectren Energy Delivery of Ohio, or Vectren, and added Georgia to

the list of states in which MXenergy operates. We consummated the SESCo acquisition with the proceeds from a \$190.0 million senior unsecured loan, referred to herein as the bridge loan. On August 4, 2006, we sold \$190.0 million aggregate principal amount of Floating Rate Senior Notes due 2011, referred to herein as the notes, in a Rule 144A offering. The net proceeds from the sale of the notes were used to repay the bridge loan. The aggregate consideration payable in connection with the purchase equaled \$125.5 million, subject to certain post closing adjustments. See Note 14 to MXenergy's consolidated financial statements included elsewhere in this Annual Report.

Concurrently with the closing of the SESCo acquisition, we entered into a committed exclusive hedge facility with Société Générale, referred to herein as the hedge facility. The hedge facility has an initial term of two years with subsequent one year renewal terms. The hedge facility provides us with the ability to enter into financial swaps based on settlement prices of the New York Mercantile Exchange, or NYMEX, natural gas contract for the Henry Hub delivery point as well as basis swaps settled against widely published indices for a tenor of up to 39 months. The hedge facility is secured by a first lien on customer contracts and a second lien on substantially all other assets of the Company. We will continue to procure physical supply for customers in LDC markets where MXenergy operated prior to the SESCo acquisition under our agreement with Virginia Power Energy Marketing, or VPEM, through the end of its term (June 30, 2007). We will purchase physical supply for customers in Georgia, the Vectren LDC market in Ohio and any new LDC market we may enter from a portfolio of energy suppliers under standard North American Energy Standards Board contracts.

Concurrently with the SESCo acquisition, we amended and restated our existing credit facility with Société Générale and a syndicate of lenders. The amended and restated revolving credit facility, which is referred to herein as the revolving credit facility, provides up to \$280.0 million of borrowing availability and is secured by a second priority lien on customer contracts and a first priority lien on substantially all of our and our subsidiaries' other existing and future assets.

In this Annual Report, the offering of the notes, the funding and repayment of the bridge loan, the SESCo acquisition, the entrance into the hedge facility, the amendment and restatement of the existing credit facility and the payment of related fees and expenses are referred to as the transactions.

Commodity Supply

Each month, we purchase physical natural gas and electricity to enable us to meet our estimated supply obligations to our customer base and fix the margins for our variable priced natural gas customer base. Prior to the SESCo acquisition, MXenergy purchased natural gas and performed all natural gas hedging activity under an exclusive supply arrangement with VPEM. The agreement with VPEM expires on June 30, 2007.

Concurrently with the closing of the SESCo acquisition, we entered into a committed exclusive hedge facility with Société Générale. Shortly after the closing of the SESCo acquisition, all forward hedged positions then in place between MXenergy and VPEM were novated from VPEM to Société Générale. The hedge facility has an initial term of two years with subsequent one year renewal terms. The hedge facility provides us with the ability to enter into NYMEX and basis swaps for a tenor of up to 39 months. Fees under the hedge facility include an annual management fee and a volumetric fee based on the tenor of the swap.

The hedge facility is secured by a first lien on the customer contracts and a second lien on substantially all other assets of the Company. In addition, we provided \$25.0 million of collateral for potential negative mark-to-market changes in the value of the forward hedged position. We will not be required to post additional collateral beyond the initial margin requirements unless our forward hedged

positions exceed 65,000 million British thermal units, or MMBtu, which is a standard unit of heating equivalent for natural gas. Pro forma for the SESCO acquisition, our forward hedged positions as of June 30, 2006 totaled approximately 42,600 MMBtu which provides us with the ability to increase our forward hedged positions by 53% before we would be required to post any additional collateral.

We will continue to procure physical supply for the customers in LDC markets where MXenergy operated prior to the SESCO acquisition under our agreement with VPEM through the end of its term. We will purchase physical supply for customers in Georgia, the Vectren LDC market in Ohio and any new LDC market we may enter from a portfolio of energy suppliers, a majority of which are investment grade rated, under standard North American Energy Standards Board contracts. Physical supply is purchased from various energy trading firms in either a producing region or at a delivery point that will enable us to deliver to the city gate of the respective LDCs. In some markets, we may enter into transactions with the LDC to purchase or sell natural gas to us in order to balance deliveries with customer.

As of June 30, 2006, electricity for fixed rate customers behind National Grid USA in Massachusetts is supplied through DTE Energy Trading Inc., or DTE, pursuant to a supply agreement dated March 8, 2005. We purchase electricity supply for all customers in New York State from the New York Independent System Operator, or NYISO, pursuant to the terms of NYISO's Market Services Tariff. Electricity for fixed rate customers behind Rochester Gas & Electric, or RG&E, is hedged pursuant to a swap agreement with DTE dated as of January 12, 2006.

Risk Management

Because our contracts require that we deliver full commodity requirements to many of our customers and because our customers' usage is impacted by factors such as weather, we may periodically have purchased more or less commodity than our aggregate customer volumetric needs. In buying or selling excess volumes, the Company may be exposed to price volatility. In order to address the potential volumetric variability of our monthly deliveries for fixed priced customers, we implement various hedging strategies to attempt to mitigate our exposure. For variable priced customers, we typically pass on the financial impact of the volumetric mismatches in subsequent months.

For fixed price natural gas, our hedging tools include: (i) increasing our winter volume estimates by up to 10% in certain markets that require daily balancing of customer demand in order to minimize the financial impact of high prices during greater-than-normal demand as a result of colder-than-normal weather conditions; (ii) maximizing the use of storage in our daily balancing market areas in order to give us the flexibility to offset volumetric variability arising from changes in winter demand; (iii) entering into daily swing contracts in our daily balancing markets over the winter months to enable us to increase or decrease daily volumes if demand increases and (iv) purchasing put options on some portion of our fixed price requirements to protect against falling prices if unused volume needs to be sold at prices lower than cost. Being geographically diversified in our delivery areas also permits us, from time to time, to deploy commodity not being used in one area to other areas, thereby mitigating potential increased prices for natural gas that we may have otherwise had to acquire at higher prices to meet increased demand. We also try to balance our portfolio by shifting unused fixed price natural gas to variable price customers under financially acceptable terms. For fixed price electricity contracts, we aim to avoid volumetric risk by purchasing full requirements load following services from DTE which insulates us from price exposure within a +/-10% volume range.

By following our various hedging strategies, we are able to target stable and predictable cash flows. We also mitigate the risk of changing volumes resulting from weather and attrition by signing up new customers and renewing existing customers onto new fixed price contracts at prices that reflect

current market prices as well as by hedges that are entered into to offset our anticipated but unrealized demand.

We utilize NYMEX-settled and basis swaps to offset price risk associated with volume commitments under fixed price contracts. The NYMEX-based financial swaps are settled against each month's last trading day's closing price for natural gas listed on the NYMEX Henry Hub futures contract. The financial basis swaps are typically settled against the first of the month published index prices at various trading points which relate to locations where we have customer obligations. Physical basis swaps are priced based on NYMEX last day settle plus or minus an agreed upon premium or discount. All of the swaps we have executed have been done over the counter on a bilateral basis under our VPEM Supply Agreement, under our new hedge facility or with other credit worthy counterparties. We only execute financial swaps with investment grade rated entities.

Our risk oversight committee is currently chaired by Stuart Porter, a member of our board of directors who has extensive trading and risk management experience. The committee, whose members are appointed by the board of directors, establishes and oversees the execution of our credit risk management policy, supplier risk management policy and market price risk management policy. The risk management policies are reviewed at least annually, and the committee typically meets quarterly to assure that we have followed its policies and that we continue to be price neutral through proper commodity hedging. The committee seeks to assure the application of our risk management policies to new products and to any acquisition of new assets. The committee reports to the board of directors on a regular basis as to the status of the risk management activities and positions. We employ a risk manager who reports directly to the Chief Financial Officer and whose compensation is unrelated to trading activity. Commodity positions are typically reviewed and updated daily based on information from our customer databases and pricing information sources. On a weekly basis, a report is sent to our hedge facility provider that includes, among other things, our total estimated volumetric sales and purchase requirements, the net long or short position that may exist in any forward month, and the mark-to-market of those positions. The risk policies currently require that any position with an exposure in excess of \$5.0 million for more than two days must be mitigated promptly.

When executing hedges, the position is reviewed by the risk manager who makes a recommendation to the Chief Financial Officer, Chief Operating Officer and/or the Chief Executive Officer, who approve the action, which is then implemented by the supply department. For basis hedges, any of the Vice President of Supply, Chief Financial Officer, Chief Operating Officer or Chief Executive Officer approves the action recommended by the risk manager.

Our Competitive Strengths

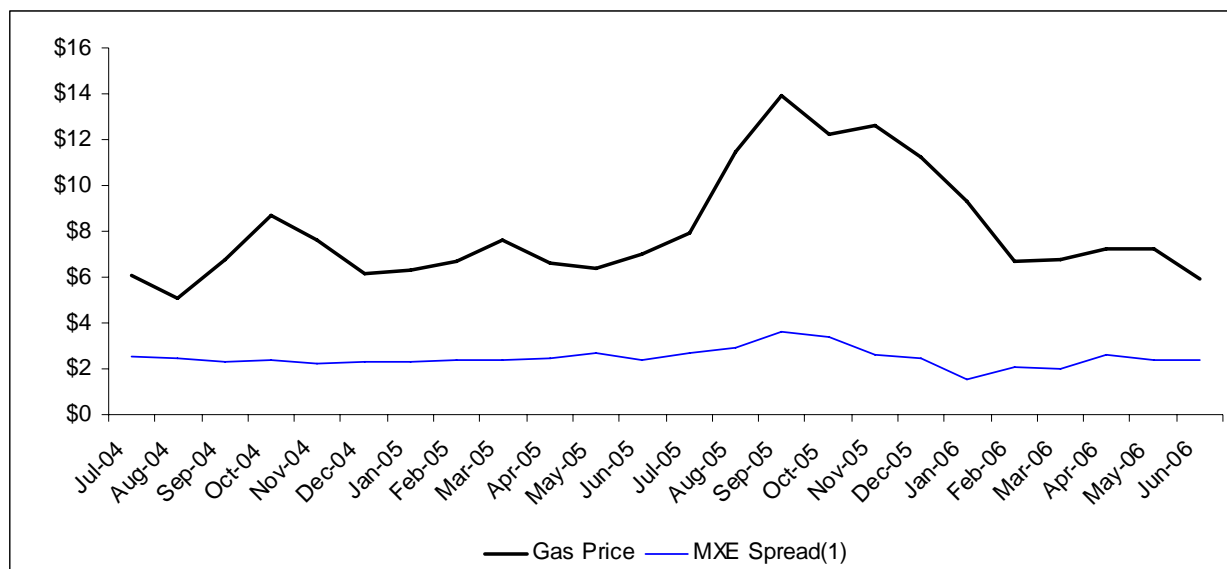
We are one of a small number of successful retail energy marketers in the growing deregulated market. We believe we are well-positioned relative to our competitors and possess a combination of strengths that will enhance our ability to continue to grow.

Significant Risk Management Expertise

We deliver fixed price, full requirements product offerings for commodities that are volatile, and as such, may be periodically exposed to price volatility and volumetric changes. In order to address the potential price and volume variability of future deliveries, we implement various hedging strategies to mitigate our exposure. For fixed price contracts, which represent 59% of our business, we reduce our exposure to potentially high spot energy prices by following a policy of hedging all estimated customer supply obligations in advance. Additional hedging tools include: (i) increasing our winter volume estimates by up to 10% in certain markets that require daily balancing of customer demand, in order to

minimize the financial impact of high prices during greater-than-normal demand as a result of colder-than-normal weather conditions; (ii) maximizing the use of storage in our daily balancing market areas in order to give us the flexibility to offset volumetric variability arising from changes in winter demand; (iii) entering into daily swing contracts in our daily balancing markets over the winter months to enable us to increase or decrease daily volumes if demand increases and (iv) purchasing put options on some portion of our fixed price requirements to protect against falling prices if unused volume needs to be sold at prices lower than cost. We have historically demonstrated the effectiveness of our risk management strategies through our ability to maintain margins despite both the highly volatile commodity price environment of recent years and the variation in seasonal temperatures, including, for example, the winter quarter of 2005-2006 when heating degree days were 13% lower than the 30 year average. Our mix of fixed price and variable price customers affords us additional flexibility to supply variable price customers with unused, pre-purchased commodity supply in periods of lower than expected usage.

Our risk management policies and hedging track record have enabled us to maintain stable margins for natural gas sales despite volatility in gas prices:



(1) The spread is equal to the fixed price weighted average sales price less the hedge price for a given period.

Attractive Customer Base

We have approximately 418,000 residential, small and mid-market commercial RCEs under fixed price contracts. In addition, we have approximately 296,000 residential, small to mid-market commercial RCEs under variable contracts. Among the retail marketers and wholesale merchants, competition is most intense for the larger volume commercial and industrial accounts. Our primary target customer segments are residential and small to mid-market commercial customers. No single customer accounts for more than 1.7% of our volume.

Approximately 98% of our RCEs are natural gas customers. The states in which we operate allow contracts to be automatically renewed for fixed terms or otherwise extended based upon procedures set forth in each state. In six of the last seven years, MXenergy has been able to grow its customer base, adding more customers each year than those lost through attrition. In part, this has occurred because of our high renewal rate of approximately 90% of customers with fixed rate contracts and is evidenced by the fact that approximately 60% of our customers have been with us for two or more years. Bad debt

expense associated with our customer base has also historically been low at approximately 1% of total sales. Since we participate in 28 different LDC markets, we are uniquely positioned to take advantage of marketing opportunities as presented and to deploy a regional marketing focus.

Successful Track Record of Acquiring and Integrating Retail Customer Businesses and Customer Portfolios

Through our acquisitions, we have developed a unique ability to integrate businesses and retain customers successfully.

Since our inception in 1999, we have completed the following acquisitions:

<u>Date</u>	<u>Company</u>	<u>No. and Type of RCEs</u>
May 2000.....	Keyspan Energy	18,000 natural gas
March 2001.....	Summit Energy	15,000 natural gas
September 2001.....	Energy.com	5,000 natural gas
February 2003.....	Nicor Gas	28,000 natural gas
March 2004.....	Total Gas & Electric	90,000 natural gas 13,000 electricity
November 2005.....	Castle	53,000 natural gas
August 2006.....	SESCo	315,000 natural gas

Many of these acquisitions were in markets that were not previously served by MXenergy and hence provided new marketing opportunities.

Experienced Management Team

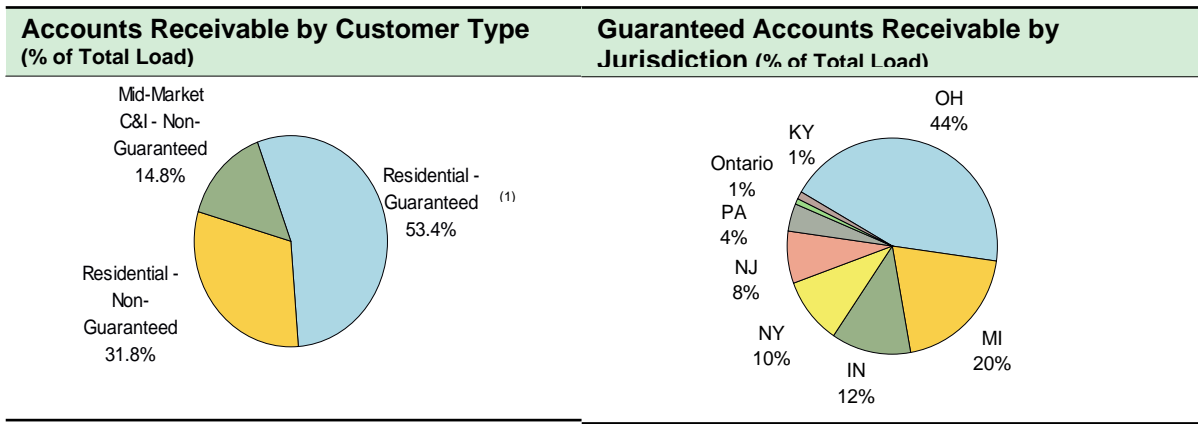
Several members of our senior management team have extensive experience in energy risk management and retail marketing as well as in creating, developing and managing businesses and risk on behalf of major international corporations. Jeffrey Mayer, our Chief Executive Officer, has over 27 years of experience as a lawyer and expert in energy derivatives including futures, swaps, and options. Mr. Mayer’s prior experience includes serving as a Managing Director at Sempra Trading Corporation, as the Chairman of AIG Clearing Corporation and AIG Securities Corporation and in various roles at Goldman, Sachs & Co., including serving as the Chief Counsel of its J. Aron Commodities Division and manager of its Energy Futures Department. Carole R. (“Robi”) Artman-Hodge, our Executive Vice President, has over 28 years of experience as a commercial banker, energy credit and energy and commodity finance specialist, including positions in the Project Finance unit of Bank of Ireland, the Natural Resources unit of ING and the Treasury Marketing unit of Banque Paribas. Steven Murray, our Chief Operating Officer, served in the Royal Dutch Shell group of companies over a period of 25 years in a variety of roles, most recently as President and Chief Executive Officer of SESCO. Other significant roles held by Mr. Murray at Royal Dutch Shell included President and Chief Executive Officer of Shell Trading US Co. and Director of Shell Chemicals Risk Management Services. Emmett Capanna, our Senior Vice President of Supply and Marketing, has almost 40 years of experience in natural gas and fuel oil supply acquisition, and hedging, and was a co-founder of one of the first deregulated natural gas marketers, U.S. Energy Partners which eventually became PSEG Energy Technologies. Chaitu Parikh, our Chief Financial Officer, spent five years with a Big Four accounting firm and, prior to joining MXenergy, worked with three deregulated natural gas marketing firms in Canada and the United States for over 10 years.

Geographically Diverse Operations

Our diversified geographical coverage, where we serve customers in more LDC markets than most other competitive marketers, provides several benefits to us, including flexibility in product offerings and marketing campaigns, broad demographic mix, diversified credit exposure and economies of scale. Our multi-state approach helps protect us from the risk of a single LDC default, a material regulatory change in a single jurisdiction, extreme local weather patterns or localized economic downturn. In addition, operating in multiple regions allows us to utilize a diverse natural gas transportation and storage infrastructure and capitalize on our regional supply and pricing knowledge.

Guaranteed Accounts Receivable

Approximately 53% of our accounts receivable are with residential and small commercial customers that are guaranteed or purchased by the LDCs at a weighted average discount rate of approximately 1%. Such discount is the cost of service to guarantee or purchase the receivable. In cases where receivables are guaranteed or purchased by the LDC, we are exposed only to the credit risk of the LDC, rather than that of our actual customers. 92% of our accounts receivable in guaranteed markets are with investment grade LDCs. We assume the credit risk for approximately 9% of the total volume billed by LDCs on our behalf and for the remaining 38% of the total volume billed by us.



1. Weighted average discount rate of Guaranteed Accounts Receivable is 1%.

Committed and Knowledgeable Equity Ownership

Our primary stockholders include Sowood Commodity Partners Fund LP, or Sowood, The Charterhouse Group, or Charterhouse, and Greenhill Capital Partners, or GCP. These stockholders have made equity investments that have provided us with sufficient financial capital to grow and support our business. These stockholders have an in-depth understanding of the energy and financial markets, and provide strength and insight for our activities and strategy. Sowood and its affiliated funds have investments in assets and companies that provide goods and services in commodity markets, primarily in the energy sector. Charterhouse is a New York-based, middle-market private equity investment firm with a focus on buyouts, build-ups and growth capital financings. Since its inception in 1973, Charterhouse has invested more than \$1.9 billion in over 100 platform businesses on behalf of global institutional investors through its limited partnerships. GCP is an affiliate of Greenhill & Co., Inc., an independent global investment banking firm. GCP manages several private equity funds which total \$1.3 billion in capital, focusing on the energy, financial services and telecommunications industries.

Our Strategy

Our retail energy sales depend upon our ability to identify and enter profitable, deregulated, retail energy markets, manage the cost of customer acquisitions, integrate acquired businesses successfully, retain customers and attract new customers in our existing markets. The principal components of our strategy are to:

Offer a Competitively Priced, Differentiated Product

Our fixed price product offering is differentiated from that offered to consumers by most incumbent LDCs and many of our competitors. We offer our customers a fixed price product with a term of up to three years in contrast to the floating rate, market-priced product of most LDCs and many of our competitors. We believe we are one of few retail marketers that offer a fixed price product that extends for a three year term. By offering energy supply at fixed prices, residential and commercial consumers are protected from volatile and potentially higher energy prices. We also offer a variable price product which is designed to be competitive with the variable price product offered by the LDCs. We selectively focus on markets that have rate structures, market rules, consumer demographics, energy consumption patterns and liquidity for risk management products that enable us to provide value added products offering flexibility to our customers at an acceptable margin. We continue to explore other attractive product opportunities that may be marketable in the changing energy markets, including, among others, capped products, capped escalating fixed rate products, descending rate fixed products, seasonal fixed rate products, partially fixed rate products and a flat rate bill product where the customer pays the same monthly amount with no annual or seasonal true up.

Maintain Prudent and Proven Hedging and Risk Management Policies

Our leadership team has substantial experience managing risk in energy companies and maintains conservative risk management policies with a strong emphasis on price and volumetric neutrality. We employ a separate risk manager who is responsible for monitoring our hedge book and ensuring compliance with our risk management guidelines. Our board of directors has a risk oversight committee which typically meets quarterly to, among other things, review and revise current risk management policies.

Our strategy is to minimize our risk positions and not enter into speculative trading positions. As a marketing company, we hedge up to one month of anticipated contract sales to residential and small commercial customers. In the case of mid-market commercial customers, we hedge the contract sale at the time of execution. By following a policy of hedging all of our estimated customer supply obligations in advance or, in the case of more price sensitive mid-market customers, at the time of contract execution, we are able to achieve more stable and predictable cash flows.

We monitor our forward fixed price exposure on a daily basis. Each day, we update our position from data in our customer database systems, which enables us to estimate the expected forward consumption volume based on our past historical usage profiles, in the case of residential and small commercial customers, and based on actual contracted volume, in the case of our mid-market commercial customers. The resultant sales volumes are then deducted from our anticipatory hedge to determine our net position. This approach ensures that we maintain a forward hedged position sufficient to cover expected demand from existing, renewal and new customers. In addition, we receive new volumetric profile information from the LDCs at least monthly, which is incorporated into our estimated customer demand reports. Any resulting change in volume from attrition or new accounts is covered by adjusting our hedges to a neutral position in accordance with our risk management policy.

Build and Maintain an Excellent Commodity Supply Team

The retail energy supply business demands excellence in managing the procurement, transport, storage and balancing of commodity supply. We have recruited a team of professionals with expertise not only in natural gas and electricity supply generally but also in the supply to our specific markets. This expertise is essential to procure commodity and transport, and nominate and schedule commodity on interstate pipelines and LDC systems. We believe the addition of key members of the SESCO team in our Houston office will bolster our expertise.

Pursue Organic Growth And Opportunistic Acquisitions

We plan to continue to grow our customer base by aggressively pursuing growth opportunities both organically and through acquisitions. Given the broad and expanding support for a competitive retail energy marketplace, coupled with the fact that only 11% of the eligible participants nationwide currently participate in deregulated programs, we believe the growth opportunities for competitive retail marketers such as the Company are considerable. We have developed a set of criteria for identifying attractive markets and for acquiring, integrating and retaining customer business in such markets. We intend to expand our distribution of natural gas within our existing markets and to move into new LDC markets by leveraging our success in prior acquisitions, our customer care platform and our established multi-channel marketing system. As a result of the acquisition of a robust customer data system plus billing and collections platform as part of the SESCO acquisition, we foresee an ability to penetrate further into the mid-market commercial segment in territories where we do not currently market to such customers.

Maintain A Low Cost Operating Structure

We aim to keep our overhead costs low by (i) relying on incentivized sales personnel and (ii) selectively outsourcing certain sales and marketing, customer servicing, systems and web-development functions. We also attempt to keep our direct customer acquisition costs to a level that can be repaid by no more than one year's gross margins and expect that we will effectively enjoy an annuity from subsequent years of supply.

Uphold High Customer Service Standards

In order to ensure customer satisfaction and minimize attrition, we maintain a call center in Maryland with a staff exclusively dedicated to customer inquiries, enrollments and renewals. We aim to maintain the highest standards in customer service. We track our call center metrics and measure them against industry standards and our target customer service levels. We continuously strive for improvement in our customer service levels by tracking the number of dropped calls, average hold time, nature of inquiry or complaint, and disposition time. MXenergy experienced significant improvement in its customer care center between 2005 and 2006. For example, in 2006 our call center volume increased by 12% while the number of calls answered within 120 seconds increased to 93% from 87% in the prior year.

To reduce the potential for unethical marketing practices by sales agents, we have implemented the following processes to achieve our objectives: (i) recorded independent third party verification calls on sales, including those made door to door, (ii) recorded telemarketing sales calls and periodic quality assurance calls to customers and remote call monitoring; (iii) incorporated legal review and submission of telemarketer scripts and marketing materials to LDCs and public utility commissions for review; (iv) mailed welcome letters with terms and conditions; and (v) conduct audits to ensure compliance by marketers with all FTC, LDC, and local public utility commission rules, regulations and guidelines. For our Georgia and Ohio markets, we are using an outsourced call center service which has proven to be

compliant with our customer care performance metrics. We have extended the former SESCO contract with this group of outsourced call centers.

Leverage Our Investment In Information Systems

We have identified what we believe are the best customer relationship management software, billing engine, weather forecasting and risk-management software systems available. We have worked with vendors to customize these systems to operate our back-office functions, including customer enrollment, inventory management, forecasting, risk management settlement and billing. This combination of purchased software and internally developed systems creates a powerful, integrated solution that has been continuously improved with automated interfaces and process efficiencies. A streamlined information system allows us to avoid delays in the launch of commercial operations into new markets, maintain an attractive cost structure due to minimal support staff requirements, ensure superior customer service, aid in our sales and marketing efforts and manage exposure to significant price variations and exchange data through electronic data interface systems with the legacy systems of the respective LDCs. These information systems create a strong leveraging opportunity for growth.

Core Products and Services

Our core business is the retail sale of natural gas and electricity to end-use customers. We offer natural gas and electricity service to customers under contracts with terms of up to three years. We offer fixed and variable price products and, in the case of natural gas, several other innovative pricing programs designed to cap prices or manage the risks of energy volatility. The positive difference between the sales price of energy to our customers and the sum of the wholesale cost of our energy supplies, hedging costs, transmission costs and ancillary services costs provides us with a gross profit margin. The natural gas and electricity we sell are generally metered and delivered to our customers by the local utilities. The local utilities frequently provide billing and collection services on our behalf. Currently, Georgia is the only market where the local utility does not provide billing and collection services on our behalf for residential customers.

We aim to keep our products simple in order to facilitate marketing to residential and small commercial customers. Our fixed rate product protects consumers from increases in the unit price of natural gas or electricity for a term of up to three years. In marketing this product, we do not promise savings as a consumer could pay more if local utility prices, which are based on variable market prices, fall during the term of the fixed rate contract. We offer customers different variations on the fixed rate product if they wish. For example, customers may wish to have fixed rate protection only for the winter months while letting the summer price float with the market. We also have offered some customers a cap product in which their price floats with the market but cannot exceed a fixed rate cap. Because of the high volatility of energy products like natural gas and electricity, the cost of such caps, which must be hedged with call options, is very high. Our variable rate product is similar to utility variable rate pricing but without the cost recovery factors that frequently conceal from customers the true cost of energy supplied by the utilities. By using alternative supply arrangements, we are sometimes able to supply customers with commodity at a price lower than the utility's tariff pricing which often includes costly items such as firm transportation.

We sell natural gas and electricity at contracted prices based on the real-time demand or usage of our customers. We buy natural gas and electricity in the wholesale market in time specific, bulk or block quantities, usually at fixed prices. We manage the differences between the actual sales demand of our customers and our bulk or block purchases by buying and selling any shortfall or excess in the spot market. Independent system operators, or ISOs, and regional transmission organizations, or RTOs, which manage transmission infrastructure in a particular region, perform real-time load balancing for each of the

electric grids in which we operate. Similarly, balancing is performed by the utilities or LDCs, for each of the natural gas markets in which we operate. We are charged or credited by the ISOs and LDCs for balancing of our electricity and natural gas purchased and sold for our account.

For medium and large commercial customers, we enter into bilateral agreements which set out our responsibilities to deliver natural gas to the customer and the customer's responsibilities to pay for the natural gas. For a residential or small commercial customer to switch from the local utility offering to one of our rate plans requires that the customer confirm its enrollment in writing or in a recorded telephone call. Enrollment requires disclosing the customer's utility account number, visible on the customer's bill, and in some cases the customer's meter number. Upon enrollment, we are responsible for uploading to the applicable utility customer details, including name, address, and account or meter numbers. Utilities must accept the customer enrollment before we are required to flow gas or electricity to the customer. Acceptance rates vary, in our experience, from 50-100% of enrollments. Once a customer has been accepted, the utility advises us of the customer's annual, monthly and in some cases, daily consumption needs, and we must meet those needs by supplying energy to locations determined by the utility. Periodically, the utility will read the customer's meter and send a monthly bill to the customer which lists us as the supplier. In addition to meter reading and generating bills (except in Georgia) for our residential and small commercial customers, the utility will provide emergency service and maintenance on the customer's account.

Generation of Revenue

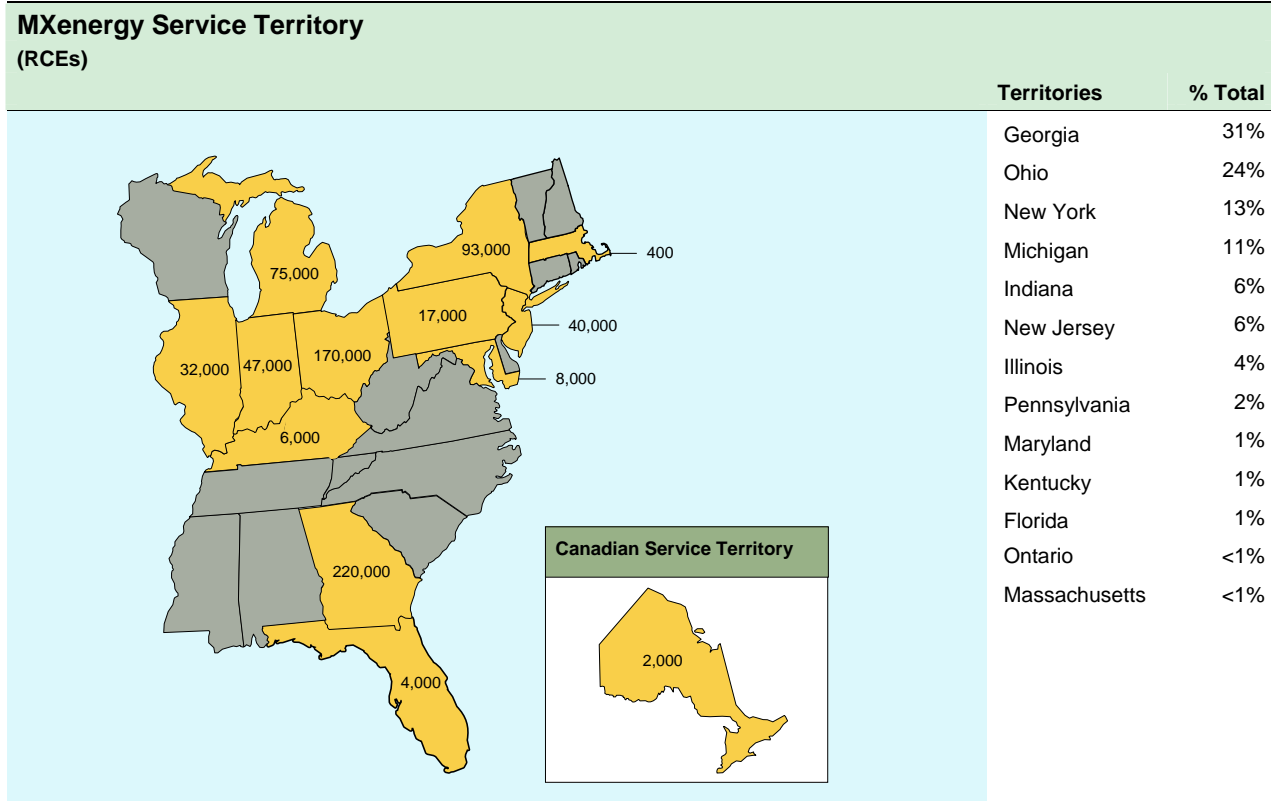
We primarily generate revenue through retail sales of natural gas to residential and small commercial customers. We have approximately 714,000 RCEs, 12,000 of which are derived from our electricity operations, with approximately 59% under fixed priced contracts and approximately 41% under variable priced contracts. For the year ended June 30, 2006, approximately 98% of our sales were derived from the supply of natural gas and the remaining sales were derived from the supply of electricity. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" for more information regarding our revenue sources.

Our Customers and Markets

We deliver natural gas to approximately 702,000 RCEs in 28 LDC markets and electricity to approximately 12,000 RCEs in six market areas across 12 states and Ontario, Canada. Our customer base consists of residential, small and mid-market commercial customers. Our business is not dependent upon any one customer or a single territory or market. No single customer accounts for more than 1.7% of our volume. Our multi-state approach allows us to benefit from a diverse stream of sales, capitalize on economies of scale and realize synergies from our existing business. In addition, our multi-state approach allows us to be insulated from the risk of a single LDC default, a material regulatory change in a single jurisdiction, extreme local weather patterns or a localized economic downturn.

The following map illustrates the regions in which we are currently active in the U.S. and Canada and the respective number of RCEs as of June 30, 2006:

**MXenergy Service Territory
(RCEs)**



Natural Gas

We have approximately 702,000 natural gas RCEs, with approximately 59% under fixed priced contracts and approximately 41% under variable priced contracts. Our customer contracts have an average remaining life of 18 months. Due to both our history of acquisitions and strong organic growth, we have enjoyed steady expansion of our natural gas customer base over the past several years. From 2001 to 2006, our natural gas RCEs grew from 81,120 to approximately 702,000.

During 2005, as a result of new telemarketing regulations (i.e., FTC guidelines and Do Not Call listings), we transitioned many of our outsourced marketing companies to new, fully compliant companies. We experienced a slight decline in customers between 2004 and 2005 due to the impact of transitioning third-party marketing efforts. Since the beginning of the last quarter of fiscal 2006, we have experienced a decline in customers, largely due to expected customer attrition related to the SESCO acquisition, the scheduled roll-off of mid-market commercial customers and reduced marketing to residential customers due to the historically unusual current gas market economics in which the weighted average cost of long-term natural gas supply is higher than the cost of near-term natural gas.

Currently, we actively market natural gas across 28 LDC markets in 11 states (Florida, Georgia, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, New York, Ohio, Pennsylvania) and the

Province of Ontario. All of these markets are open for direct access purchasing of natural gas from retail marketers.

Electricity

MXenergy has taken a conservative approach in entering the deregulated retail electricity market. There are currently 19 states that are open for direct access sales to end use customers of electricity. We are evaluating each market to determine which are most advantageous to enter. Our intent is to develop this business organically and through acquisitions and leverage potential cross-selling opportunities with our natural gas business. We believe offering both natural gas and electricity to the same customer leverages our existing infrastructure and decreases customer churn.

MXenergy entered the deregulated retail electricity market in 2004 via the acquisition of TG&E. The acquisition provided MXenergy a New York electric customer base. Currently, we service approximately 12,000 RCEs in New York and Massachusetts (16% fixed and 84% variable price contracts).

Renewals and Attrition

At the end of each customer contract term, customer contracts in most of our markets are renewed upon notification by the marketers unless the customer indicates otherwise. We notify customers about the expiration of their contract with a letter, which is mailed in advance of expiration in accordance with applicable law and regulation. The letter indicates that the contract will automatically renew and sets forth the new contract terms, leaving the customer the option to decline service. From 2003 to 2005, approximately 90% of MXenergy's customers that received such notification of contract expiration ultimately renewed their contracts.

From 2003 to 2006, MXenergy experienced an average annual in-contract customer attrition rate of approximately 23%, which we believe is consistent with the industry average. The loss of customer accounts is largely due to: (i) residential moves, (ii) customer payment defaults and (iii) customer initiated switches. We are focusing our efforts on lowering our attrition rate. We have instituted a "move" program to follow customers who have moved within another area serviceable by us, offering the ability to re-establish their rate plan. Historically, new customers gained through organic growth and acquisitions have offset the number of customers lost, evidenced by our growing customer base over time.

Sales and Marketing

We have developed a strong, differentiated brand that is "personality-driven." Our brand message offers customers the ability to control their energy rates and better manage their household (or business) budgets. Through the use of a distinct logo and two iconic animated characters, our product proposition is presented in an easy-to-understand message. We aim to achieve a tone and manner of communication that is friendly and approachable and marketing materials that are distinctly different from those of our competitors by avoiding the look and feel of a traditional utility company.

Our year-round sales and marketing efforts focus on three strategic areas of concentration: attracting new customers, retaining and renewing existing customers and winning back former customers who have cancelled or switched to the local utility or another supplier.

Branding & Customer Communications

We differentiate ourselves through our branded communications to our customer. We strive to simplify all marketing communications and impart practical, straight-forward information.

To acquire new customers, we employ an integrated marketing mix that consists of multiple combinations of direct marketing, traditional and online media, public relations and local event participation. Our goal is to have direct marketing efforts, which include outbound telemarketing to both residential and small commercial customers, direct sales (outside sales focusing on small and mid-market commercial customers), and direct mail targeted to high purchase propensity residential and small commercial customers, all of which account for the majority of our total tactical marketing mix.

To retain existing customers, we rely on our highly-trained internal and external customer care representatives. Customers requesting cancellation of service are provided helpful information on the volatility of natural gas rates and encouraged to retain the benefits of long-term rate protection, if appropriate. We proactively contact customers who have moved to another area we service. We permit customers to remain on an existing contract if the move has occurred within 30 days following cancellation notice.

If we receive notification from an LDC that customers have cancelled or switched to another supplier, we will attempt communication through both mail and phone, encouraging customers to reconsider their decision, reminding them of penalties they may incur and, in some cases, offering a new rate plan.

We frequently refine our marketing methodologies to target favorable customers. We rely on data analytics obtained from past marketing campaigns to guide future target marketing efforts. Many natural gas and electricity marketing variables are studied including but not limited to: geographic regions; demographic profiles (age, gender, home ownership, income, presence of children); consumer participation in retail choice programs; product rate plan type; volumetric usage; seasonality; competitor offerings; weather patterns; changes in state or federal regulations; sales channel effectiveness and national consumer trend research. We model customer purchase, retention and renewal behaviors respective to product offerings and lifecycles.

Developing new and innovative marketing programs remains an ongoing objective. We are currently developing programs to offer our products to under-served customer constituencies in multicultural markets. We recently developed bilingual marketing materials and customer contracts in Spanish. We have employed bilingual sales and customer care representatives to better serve our Spanish-speaking customers. We plan to replicate our efforts in other multi-cultural markets.

We plan to continue our efforts targeting new movers through agency-led initiatives and through outbound telemarketing efforts targeting newly connected phone numbers.

We will increase our local presence in-market through greater participation in LDC energy fairs and related home owner and commercial business events. We will endeavor to generate enrollments or leads for future marketing initiatives. Additionally, we will increase our membership and participation in associations that can foster direct sales prospects (e.g., business associations, chamber of commerce, service organizations, etc.).

We have developed attractive, contemporary, mid-market, commercial marketing materials that serve to differentiate us from competitors. Our innovative rate plans and genuine sales consultancy approach is highlighted throughout our mid-market, commercial communications. We will complement

our sales force efforts with targeted mail and e-mail communications to energy decision makers. Such communications will serve to impart important information and invite consideration of future energy needs.

Simple, On-line Enrollment

We have invested in web site functionality and revamped our website at www.mxenergy.com to allow a customer to enroll with us 24/7. Detailed information about our company, our products and special promotional opportunities provide us with an efficient, low cost means of transacting with customers. Many energy marketers do not have on-line enrollment capability and force the prospective customer into calling a call center for more information.

Public Relations

Unlike other energy marketers, we rely on press communications to communicate with our potential customers. We have actively encouraged the press to publish articles on deregulated energy offerings and play an active, public role in informing customers that they have the ability to choose their energy supplier. We position ourselves as industry leaders in press articles and releases. We believe our interviews with reporters often serve to increase awareness of our company and add credibility to our product offerings. Articles in the press have generated calls to our call center which are sometimes converted into sales.

Product Offerings

We offer multiple product offerings to customers so that at any given time, potential customers can choose which product meets their household or business needs. We aim to be flexible and to respond quickly to market conditions to ensure that our offers match consumer interests. Unlike competitors offering one product choice at a time, our ability to present the customer with multiple product offers confirms our overall commitment to customer satisfaction.

We aim to keep our products simple in order to facilitate marketing to residential and small commercial customers. Our fixed rate product protects consumers from increases in the unit price of natural gas or electricity for a term of up to three years. In marketing this product, we do not promise savings as a consumer could pay more if local utility prices, which are based on variable market prices, fall during the term of the fixed rate contract. We offer customers different variations on the fixed rate product if they wish. For example, customers may wish to have fixed rate protection only for the winter months while letting the summer price float with the market. We also have offered some customers a cap product in which their price floats with the market but cannot exceed a fixed rate cap. Because of the high volatility of energy products like natural gas and electricity, the cost of such caps, which must be hedged with call options, is very high. Our variable rate product is similar to utility variable rate pricing but without the cost recovery factors that frequently conceal from customers the true cost of energy supplied by the utilities. By using alternative supply arrangements, we are sometimes able to supply customers with commodity at a price lower than the utility's tariff pricing which often includes costly items such as firm transportation.

Competition

In markets that are open to competitive choice of retail energy suppliers, our primary competition comes from utility-affiliated retail marketers and small to mid-size independent retail energy companies. Competition is based primarily on product offering, price and customer service.

The competitive landscape differs in each utility service area, and within each targeted customer segment. For residential and small commercial customers in most service territories, our primary competition comes from utility-affiliated marketing companies and small to mid-size independent retail energy companies. Over the last several years, a number of utility-affiliated marketing companies have exited this segment of the market. For the mid-market commercial customer, competitive challenges come from both the utility and its affiliated marketing company, as well as other independents. However, this segment is still the least targeted segment among our competition due to the difficulty in balancing cost of acquisition and margin objectives. The large commercial, institutional and industrial segments are very competitive in most markets with nearly all customers having already switched away from the utility to an alternate provider. National affiliated utility marketers, energy producers and other independent retail energy companies often compete for customers in this segment. Historically, we have not focused on this segment.

Increasing our market share depends on our ability to convince customers to switch to our service. The local utilities and their affiliates have the advantage of long-standing relationships with their customers and they have longer operating histories, greater financial and other resources, and greater name recognition in their markets than we do. In addition, local utilities have been subject to many years of regulatory oversight and thus have significant experience regarding the regulators' policy preferences, as well as a critical economic interest in the outcome of proceedings concerning their revenues and terms and conditions of service. The incumbent's advantages in many markets are intended to be limited, however, by regulatory structures that, for example, prohibit the incumbent from offering non-standard service and pricing structures, minimize the opportunity for the regulated business to subsidize the unregulated business and limit the ability of the utility to solicit customers that have switched. In Georgia, however, the incumbent utility has fully exited the retail segment.

In many cases, LDCs actively support deregulation and have welcomed the entry of retail energy marketers. By relieving LDCs of the need to engage in risk management, retail energy marketers allow LDCs to focus on their core competency of local distribution, which typically constitutes a significant portion of most customers' utility bills. Many LDCs assume customer bad debt exposure since this encourages more market entrants and supports continued deregulation. LDCs may recover the bad debt expense as part of their tariff rates. The interests of retail energy marketers and most LDCs are thus highly aligned, providing crucial support for continued deregulation, while increasing penetration of the retail energy marketer model. We have successfully forged strong relationships with many of the LDCs throughout our service territories.

Most customers who switch away from the local utility do so for economic benefit or price stability. Once switched, customer retention is based on continued competitive pricing, reliability of supply and customer service. Our customer service record has enabled us to maintain a consistently high customer retention rate.

Some of our competitors, including local utilities, have formed alliances and joint ventures in order to compete in the restructured retail electricity and natural gas industries. Many customers of these local utilities may decide to stay with their longtime energy provider if they have been satisfied with their service in the past. Therefore it may be difficult for us to compete against local utilities and their affiliates.

Information Systems

We maintain a number of information systems for capturing customer, accounting, supply forecasting and risk management information. These systems operate on hardware within all four of our offices, including locations in Connecticut, Maryland, New Jersey and Texas, but we are planning to

move these systems to an outside service provider in Houston by December 2006. Further, to supplement our business continuity plans, we will also establish backup systems at a second site, the location of which is to be determined.

Given the inherent challenges of managing multiple systems, the information technology team is expected to consolidate our five existing customer relationship management tools into one or two. Furthermore, the multiple billing platforms are expected to be consolidated into our Lodestar application.

We are also in the process of converting the forecasting of our gas scheduling and risk management operations from internally developed Excel spreadsheets to a third party software system developed by Sungard. We expect to go live with these conversions by December 2006.

Our web site is hosted offsite with a full-time employee serving as webmaster. It is custom developed by an outsourced marketing company.

We perform daily backup of our key servers and maintain backup tapes for a period of four weeks before they are overwritten. We also perform a month-end backup of key servers and keep such data for a period of one year. All backup tapes are stored offsite at a secure storage facility on a weekly basis.

We currently replicate our email and various other production servers to ensure availability of our critical systems. We are in the process of increasing this functionality to additional servers. Our managed hosting facility in Houston maintains 24/7 security and has stand-alone power generation to keep the datacenter functional in the case of an extended power outage. We are also reviewing options for additional hosting facilities to further increase our stability in the event of a disaster. The goal is to have all critical servers relocated from the regional offices to a hardened hosting facility before the middle of next year.

We have taken a multi-tiered approach to protecting our network from malware and intrusions. We employ endpoint security that includes locked down routers, dual firewalls, and other security appliances. These are supplemented with software spyware and virus protection on all workstations and windows servers. These applications are monitored and updated to respond pro-actively and successfully to changing threats. In April 2006, we had an outside consultant conduct a system-wide audit of our security systems and provide recommendations for improvement. To date, we have implemented the majority of these recommendations.

Employees

As of September 30, 2006, we had approximately 181 full-time employees in the United States and Canada. None of our employees are subject to collective bargaining agreements, and we believe that our relationship with our employees is good.

Environmental Matters

We do not view potential environmental liabilities as a significant concern. We do not have physical custody or control of the natural gas or any facilities used to transport it and title to the natural gas sold to our customers is passed at the same point at which we accept title from our natural gas suppliers.

RISK FACTORS

Any of the following risks could materially adversely affect our business, financial condition and operating results. The risks described below are not the only risks facing us. Additional risks and uncertainties not currently known to us or which we currently deem to be immaterial may also materially and adversely affect our business, financial condition and operating results.

Risks Related To Our Business

We may not fully hedge our commodity supply or other market positions against changes in commodity prices and consumption volumes, and our risk management policies and hedging procedures may not work as planned, which would adversely affect our business.

To provide energy to our customers, we purchase the relevant commodity in the wholesale energy markets, which are often highly volatile. It is our policy to match estimated requirements of our customers by purchasing offsetting volumes of natural gas and electricity. To lower our financial exposure related to commodity price fluctuations and changes in consumption volumes, we routinely enter into contracts to hedge our fixed price sale commitments, fuel requirements and inventory of natural gas.

We have contractual obligations to many of our customers to provide full requirements service and as a result, our hedging procedures require constant monitoring and adjustment. Failure to continue to use valid assumptions may lead to inappropriate hedging positions. In addition, there are a number of factors that are beyond our control, such as risk of loss from counterparties' nonperformance, volumetric risks related to customer demand and seasonal fluctuations. Although we try to purchase anticipatory hedges that represent volume we expect to sell to residential and small commercial customers for up to one month, we are exposed to the risk of a shortfall in marketing that could result in our purchases exceeding our supply commitments to those customers. We cannot fully protect ourselves against these factors and if our risk management policies are insufficient, this will have a detrimental effect on our business.

Our customers may terminate their contracts at any time, and the resulting attrition can result in a cost of cover for previously purchased fixed price hedges and physical supplies, which could have a negative impact on our financial results.

All customers are subject to the terms of written contracts which are governed by the tariff rules of utilities and LDCs as well as regulations administered by public service commissions. Although our fixed price contracts with residential customers may have terms of up to three years, those customers may terminate their contracts at any time for a termination fee that, in most cases, is relatively modest and does not bear any relation to our costs or lost profit with respect to the remainder of the contract. Our small and mid-market commercial customers cannot terminate their fixed price contracts without triggering a damages provision designed to cover the cost related to the termination of those contracts. However, seeking to enforce contracts for relatively small volumes is often impractical. As a result, we depend on our hedging strategies to cover the costs related to terminations by residential and small commercial customers. To hedge effectively against terminations, we must, at the inception of the contracts, attempt to accurately forecast the number of residential and small commercial customers that will terminate their contracts prior to the end of their term. If we are not able to replace terminating customers with new customers, or if we experience an unusually high number of cancellations, our financial results may be negatively impacted.

We may not have sufficient liquidity to hedge market risks effectively or conduct our business.

We enter into physical hedges, and MXenergy historically entered into financial hedges for its supply obligations under agreements with VPEM, a wholly owned subsidiary of Dominion Resources Inc. Under our new hedge facility, we will enter into financial hedges for our supply with Société Générale. To date, we have been successful at negotiating arrangements that do not require us to provide cash margining for changes in the market value of forward positions. Under the hedge facility, we have posted an initial \$25.0 million of collateral, but no additional amounts would be required for changes in market prices of the commodity unless our forward hedged positions exceed 65,000 MMBtu. These hedging arrangements are for a limited duration and typically need to be renegotiated or replaced every two to five years. We may not be able to replace these agreements upon expiration under similar terms and may be required to provide guarantees, letters of credit, or additional cash collateral to protect counterparties against the risk of our default or insolvency.

In addition, our contractual agreements with LDCs require us to maintain restricted cash balances or letters of credit as collateral for the performance risk associated with the future delivery of natural gas. These collateral requirements may increase as we grow our customer base. Additionally, we must post letters of credit with our natural gas and electricity supply providers. The amount of such credit support that must be provided typically is based on the volume of the commodity purchased in any given month. Significant movements in market prices can result in our being required to provide cash collateral and letters of credit in very large amounts. The effectiveness of our operations may be dependent on the amount of collateral available to enter into or maintain these contracts, and liquidity requirements may be greater than we anticipate or are able to meet. Without a sufficient amount of working capital to post as collateral in support of performance guarantees or as cash margin, we may not be able to manage price volatility effectively or to implement our strategy. An increase in demands from our counterparties to post letters of credit or cash collateral may negatively affect our liquidity position and financial condition.

Our financial results may fluctuate on a seasonal and quarterly basis and are susceptible to changing weather conditions and commodity price fluctuations.

Our business is affected by weather. Consequently, our overall operating results may fluctuate substantially on a seasonal basis, and the pattern of this fluctuation may change depending on the nature and location of any customer we acquire and the terms of any contract to which we become a party. Weather conditions directly influence the demand for electricity and natural gas and affect the price of energy commodities.

Generally, demand for electricity peaks in the summer and demand for gas peaks in the winter. Recent growth in natural gas-fired electric generation has introduced a secondary peak for natural gas in the summer. Typically, when winters are warmer than expected and summers are cooler than expected, demand for energy is lower, resulting in less electric and gas consumption than forecasted. Likewise, when winters are colder than expected or summers warmer, consumption may be greater than we have hedged and greater than we are able to meet with storage, swing supply or full requirements contracts that we have negotiated. Depending on prevailing market prices for electricity and gas, these and other unexpected conditions may reduce our sales or increase our costs and negatively impact our results of operations. We may experience lower consumption volumes and, therefore, lower sales. We may experience losses from the purchase of additional volumes at higher prices or the sale of excess volumes at prices below acquisition cost. Our failure to anticipate changing weather demands or to effectively manage our supply in response to changing demands could negatively impact our financial results.

In addition, our marketing efforts may be hindered in a market where our offers are less competitive relative to price offerings of the utilities or other marketers. Utilities historically react more

slowly to changing commodity prices, whereas our products generally reflect the prevailing market prices. These factors may result in less effective marketing or higher than anticipated attrition.

Integration of the SESCO assets into our operations may not be successful and our pro forma financial results may not reflect our results after such integration.

The SESCO acquisition is the largest acquisition we have undertaken. In order to accommodate the new customers, we purchased and utilize the systems used by SESCO in Georgia and Ohio and moved MXenergy's existing Ohio customers onto such systems, as well. If we are unable to utilize successfully the SESCO systems or maintain the SESCO employees' expertise through the transition, our results of operations could suffer. We have never arranged physical supply for Georgia which is the first market in which we have had primary responsibility for direct customer billing. If we are unable to manage supply or integrate processes to manage our billing functions appropriately, our financial results may be negatively impacted. Prior to the closing of the SESCO acquisition, each SESCO residential customer in Georgia had the option not to continue the customer contract with us without penalty. As a result, we have experienced higher than usual customer attrition, which could have a negative impact on our financial results.

The accounting for our hedging activities may increase the volatility in our quarterly and annual financial results.

We engage in price-risk management activities related to our natural gas and electricity purchases in order to economically hedge our exposure to commodity price risk. Through the use of financial and physical derivative contracts, we attempt to balance our physical and financial purchases and sales commitments. These derivatives are accounted for in accordance with Statement of Financial Accounting Standards, or SFAS, No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 137, SFAS No. 138 and SFAS No. 149. SFAS No. 133 requires us to record all derivatives on the balance sheet at fair value. Changes in the fair value of a derivative as a result of fluctuations in the underlying commodity price, are recognized immediately in earnings, unless the derivative qualifies for hedge accounting treatment. Since MXenergy has not designated the derivative instruments as hedges for accounting purposes under SFAS No. 133, changes in forward prices of natural gas and electricity will cause volatility in our earnings. Economic hedges will not necessarily qualify for hedge accounting treatment. As a result, we are unable to fully anticipate the impact that our risk management decisions may have on our quarterly and annual operating results.

We depend on our billing systems and the utilities with whom we have billing service agreements, and we bear the related credit risk for certain customers.

We are responsible for the billing and collection functions for all of our customers in Georgia and our mid-market commercial customers in our New York, New Jersey and Ohio markets. This group of customers represents approximately 38% of our total volumes. In these markets we bear the risk of customers' failure to pay their utility bills. With the exception of customers in Georgia, we only have the ability to terminate our agreement with customers for non-payment, not to terminate their electric or gas service. Even if we terminate service to customers who fail to pay their utility bill, we remain liable to our suppliers of electricity and natural gas for the cost of those commodities. Furthermore, in the Georgia market, we are responsible for billing the distribution charges for the local utility and are at risk for these charges, in addition to the cost of the commodity, in the event customers fail to pay their bills. The failure of our customers to pay their bills or our failure to maintain adequate billing and collection procedures could materially adversely affect our business.

For approximately 62% of our RCEs, we have billing service agreements with utilities that require the utilities to prepare and send a bill to our customers and collect the cost of energy supply from customers before remitting the proceeds to us. The majority of these utilities have guaranteed the payment of the energy supply portion of customer bills or have agreed to purchase these bills at a discount from their face value. We rely on the utilities to perform timely and accurate billing under these agreements. As we grow, the proportion of customers we serve that are billed by utilities could increase. The bankruptcy of a utility could result in a default in the utilities' payment obligations to us.

The number of territories within which we provide natural gas and electricity supply poses a constant challenge that demands considerable personnel, management time and resources. Each territory requires unique and often varied electronic data interface systems. Rules that govern the exchange of data may be changed by LDCs. In certain instances, we must rely on manual processes and procedures and from time to time we have had difficulties uploading new customer files, contract rates and changes on a timely basis. Our failure to provide the local utilities with accurate billing information to include on the customer bills could negatively impact our results of operations.

We depend on local transportation and transmission facilities to supply our customers. Our financial results may be harmed if transportation and transmission availability is limited or unreliable.

We depend on transportation and transmission facilities owned and operated by utilities and other energy companies to deliver the electricity and natural gas we sell to customers. Under the regulatory structures adopted in most jurisdictions, we are required to enter into agreements with local incumbent utilities for use of the local distribution systems and to establish functional data interfaces necessary to serve our customers. Any delay in these negotiations or our inability to enter into reasonable agreements could delay or negatively impact our ability to serve customers in those jurisdictions, which could have a materially negative impact on our business, results of operations, and financial condition.

We also depend on local utilities for maintenance of the infrastructure through which we deliver electricity and natural gas to our customers. We are limited in our ability to control the level of service the utilities provide to our customers. Any infrastructure failure that interrupts or impairs delivery of electricity or natural gas to our customers could cause customer dissatisfaction, which could materially adversely affect our business.

If transportation or transmission is disrupted, or transportation or transmission capacity is inadequate, our ability to sell and deliver products may be hindered. Such disruptions could also hinder our providing electricity or natural gas to our customers and materially adversely affect our financial results.

Regulations in many markets require that meter reading and the billing and collection processes be retained by the local utility. In those states, we also are required to rely on the local utility to provide us with our customers' information regarding energy usage. Our inability to confirm information received from the utilities may negatively impact our sales and results of operations.

We are subject to competition in each of our markets.

While there are barriers to entry, we operate only in markets that are open to alternate energy suppliers. Competition is based primarily on product offering, price and customer service. We generally face competition in those markets from utility-affiliated retail marketers and small to mid-size independent retail energy companies. Some of these competitors or potential competitors may be larger and better capitalized than we are.

Increasing our market share depends on our ability to convince customers to switch to our service. The local utilities have the advantage of long-standing relationships with their customers, longer operating histories, greater financial strength and greater name recognition than we do. In addition, customers are less familiar with the fixed price product that we offer, and we may not be successful in educating potential customers about the benefits of fixed price energy supply nor of the other products we offer. Convincing customers to switch to a new company for the supply of a critical commodity such as electric power or natural gas is a challenge. If our marketing strategy is not successful, our business, results of operations and financial condition will be materially adversely affected.

We depend on continued state and federal regulation to permit us to operate in deregulated segments of the electric and gas industries. If competitive restructuring of the electric or gas utility industries are altered, reversed, discontinued or delayed, our business prospects and financial results could be materially adversely affected.

The regulatory environment applicable to the electric and gas LDC distribution systems has undergone substantial change over the past several years as a result of restructuring initiatives at both the state and federal levels. These initiatives have had a significant impact on the nature of the electric and gas LDCs. We have targeted the deregulated segments of the electric and gas markets created by these initiatives. Regulations may be revised or reinterpreted or new laws and regulations may be adopted or become applicable to us or our operations. Such changes may have a detrimental effect on our business.

In certain deregulated electricity markets, proposals have been made by governmental agencies and/or other interested parties to re-regulate areas of these markets. Other proposals to re-regulate may be made and legislated or other attention to the electric and gas restructuring process may delay or reverse the deregulation process or interfere with our ability to do business. If competitive restructuring of the electric and gas markets is altered, reversed, discontinued or delayed, our business prospects and financial results would be negatively impacted.

We may not be able to manage our growth successfully. Any such failure could overly burden our resources and lead to poor customer satisfaction in our services.

We intend to continue to make investments in complementary companies, assess new product offerings and apply new technologies for our business development. If we buy a company or business, we may experience difficulty integrating that company's personnel and operations. In addition, the key personnel of the acquired company may decide not to work for us. Furthermore, if we acquire the residential or small commercial businesses of an incumbent utility or other energy provider in a particular market, the customers of that entity may not be under any obligation to use our services. If we make other types of acquisitions, we may experience difficulty in assimilating the acquired technology or products into our operations. These difficulties could disrupt our ongoing business, distract our management and employees, and increase our expenses.

The growth of our operations will depend upon, among other things, our ability to expand our customer base in our markets and to enter new markets in a timely manner at reasonable costs. In addition, we anticipate that our employee base will grow to accommodate our increased customer base. As we expand our operations, we may encounter difficulties integrating new customers and employees as well as any legacy systems of acquired entities. We also may experience difficulty managing the growth of a portfolio of customers that is diverse both with respect to the types of service offerings, applicable market rules and the infrastructure for product delivery.

Expanding our operations also may require continued development of our operating and financial controls and may place additional stress on our management and operational resources. If we are unable

to manage our growth and development successfully, our operating results and financial condition could be materially adversely affected.

We may need to raise additional capital, which may not be available. This could jeopardize our financial position.

Our business requires substantial capital to fund growth through organic marketing or acquisition, for supporting working capital, for the purchase of natural gas and electricity supply to meet our customers' needs, and for the credit requirements of forward physical supply.

The net proceeds from the offering of the notes were used to repay the bridge loan used to finance the SESCo acquisition. We may need to incur additional debt in order to fund working capital, finance other acquisitions or for other purposes. We cannot be certain that we will be able to obtain such additional financing on favorable terms or at all. If we need additional capital and cannot raise it on acceptable terms, our financial condition and business will be materially adversely affected.

We believe our lines of working capital financing are sufficient to meet our current and anticipated needs, but these lines may be reduced in accordance with the terms of such agreements. Moreover, in the event our needs change, either because of growth or higher energy costs, additional lines may be necessary and there can be no assurance that such arrangements will be available on terms acceptable to us or at all.

We have identified a material weakness in the design and operation of our internal controls as of June 30, 2006, which, if not properly remediated, could result in material misstatements in our financial statements in future periods.

In connection with the audit of MXenergy's financial statements for the year ended June 30, 2006, MXenergy's independent auditors reported to the audit committee of the board of directors that certain significant deficiencies in internal controls, when evaluated in the aggregate, resulted in a material weakness in the design and operation of our internal controls as of June 30, 2006.

A material weakness is defined as a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

In connection with the audit of MXenergy's financial statements for the year ended June 30, 2006, MXenergy's independent auditors communicated to the audit committee of MXenergy's board of directors that MXenergy has inadequate staffing levels in the accounting department which results in the lack of a proper segregation of duties at the Controller level and that the overall supervision and review of the daily accounting function and the accounting for transactions may not operate at a level which could detect errors of significance and that improved monitoring of transactions with the LDCs was appropriate. More recently, MXenergy's independent auditors advised MXenergy's audit committee that the lack of formalization of MXenergy's policies and procedures pertaining to change management controls and logical security over its information technology systems results in an ineffective information technology general controls environment.

In response to these identified control deficiencies, we have implemented certain disclosure control enhancements, policies and procedures, including:

- adding personnel to our accounting team, including a director of financial reporting, treasury manager, an accounts payable clerk, a tax manager, and an accounting systems

manager, as well as the core group of well-qualified and experienced accounting personnel that joined us in connection with the SESCO acquisition;

- purchasing and implementing an accounting system designed to facilitate reconciliation and reporting of transactions;
- initiating a process whereby the Controller and/or the Chief Financial Officer sign-off on the review and approval of significant accounting entries;
- purchasing and implementing a risk management system designed to help better track our risks and to facilitate reconciliation and reporting of transactions and risks and, in the interim, centralizing the risk management reporting function to a risk manager and initiating monthly meetings between supply and operations and the accounting team to ensure that all transactions are appropriately recorded;
- employing a risk oversight committee, chaired by a member of the board of directors, which has adopted policies and guidelines regarding the management of our supply portfolio and hedging instruments;
- initiating the process to add additional personnel to the office of the General Counsel; and
- implementing information technology policies and procedures, including increased regulation of network access, enhanced database management and added segregation of responsibilities.

The remediation process has not yet been completed and there can be no assurance that the measures we have taken or will take to remediate the identified control deficiencies will result in adequate controls over our financial processes and reporting in the future. If we are unable to establish appropriate internal controls over financial reporting, it could cause us to fail to meet our reporting obligations or result in material misstatements in our financial statements.

Our success depends on key members of our management, the loss of whom could disrupt our business operations.

We depend on the continued employment and performance of key management personnel. A number of our senior executives have gained substantial experience in consumer and energy markets that have undergone regulatory restructuring and have extensive risk management and hedging expertise. We believe their experience will be important to our success. If our key executives do not continue in their present roles and are not adequately replaced, our business operations could be materially adversely affected. In addition, if certain key executives are not retained or not replaced with replacements acceptable to the lenders under our revolving credit facility, such failure to so retain or replace could give rise to a default under our revolving credit facility.

Risks Related To Our Indebtedness

Our substantial debt obligations could adversely affect our financial health and prevent us from fulfilling such obligations, including our obligations under the notes, and we might have difficulty obtaining more financing.

We have a substantial amount of indebtedness in relation to our equity. As of June 30, 2006, after giving pro forma effect to the transactions as if they had occurred on that date, we would have had

\$190.0 million total outstanding indebtedness and \$41.5 million in issued letters of credit (plus an additional \$77.9 million of unused availability under our revolving credit facility and \$12.0 million of unused availability under our credit facility with Sowood, or the Sowood credit facility). Our substantial debt obligations could have important consequences to holders of the notes. For example, they could:

- make it more difficult for us to satisfy our obligations with respect to the notes;
- increase our vulnerability to general adverse economic and industry conditions;
- require us to dedicate a substantial portion of our cash flow from operations to payments on our debt obligations, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, acquisitions and other general corporate purposes;
- limit our flexibility in planning for, or reacting to, changes in our business and the markets in which we operate;
- place us at a competitive disadvantage compared to our competitors that have less debt; and
- limit our ability to borrow additional funds.

We may incur substantial additional indebtedness in the future. The terms of the indenture governing the notes and our credit facilities will allow us to incur additional debt subject to certain limitations. If new debt is added to current debt levels, the related risks described above could intensify. If such debt financing is not available when required or is not available on acceptable terms, we may be unable to grow our business, take advantage of business opportunities, respond to competitive pressures or refinance maturing debt, any of which could have a material adverse effect on our operating results and financial condition.

Our interest expense would increase if interest rates increase.

As of June 30, 2006, on a pro forma basis after giving effect to the transactions, we would have had \$190.0 million of outstanding floating rate debt and the ability to incur up to \$280.0 million of floating rate debt under our revolving credit facility. Any increase in short-term interest rates would result in higher interest costs which would increase our interest expense. A 1% change in LIBOR would result in our interest expense fluctuating approximately \$2.5 million per year based on our average monthly balance for the year ended June 30, 2006 without taking into account the effect of any interest rate hedging instruments. While we may seek to use interest rate swaps or other derivative instruments to hedge portions of our floating rate exposure, we may not be successful in obtaining or renewing hedges on acceptable terms or at all, which could have a material adverse effect on our ability to service our outstanding indebtedness, including the notes.

We will require a significant amount of cash to service our debt obligations. Our ability to generate cash depends on many factors beyond our control, including cash flow from our operating subsidiaries.

Our ability to make payments on and to refinance our debt, including the notes, and to fund planned capital expenditures and expansion efforts and any strategic acquisitions we may make in the future, if any, will depend on our ability to generate cash in the future. This, to a certain extent, is subject to general economic, financial, competitive and other factors that are beyond our control.

We have no operations except for those conducted through our operating subsidiaries. Accordingly, our only material source of cash, including cash to make payments on or to redeem the notes, comes from distributions with respect to our ownership interests in our operating subsidiaries that are derived from the earnings and cash flow generated by such operating subsidiaries. Distributions to us from our operating subsidiaries will depend on:

- the financial performance of our operating subsidiaries;
- covenants contained in our debt agreements, including the agreements governing our revolving credit facility;
- covenants contained in other agreements to which we or our subsidiaries are or may become subject;
- business and tax considerations; and
- applicable law, including laws regarding the payment of distributions.

Based on the current level of operations of our subsidiaries, we believe that our cash flow from operations, together with available cash and available borrowings under our credit facilities, would be adequate to meet future liquidity needs for at least the next twelve months. However, there can be no assurance that our business will generate sufficient cash flow from operations in the future, that our currently anticipated growth in net sales and cash flow will be realized on schedule or that future borrowings will be available to us in an amount sufficient to enable us to repay indebtedness, including the notes, or to fund other liquidity needs. We may need to refinance all or a portion of our indebtedness, including the notes, on or before maturity. There can be no assurance that we will be able to refinance any of our indebtedness on commercially reasonable terms or at all.

PROPERTIES

We lease all of our properties. Our headquarters are located in Stamford, Connecticut, and we also have offices in New Jersey, Texas and Maryland. We currently operate the former SESCo activities out of the existing SESCo space in Houston but expect to occupy another space by November 2006. We believe that our properties are suitable and adequate for the business conducted therein, are being appropriately used and have sufficient capacity for the present intended purposes.

LEGAL PROCEEDINGS

On January 6, 2006, Rochester Gas & Electric Corporation, or RG&E, and New York Gas & Electric Corporation, or NYSEG, notified two of our subsidiaries, MxEnergy Inc. and MxEnergy Electric Inc., that RG&E and NYSEG were suspending the enrollment of customers of such subsidiaries. As a result, on January 13, 2006, the two subsidiaries brought an action against RG&E in the United States District Court for the Western District of New York, alleging breach of contract, tortious interference with economic opportunity, defamation, deceptive acts, false advertising and injurious falsehood. The subsidiaries sought certain injunctive relief requiring RG&E to enroll customers of the subsidiaries and limiting what RG&E may state publicly about the subsidiaries. The subsidiaries further sought unspecified money damages, punitive damages and attorneys' fees. The subsidiaries obtained a temporary restraining order restraining RG&E's call center from making certain statements about the subsidiaries.

RG&E counterclaimed, alleging misconduct relating to the subsidiaries' marketing efforts, and sought injunctive relief relating to the subsidiaries' marketing efforts in the Rochester region. RG&E also sought unspecified money damages, statutory penalties, attorneys' fees and costs of disbursements. The subsidiaries have vigorously contested all of these claims.

The subsidiaries sought and obtained a preliminary injunction requiring RG&E (as well as NYSEG) to enroll certain customers and restraining their call centers from making certain statements about the subsidiaries. On April 11, 2006, the court agreed to stay the action indefinitely, while the parties pursued an amicable settlement. The parties settled the action as well as certain administrative proceedings pending before the State of New York Public Service Commission, or NYPSC, (involving the same underlying issues as those presented in the litigation before the court) at no cost on July 12, 2006. The NYPSC has indicated that it has no intention of pursuing the matter further.

From time to time, we are a party to claims and legal proceedings that arise in the ordinary course of business. We do not believe that any such proceedings to which we are currently a party is material to our business.

MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

There is no established trading market for our common stock, par value \$.01 per share. As of September 25, 2006, there were 100 holders of record of our common stock.

Dividend Policy and Restrictions

We have never declared or paid any cash dividends on our common stock and do not intend to pay any cash dividends on our common stock in the foreseeable future. Currently we intend to retain any future earnings to finance the expansion of our business and for general corporate purposes. Our board of directors, in its discretion, has the authority to declare and pay dividends on our common stock provided there are funds legally available to do so.

We are restricted in our ability to pay distributions under various covenants of our debt agreements. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a more detailed description of our revolving credit facility and the notes.

Equity Compensation Plan Information

The table below provides information, as of June 30, 2006, concerning securities authorized for issuance under MXenergy's equity compensation plans.

<u>Plan Category</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants and rights</u> ⁽¹⁾	<u>Weighted average exercise price of outstanding options, warrants, and rights</u> ⁽¹⁾	<u>Number of securities remaining available for future issuance under equity compensation plans</u> ⁽²⁾
Equity compensation plans approved by our stockholders	2,259,693	\$10.77	756,580
Equity compensation plans not approved by our stockholders	—	—	—

(1) Includes 759,920 options to purchase shares of our common stock under the 2001 Stock Option Plan and the 2003 Stock Option Plan and 1,499,773 warrants to purchase shares of our common stock. All warrants were granted on a discretionary basis under no formal equity compensation plan.

(2) Includes 6,580 shares under the 2003 Stock Option Plan and 750,000 shares under the 2006 Equity Incentive Compensation Plan. Available shares shown above for the 2003 Stock Option Plan and the 2006 Equity Incentive Compensation Plan include shares that have become available due to forfeitures or have been reacquired by the Company for any reasons without delivery of the stock, as allowed under the terms of the plan.

SELECTED FINANCIAL DATA

The following financial information should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and notes thereto contained elsewhere in this Annual Report. Amounts are in thousands, except RCEs and per MMBtu data.

	Year Ended June 30,				
	2006	2005	2004	2003	2002
Statement of Income Data					
Sales of natural gas and electricity	\$362,561	\$277,196	\$185,659	\$102,475	\$52,292
Cost of goods sold (excluding depreciation and amortization below):					
Cost of natural gas and electricity sold.....	392,612	255,724	172,178	106,240	37,947
Realized (gains) losses from risk management activities.....	(82,983)	(37,608)	(15,892)	(18,578)	13,184
Unrealized (gains) losses from risk management activities.....	79,897	(16,004)	(46,360)	(17,889)	(11,146)
Total cost of goods sold.....	<u>389,526</u>	<u>202,112</u>	<u>109,926</u>	<u>69,773</u>	<u>39,985</u>
Gross profit (loss) (excluding depreciation and amortization below).....	(26,965)	75,084	75,733	32,702	12,307
Operating expenses:					
General and administrative expenses	22,623	17,938	11,597	5,386	3,314
Reserves and discounts	3,395	4,533	3,432	1,753	1,336
Depreciation and amortization.....	8,504	6,166	6,894	906	737
Advertising and marketing expenses.....	2,096	2,359	408	—	—
Total operating expenses	<u>36,618</u>	<u>30,996</u>	<u>22,331</u>	<u>8,045</u>	<u>5,387</u>
Operating profit (loss)	(63,583)	44,088	53,402	24,657	6,920
Interest expense, net	3,200	2,858	3,109	2,197	1,416
Income (loss) before income tax benefit (expense).....	(66,783)	41,230	50,293	22,460	5,504
Income tax benefit (expense)	27,001	(18,142)	(20,117)	(2,971)	—
Net income (loss).....	<u>(39,782)</u>	<u>\$23,088</u>	<u>\$30,176</u>	<u>\$19,489</u>	<u>\$5,504</u>
Other Data					
No. of RCEs(a)	387,000	348,000	361,000	226,000	169,000
Sales in MMBtu’s (in thousands)	35,488	32,957	25,771	19,961	9,397
Sales per MMBtu.....	\$9.74	\$8.03	\$7.04	\$5.13	\$5.56
Gross profit per MMBtu(b).....	\$1.39	\$1.75	\$1.11	\$0.74	\$0.12
Adjusted EBITDA(c)	\$25,729	\$36,283	\$15,830	\$8,370	\$(3,489)
Balance Sheet Data (at period end)					
Total current assets	\$67,517	\$157,122	\$122,363	\$46,646	\$15,419
Customer acquisition costs, net.....	10,822	7,171	10,439	7,393	4,663
Total assets	97,969	191,592	162,221	57,697	21,252
Total current liabilities	29,893	74,640	60,607	32,921	25,607
Redeemable convertible preferred stock(d)...	29,357	29,357	29,730	—	—
Total liabilities, redeemable convertible preferred stock and stockholders’ equity	97,969	191,592	162,221	57,697	21,252
Total debt.....	—	21,379	27,221	22,561	17,446

- (a) Represents gas and electricity RCEs serviced at end of period.
- (b) Adjusted to exclude the effect of unrealized gains or losses from risk management activities.
- (c) EBITDA is defined as net income (loss) before provision (credit) for income taxes, interest expense, depreciation and amortization. Certain financial covenants in our revolving credit facility contain ratios based on Adjusted EBITDA. EBITDA is a measure commonly used by financial analysts in evaluating operating performance of companies. Adjusted EBITDA is defined by management as net income (loss) before provision (credit) for income taxes, interest expense, depreciation and amortization, non-cash stock compensation and unrealized gains (losses) from risk management activities. Management uses Adjusted EBITDA as a key metric to measure the operating performance of the business. We believe that EBITDA would not provide an accurate reflection of the economic performance of the business since it includes the unrealized change in the market value of the underlying customer contracts which are being hedged. Accordingly, management believes that Adjusted EBITDA may be useful for potential purchasers of notes in assessing our operating performance.

The following table provides a reconciliation of net income (loss) to EBITDA and from EBITDA to Adjusted EBITDA.

	Year Ended June 30,				
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
	(dollars in thousands)				
Net income (loss)	\$(39,782)	\$23,088	\$30,176	\$19,489	\$5,504
Add: Interest expense, net.....	3,200	2,858	3,109	2,197	1,416
Income tax (benefit) expense	(27,001)	18,142	20,117	2,971	–
Depreciation and amortization.....	8,504	6,166	6,894	906	737
EBITDA	<u>\$(55,079)</u>	<u>\$50,254</u>	<u>\$60,296</u>	<u>\$25,563</u>	<u>\$7,657</u>
Subtract: Unrealized gains (losses)					
from risk management activities.....	(79,897)	16,004	46,360	17,889	11,146
Add: Non-cash stock compensation ..	911	2,033	1,894	696	–
Adjusted EBITDA.....	<u>\$25,729</u>	<u>\$36,283</u>	<u>\$15,830</u>	<u>\$8,370</u>	<u>\$(3,489)</u>

- (d) We have reflected our Series A Convertible Preferred Stock outside of the equity section under the provisions of SEC Accounting Series Release 268 (Reg. S-X 5-02.28) which require that redeemable equity securities be presented separately from “stockholders’ equity” if they are redeemable at the option of the holder, or at a fixed date and a fixed price, or redemption is otherwise beyond the control of the issuer. The holders of our Series A Convertible Preferred Stock will have the right to “put” such stock to the Company after June 30, 2009 if the fair market value of our Common Stock as of the date a notice of redemption is delivered is at a level that would not provide such holders an annualized internal rate of return of at least 25% on their investment. For a more detailed description of our Series A Convertible Preferred Stock, see Note 10 to MXenergy’s consolidated financial statements included elsewhere in this Annual Report.

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

The following discussion should be read in conjunction with our financial statements and the notes thereto included elsewhere in this Annual Report. The following discussion includes certain forward-looking statements. Our actual results could differ materially from the results anticipated in these forward-looking statements as a result of factors including, but not limited to, those described in "Risk Factors."

Overview

We are a retail energy marketing company primarily engaged in the marketing and sale of natural gas and electricity to residential and commercial accounts throughout the eastern half of the United States and in Ontario, Canada. We serve a diverse portfolio of customers across several LDC markets with both fixed rate and variable rate contracts. This diversification in customer segment, geography, and sales product helps to mitigate our risk from volatility in market prices and weather-related demand. We intend to maximize operating income through continued customer growth, improved operational performance, opportunistic acquisitions and the efficient procurement and risk management of our commodity supply positions. As natural gas accounts for over 98% of our sales, the operating results of the electricity segment, which was initiated in 2004, are not discussed herein.

MXenergy was formed in 1999 as a retail energy marketer. As of June 30, 2006, MXenergy served approximately 714,000 RCEs across 28 LDC gas markets and six electricity market areas in 12 states and Ontario, Canada. The business has expanded through a combination of organic growth and acquisitions. Over the past two years, we acquired substantially all of the assets of SESCO, a portfolio of 315,000 natural gas RCEs throughout Georgia and Ohio, the shares of Total Gas & Electric, Inc., or TG&E, a portfolio of 103,000 gas and electricity RCEs throughout New York and New Jersey, and a portfolio of 2,200 mid-market commercial customers (representing approximately 53,000 RCEs) from Castle Power, or Castle, also based in New York and New Jersey. In addition to SESCO, TG&E and Castle, we have successfully completed the acquisition of four customer portfolios since our inception.

Our financial performance is affected by many factors. Approximately 62% of our RCEs are billed for commodity charges directly by the LDC on our behalf. We are exposed to credit risk from utilities that collect and remit customer payments as well as from a number of customers that pay us directly. Our operating results would be negatively affected by defaults in such payments. Approximately 53% of our RCEs are guaranteed by LDCs, the vast majority of which are investor-owned utilities with an investment grade rating from Moody's or Standard & Poor's. The remaining 47% of our annual volume is exposed to credit risk of the end use customer.

We serve approximately 59% of our RCEs under fixed price natural gas or electricity contracts with terms of one to three years. Our risk management strategy is to hedge 100% of our forecasted volumes. The sufficiency of such hedges is affected by unanticipated attrition and by changes in weather-related volumetric demand. From 2003 to 2006, MXenergy experienced an average annual in-contract customer attrition rate of approximately 23%, which we believe is consistent with the industry average. The loss of customer accounts is primarily due to: (i) residential moves, (ii) customer payment defaults and (iii) customer initiated switches, among other factors. Total attrition is composed of customers who leave prior to the end of their contracts (in-contract attrition) and those who do not renew with us at the end of their contracts (renewal attrition). We use historical experience to determine the amount of in-contract attrition to project demand from fixed price customers over the term of their contract. If the actual demand from fixed price customers is significantly different from our projection, we may suffer financial losses if the market price of gas has increased or decreased from the original

hedge price. Customer demand is also impacted by weather. We use utility-provided historical, actual or forward projected customer volumes as a basis for our forecasted volumes and mitigate the risk of winter volume fluctuation for some customers by purchasing excess fixed rate hedges by up to 10% of normalized winter projections. Should winter weather demand exceed our weather normalized projections, we may suffer a negative impact on financial results.

We use both physical instruments and derivative financial instruments to reduce our exposure to fluctuations in the price of natural gas. We account for derivatives under the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended and interpreted. SFAS 133 requires all derivatives to be carried on the balance sheet at fair value. Forward physical purchase contracts have been designated as normal purchases under SFAS 133. If a derivative is designated as a cash flow hedge, changes in the fair value of the derivative are recorded in accumulated other comprehensive income and recognized as a component of cost of natural gas and electricity sold in the consolidated statements of income when the hedged item affects earnings. Derivatives that are not designated as hedges or that do not qualify for hedge accounting treatment must be adjusted to fair value through earnings. Since we have not designated any of our derivatives as cash flow hedges, any change in the forward price of natural gas or electricity will be reflected in the statement of income as unrealized gains or losses from risk management activities. The underlying fixed price contracts that are being hedged do not meet the definition of a derivative under SFAS 133 and as a result, the corresponding change in fair value of these customer contracts is not reflected in the statement of operations. The application of this accounting treatment results in earnings volatility.

In addition to the volatility described above, we incur volatility from quarter to quarter associated with gains and losses on settled hedges relating to natural gas in inventory. Inventory is typically purchased from April to October and drawn down from November through March. Since a portion of the inventory is used to satisfy delivery obligations to fixed priced accounts over the winter months, we hedge the associated price risk using NYMEX based derivative contracts. Any gains or losses associated with settled derivative contracts are reflected in the statement of operations as a component of cost of goods sold under the caption "Realized gains or losses from risk management activities." As a portion of these settled hedges are used to mitigate the price risk associated with the inventory purchases, we may experience a timing difference between when the gain or loss on the hedge is recognized in the statement of operations and when the gas is consumed by the customer and sales are recognized.

We rely on utilities to provide billing and collection of receivables from residential and small commercial customers as well as to provide other services. Approximately 53% of our volumetric receivables are guaranteed or purchased by the utilities at a weighted average discount rate of approximately 1%. Should a utility increase the discount or discontinue the guarantee or purchase of such receivables, the forecasted margin for the fixed rate contracts currently in place may be reduced. Incorporated into the calculation of our fixed prices are also prevailing billing charges, switching fees, volumetric conversion rates, and other such factors. Though we are advised in advance of future changes in these items through tariff filings and notices by the utilities, ultimate changes in these charges, fees, rates and other factors could take place prior to the termination date of current fixed price contracts and could negatively impact projected margin on these contracts.

We market to new customers using direct mail, internet, telemarketing, and door to door channels. Based on historical experience plus costs associated with specific contracts, our marketing costs for a new customer are estimated and revised from time to time. Should marketing expenses exceed those which we have forecasted, our financial results can be negatively impacted.

In determining the selling price for fixed and variable customers, we target a per unit gross profit rather than a percentage gross margin. The target margin is set in relation to the cost of acquiring new

customers with the objective of earning a contribution margin in excess of the acquisition cost of a customer within the first year. We consider all direct variable costs associated with servicing new customers prior to application of the per unit margin. Since we are targeting a per unit gross profit and commodity prices are highly volatile, a gross margin percentage would not be a meaningful indicator of financial performance.

Market and Regulatory

We currently serve natural gas customers in 28 LDC markets in 11 states and Ontario, Canada and electricity in six market areas in two states. Among other things, tariff filings by LDCs for changes in the billing rate to their regulated customers in the markets in which we operate, may significantly impact the viability of our sales and marketing plans and our overall operating and financial results. Although regulatory requirements are determined, administered and monitored by the public utility commission, or PUC, of each state, operating rules and rate filings for each utility are unique. Accordingly, we generally treat each utility distribution territory as a distinct market.

Natural Gas

As a result of the SESCO acquisition, we provide natural gas to approximately 702,000 RCEs in 28 LDC markets within Florida, Georgia, Illinois, Indiana, Kentucky, Michigan, Maryland, New Jersey, New York, Ohio, Pennsylvania and Ontario, Canada. Due to recent and significant decreases in the price of natural gas, a number of LDCs have decreased rates to their regulated customers. Although the impact of these price decreases cannot currently be estimated, they are not anticipated to impact adversely our financial results.

In Ohio, we provide natural gas service to residential and small commercial customers in the Dominion East Ohio, or DEO, Vectren and the Columbia Gas of Ohio service areas. In May 2006, the Public Utility Commission of Ohio approved the first phase of a plan whereby DEO will exit the merchant function. The first phase was a wholesale auction of the supply associated with the customers served by the utility which took place on August 28, 2006 and was approved by the Public Utility Commission of Ohio on August 29, 2006. The second phase is anticipated to start by 2008 and will involve the transfer of the utility customers to retail energy marketers. We are taking an active role in the regulatory process for reviewing and implementing rules that will govern phase two of the deregulation plan. While the ultimate outcome of this is unknown, at this point, the process it is not expected to adversely impact our financial results.

As natural gas accounts for approximately 98% of our sales, our operating results are significantly impacted by the price movement in natural gas. Price volatility in the natural gas market generally exceeds volatility in most energy and other commodity markets. There are various factors that contribute to price volatility in the natural gas market, including basic supply and demand, pipeline capacity, storage capacity and weather. The current prices of natural gas are at a two-year low, which provides us with both opportunities and challenges. During our recent history we have been able to effectively manage our business through volatile market conditions.

Electricity

We provide electricity to approximately 12,000 RCEs in six market areas within the states of New York and Massachusetts. There are no current rate cases or filings in the states of New York or Massachusetts that are anticipated to impact our financial results.

Recent Developments

On August 1, 2006, MXenergy acquired substantially all of the assets of SESCo, a wholly owned subsidiary of Shell Oil Company and retail energy marketer, as of that date, which supplied natural gas to approximately 315,000 residential and small commercial RCEs in the deregulated markets of Georgia and Ohio. In addition to expanding our relationships with customers of two LDCs in Ohio, the SESCo acquisition also expanded our operations in Ohio to include customers served by Vectren and added Georgia to the list of states in which we operate.

As a result of the SESCo acquisition, our customer mix changed. MXenergy's historical percentage of fixed price customers decreased from 70% to 59% after the SESCo acquisition. The higher percentage of variable priced accounts created diversity in the overall supply risk of the business. We are responsible for billing and collection of all commodity and utility distribution charges to customers in the Georgia market. In addition, we assume the credit risk associated with billing the utility distribution charges in that market. We assumed the billing systems, processes and personnel associated with billing and collections as part of the SESCo acquisition.

Our Hedge Facility

Concurrently with the closing of the SESCo acquisition, we entered into a committed exclusive hedging facility with Société Générale. The hedge facility has an initial term of two years with subsequent one year renewal terms. The hedge facility provides us with the ability to enter into NYMEX and basis swaps for a tenor of up to 39 months. Fees under the hedge facility include an annual management fee and a volumetric fee based on the tenor of the swap.

The hedge facility is secured by a first lien on the customer contracts and a second lien on substantially all of our other assets. In addition, we provided a total of \$25.0 million as collateral for potential negative mark-to-market changes in the value of the forward hedged position. We will not be required to post additional collateral beyond the initial margin requirements unless our forward hedged positions exceed 65,000 MMBtu. Pro forma for the SESCo acquisition, our forward hedged positions totaled approximately 42,600 MMBtu which provides us with the ability to increase our forward hedged positions by 53% before we would be required to post any additional collateral.

Our Revolving Credit Facility

In connection with the SESCo acquisition, we, through our wholly owned subsidiaries MxEnergy Inc. and MxEnergy Electric Inc., entered into an amended and restated credit facility with Société Générale, as administrative agent, and the lenders party thereto. Our revolving credit facility is guaranteed by us and all of our domestic subsidiaries and is secured by a second priority lien on customer contracts and a first priority lien on substantially all of our and our subsidiaries' other existing and future assets.

MxEnergy Inc. and MxEnergy Electric Inc. are permitted to borrow up to the lesser of (x) \$280.0 million (which may be increased to up to \$400.0 million under certain circumstances) and (y) the amount of the then applicable borrowing base. Borrowings under our revolving credit facility generally bear interest at a fluctuating rate based upon a base rate or a Eurodollar rate plus an applicable margin. The applicable margin for base rate loans ranges from 0.5% to 1.375% and the applicable margin for Eurodollar loans ranges from 1.5% to 2.375%. All outstanding borrowings under our revolving credit facility are due on December 19, 2008.

Our Floating Rate Senior Notes due 2011

On August 1, 2006, we entered into a \$190.0 million senior unsecured bridge loan, the proceeds of which were used to fund the SESCO acquisition. On August 4, 2006, we issued \$190.0 million aggregate principal amount of Floating Rate Senior Notes due 2011 at an original issue discount of 97.5% in a private placement pursuant to Rule 144A promulgated under the Securities Act. The net proceeds from the sale of the notes were used to repay the bridge loan. Interest on the notes is payable semi-annually at a rate of LIBOR plus 7.5% per annum and is reset semi-annually, in each case, on February 1 and August 1 of each year. We may redeem up to 35% of the aggregate principal amount of the notes before August 1, 2009 at a price equal to 100% of the principal amount, plus a premium equal to the rate per annum on the notes outstanding on the date notice is given to redeem the notes and plus accrued and unpaid interest to the redemption date.

Material Weakness in Internal Controls

In connection with the audit of our financial statements for the year ended June 30, 2006, our independent auditors reported to the audit committee of our board of directors that certain significant deficiencies in internal controls, when evaluated in the aggregate, result in a material weakness in the design and operation of our internal controls as of June 30, 2006. For additional information regarding this identified material weakness, see “Risk Factors—We have identified a material weakness in the design and operation of our internal controls as of June 30, 2006, which, if not properly remediated, could result in material misstatements in our financial statements in future periods” and “Controls and Procedures.”

Adjusted EBITDA

MXenergy utilizes Adjusted EBITDA as a key financial measure to evaluate the performance of the business. Adjusted EBITDA is calculated by adding to EBITDA certain expense items and deducting certain income items that we believe are not indicative of the true operating performance of the business and reflect non-cash charges. In particular, Adjusted EBITDA eliminates the earnings volatility associated with unrealized gains and losses from risk management activities and non-cash compensation charges from EBITDA. Since EBITDA includes unrealized gains and losses from risk management activities without giving effect to the offsetting change in market value of the underlying fixed price customer contracts that are being hedged, it may not provide an accurate reflection of earnings. Non-cash compensation charges relate to warrants that were issued to certain employees with a provision permitting cashless exercise. Any change in the value of the warrants is recorded as compensation expense in the period in accordance with variable plan accounting however, there is no cash expense incurred by MXenergy. Furthermore, financial covenants in our revolving credit facility contain ratios calculated on a basis that exclude both unrealized gains and losses from risk management activities and non-cash compensation charges.

Results of Operations

Discussed below are MXenergy’s historical results of operations prior to the consummation of the SESCO acquisition.

Year Ended June 30, 2006 Compared with Year Ended June 30, 2005

The number of RCEs for the fiscal year ended June 30, 2006 totaled 387,000, an increase of 11% or 39,000 RCEs over the prior year. The increase was related to the RCEs acquired in the Castle acquisition in November 2005.

Sales for the fiscal year ended June 30, 2006 were \$362.6 million, up \$85.4 million, or 31%, compared to the prior year, primarily due to higher natural gas prices in fiscal year 2006 and accounts purchased from Castle. The average selling price per unit increased by \$1.71 to \$9.74 per MMBtu. In addition, MXenergy sold approximately 35.5 billion cubic feet, or BCF, of gas in 2006 compared to approximately 33 BCF in 2005. The increased volume is attributable to the customers acquired from Castle during the year. However, overall usage by customers decreased over the prior year due to the warmer-than-normal weather experienced in the northeastern United States during the quarter ended March 2006, the peak usage months for natural gas.

Gross loss for the fiscal year ended June 30, 2006 was \$27.0 million compared to gross profit of \$75.1 million in the prior year. The decrease is primarily related to changes in the market value of our unrealized risk management activities of \$95.9 million, as a result of a decline in forward natural gas prices over the past fiscal year. The effect of this decrease will be offset in future periods by higher margins as physical gas is purchased for delivery to retail customers under the remaining terms of their fixed rate contracts. Included in fiscal year 2006 is a \$2.3 million charge related to MXenergy's election not to perform hedge accounting. We have not elected to designate any derivative instruments as hedges in accordance with the provisions of SFAS No. 133 and accordingly, any changes in derivative fair value must be adjusted through unrealized losses (gains) from risk management activities in the consolidated statements of operations. The election to not perform hedge accounting can have an impact on earnings as the change in value of derivatives may impact operations during a different period than the associated margin achieved on the physical sale of natural gas. We will continue to experience volatility in quarterly earnings from the settlement of hedges associated with inventory when market prices vary from the hedged price. Fiscal year 2005 includes the impact of a one time \$5.7 million gain realized from the sale of an unnecessary hedge position.

Operating expenses for the fiscal year ended June 30, 2006 were \$36.6 million, up 18.1% from \$31.0 million in the prior year primarily due to increased overhead associated with the addition of personnel in the information technology, marketing, and finance areas, along with positions required to support the Castle acquisition. Depreciation and amortization expense increased \$2.3 million over the prior year, principally due to amortization charges associated with the Castle acquisition and charges for new and enhanced data and risk management systems. Offsetting these increases was a reduction of \$1.1 million in reserves and discounts due to an improvement in credit quality associated with our customer base. Several LDCs that previously did not guarantee receivables amended their programs to guarantee receivables, resulting in a lower discount or reserve rate.

For the year ended June 30, 2006, MXenergy recorded a \$27.0 million income tax benefit compared to an \$18.1 million income tax expense in the prior year. The change from the prior year is attributable to the change from pre-tax income for the year ended June 30, 2005 compared to pre-tax loss for the year ended June 30, 2006 of which all significant changes were previously discussed.

Adjusted EBITDA for the fiscal year ended June 30, 2006 was \$25.7 million, down from \$36.3 million, or 29%, compared to the prior year. The decrease of \$10.6 million over the prior year was due to lower-than-average consumption associated with warmer-than-normal weather conditions in fiscal 2006, the impact of a one time \$5.7 million gain realized in fiscal 2005 from the sale of a hedge position that was deemed to no longer be required, and a \$2.3 million charge in fiscal year 2006 related to MXenergy's election not to perform hedge accounting.

Year Ended June 30, 2005 Compared with Year Ended June 30, 2004

The number of RCEs for the fiscal year ended June 30, 2005 totaled 348,000, down 13,000, or 4% compared to the prior year. The decrease was related to new telemarketing regulations (specifically,

Federal Trade Commission guidelines and “Do Not Call” lists). MXenergy transitioned many of its outsourced marketing companies to new fully compliant companies. MXenergy experienced a slight decline in customers due to the impact of transitioning third party marketing efforts during the year.

Sales for the fiscal year ended June 30, 2005 were \$277.2 million, up \$91.5 million, or 49%, compared to the prior year. The increase in sales was principally due to higher natural gas sales volume in the period. MXenergy sold approximately 33,000 MMBtu of gas in 2005 compared to approximately 26,000 MMBtu in 2004. The increased volume is attributable to a full year of sales associated with customers acquired in the TG&E acquisition. In addition, during the fiscal year ended June 30, 2005, the average selling price per unit increased by \$0.99 to \$8.03 per MMBtu as market prices were higher.

Gross profit for the fiscal year ended June 30, 2005 totaled \$75.1 million, down \$0.6 million, or 1%, compared to the prior year. The decrease was related to a reduction in unrealized gains from risk management activities of \$30.4 million. Adjusting for unrealized gains from risk management activities, gross profit in 2005 increased by \$29.7 million over the prior year. The increase is primarily related to higher sales volume during the year and increased per unit margin. As commodity prices increased during the period, MXenergy increased its unit margin to compensate for increased financing and bad debt costs. In addition, a \$5.7 million gain was recorded from the sale of a hedge position that was deemed to no longer be required to meet projected fixed price customer demand.

Operating expenses for the fiscal year ended June 30, 2005 were \$31.0 million compared to \$22.3 million in the prior year, up \$8.7 million, or 39%. The increase reflects the effect of increased business activity during the year. Personnel costs were higher as MXenergy incurred a full year of costs associated with the acquisition of TG&E. Non-cash stock compensation charges of \$2.0 million and \$1.9 million are included in general and administrative expenses for the fiscal year ended June 30, 2005 and the fiscal year ended June 30, 2004, respectively.

General and administrative expenses for the fiscal year ended June 30, 2005 were \$17.9 million compared to \$11.6 million in the prior year, up \$6.3 million or 54%. The increase reflects increased billing and related costs associated with the increased number of customers served during the year. MXenergy also incurred a full year of rent expense associated with the addition of the TG&E office. MXenergy incurred \$2.0 million in increased costs associated with sales and marketing during the fiscal year ended June 30, 2005 compared to the prior year. The increase is due to costs associated with the development of a new branding strategy for MXenergy. In addition, MXenergy incurred costs associated with a direct mail campaign that was launched during the year; no such costs were incurred in the prior year.

Reserves and discounts for the fiscal year ended June 30, 2005 were \$4.5 million compared to \$3.4 million in the prior year, up \$1.1 million or 32%. The increase reflects higher sales activity during the year. The cost of reserves and discounts decreased by 11% to 1.6% of sales in 2005 over the prior year due to an improvement in the credit profile of customers served.

For the year ended June 30, 2005, income tax expense decreased by approximately \$2.0 million to \$18.1 million. The decrease related to lower earnings from operations offset by an increase in the tax rate to 44% from 40% in the prior period. The current period includes an additional tax impact related to prior year adjustments and an increase in the statutory rate.

Adjusted EBITDA for the fiscal year ended June 30, 2005 was \$36.3 million, up \$20.5 million, or 130%, compared to the prior year. During the 2005 fiscal year, MXenergy realized a gain of \$5.7 million on the sale of forward hedged positions that were no longer required to meet future customer obligations. In addition, increased volume associated with a full year of activity from the accounts acquired in the TG&E

acquisition combined with an increase in the average margin per unit by 39% contributed to the increased Adjusted EBITDA over the prior year.

Year Ended June 30, 2004 Compared with Year Ended June 30, 2003

The number of RCEs for the fiscal year ended June 30, 2004 totaled 361,000 up 135,000, or 60% compared to the prior year. The increase was related to customers acquired in the TG&E acquisition in March 2004 and through organic growth realized in other market areas. In particular, new customer growth was expanded in the Illinois and Michigan natural gas markets.

Sales for the fiscal year ended June 30, 2004 were \$185.7 million, up \$83.2 million, or 81% compared to the prior year. The increase in sales was driven principally by higher sales volume in the period and increased per unit sales prices resulting from increases in the price of natural gas. Increased volume over the prior year accounted for approximately \$41.0 million of the increase and higher unit selling prices accounted for \$38.0 million of the increase. MXenergy also realized electricity sales of approximately \$4.2 million in the period resulting from the acquisition of TG&E. No comparable sales were realized in the prior period.

Gross profit for the fiscal year ended June 30, 2004 totaled \$75.7 million compared to \$32.7 million in the prior year, up \$43.0 million, or 131%. The increase was primarily related to an increase in unrealized gains from risk management activities of \$28.5 million over the prior year. Adjusting for unrealized gains from risk management activities, gross profit in 2004 increased by \$14.6 million over the prior year to \$29.4 million. The increase is primarily related to increased per unit margins during the period as MXenergy began to price new fixed price customers and renewal customers at a projected per unit margin rather than as a percentage of the selling price. Gross profit also benefited from increased sales activity over the prior year.

Operating expenses for the fiscal year ended June 30, 2004 were \$22.3 million compared to \$8.0 million in the prior year, up \$14.3 million, or 179%. The increase is primarily due to increased amortization costs associated with capitalized customer acquisition costs and acquisitions of customer portfolios. The increase of \$6.0 million over the prior year is related to a change in the amortization period of a customer from seven years to three years based on the estimated life of a customer. The change in estimate resulted in an incremental charge of \$4.6 million in the 2004 fiscal year. Salaries and related expense for the fiscal year ended June 30, 2004 were \$7.8 million compared to \$3.2 million in the prior year, up \$4.6 million, or 143.7%. Non-cash stock compensation charges of \$1.9 million and \$0.7 million are included in general and administrative expenses for the fiscal year ended June 30, 2004 and the fiscal year ended June 30, 2003, respectively. The remaining increase can be attributed to additional staff retained as part of the TG&E acquisition and increased staff across all functional areas of the business. Reserves and discounts for the fiscal year ended June 30, 2004 were \$3.4 million compared to \$1.8 million in the prior year, up \$1.6 million, or 89%. The increase is consistent with the increased sales in the period. Reserves and discounts as a percentage of sales has remained relatively consistent at 1.8% of sales compared to 1.7% in the prior year.

MXenergy incurred income tax expense of \$20.1 million in the 2004 fiscal year compared to \$3.0 million in the prior fiscal year. MXenergy's effective tax rate was 40% as compared to approximately 13% in 2003, primarily due to the use of net losses in 2003.

Adjusted EBITDA for the fiscal year ended June 30, 2004 was \$15.8 million, up \$7.5 million, or 89%, compared to the prior year. The increase is primarily attributable to increased sale volume and higher per unit margins over the prior year offset by higher operating costs in 2004.

Liquidity and Capital Resources

Our principal source of liquidity for funding our ongoing operations is cash from operations and availability under our revolving credit facilities.

As of June 30, 2006, MXenergy had \$6.1 million of cash on hand. In 2006, MXenergy used cash balances of \$47.5 million, net inflow of cash from restricted cash and short term investments of \$7.0 million and cash received from the exercise of options and warrants of \$0.5 million to fund operating activities of \$10.3 million, the purchase of a customer portfolio from Castle of \$3.2 million, a cash deposit and other costs in connection with the SESCO acquisition of \$3.3 million, customer acquisitions of \$6.2 million, capital expenditures of \$6.2 million, net payments of debt of \$16.4 million, repayments of long-term borrowings of \$5.0 million, \$2.3 million of debt financing costs and purchases of common stock for cancellation of \$2.1 million.

At June 30, 2005, MXenergy had \$53.6 million of cash on hand and \$21.4 million in outstanding borrowings owed to VPEM. In 2005, MXenergy used cash from operations of \$29.1 million, inflow of cash from restricted cash and short term investments of \$2.2 million, net proceeds from loan activities of \$3.4 million, proceeds from the issuance of common stock and exercise of warrants of \$0.8 million and proceeds from a note receivable related to the issuance of our Series A convertible preferred stock of \$30.1 million to fund the purchase of TG&E of \$2.0 million, customer acquisitions of \$3.8 million, capital expenditures of \$2.5 million, repayments of long-term borrowings of \$9.2 million, purchases of common stock for cancellation of \$0.7 million and to increase cash balances by \$47.4 million

At June 30, 2004, MXenergy had \$6.2 million of cash on hand, \$19.0 million in outstanding borrowings due to its supplier and \$8.2 million outstanding under the Sowood credit facility. In 2004, MXenergy used cash from operations of \$11.6 million, \$0.1 million of proceeds from the issuance of shares of our common stock and proceeds from borrowings under the Sowood credit facility of \$8.2 million to fund the purchase of TG&E of \$11.5 million, net outflow of restricted cash and short term investments of \$0.2 million, customer acquisition costs of \$3.1 million, capital expenditures of \$1.5 million, net payments of debt of \$0.6 million and to increase cash balances by \$3.0 million.

Our Hedge Facility

Prior to entering into the credit facility with Société Générale in December 2005, MXenergy utilized a supplier finance arrangement with VPEM. In September 2002, MXenergy entered into a five year Energy Marketing Agreement, or EMA, with VPEM. The EMA provides for exclusive physical supply in specified LDC territories and, prior to December 2005, allowed MXenergy to borrow amounts based on the level of our trade receivables and inventories. The terms of the loans varied but were generally due in either 60-day or 300-day increments for receivables and inventory. Interest under the loans accrued at prime to prime plus 2% depending on the term of the advance. In addition, the EMA provided for borrowings of up to \$6.5 million to meet certain collateral requirements with LDCs (including third party guarantees) which accrued interest at 3% per annum. The EMA provides us with the ability to enter into NYMEX Henry Hub and natural gas basis swaps for terms of up to 39 months without having to post any cash collateral for margining. Administrative fees and other volumetric based expenses also apply to the total financing costs of the EMA. The EMA was secured by a first lien on all of MXenergy's assets prior to the closing of the credit facility in December 2005.

In conjunction with the closing of the credit facility in December 2005, the EMA was amended to eliminate the provision for cash borrowings and the \$6.5 million for guarantees. In addition, we must satisfy all physical and financial purchases on industry standard credit terms. Any physical gas purchases

from VP EM in excess of \$25.0 million must be collateralized with cash or letters of credit. VP EM has a second lien on all working capital assets and continues to maintain a first lien on the customer contracts.

The hedge facility with Société Générale replaced the financial hedging component of the EMA. We posted an initial balance of \$25.0 million in collateral as initial margin for the hedge facility. For more information about our hedge facility, see “Recent Developments” above.

Our Revolving Credit Facility

Our revolving credit facility provides for the issuance of letters of credit and for revolving working capital borrowings. The availability of letters of credit and advances under our revolving credit facility is limited by the size of our borrowing base comprised principally of our unrestricted cash, receivables and natural gas inventories. Borrowings under our revolving credit facility will initially bear interest at LIBOR plus 1.625% or prime plus .375% and may be reduced depending on the leverage outstanding each quarter after July 2007. Letters of credit issued under our revolving credit facility are charged fees of 1.50%.

Our revolving credit facility contains customary covenants that restrict certain activities including, among others, limitation on capital expenditures, disposal of property and equipment, incurrence of additional indebtedness, issuance of capital stock and dividend payments. Financial covenants under our revolving credit facility include minimum tangible net worth, minimum working capital and interest coverage, each as defined in our revolving credit facility. Our revolving credit facility also contains customary events of default. For more information about our revolving credit facility, see “Recent Developments” above.

As of the date hereof, we are in compliance with the covenants under our revolving credit facility and we expect to continue to be in compliance in the next fiscal year. Because we have been in compliance with the covenants in our revolving credit facility, these covenants have not had a material impact on our operations, financial condition and results of operations. However, in the future our ability to secure financing for our operations or otherwise pursue our business plan could be limited by these covenants, and if we are unable to obtain financing for our operations or otherwise pursuing our business plan, our growth may be impaired and our revenues may decline.

Our Floating Rate Senior Notes due 2011

The indenture governing the notes contains covenants that limit our ability and the ability of our subsidiaries to, among other things, incur additional debt or issue certain preferred shares; pay dividends on, redeem or repurchase our capital stock or make other restricted payments; make investments; create certain liens; sell certain assets; enter into agreements that restrict the ability of our subsidiaries to make dividend or other payments to us; guarantee indebtedness; engage in transactions with affiliates; prepay, repurchase or redeem the notes; create or designate unrestricted subsidiaries; and consolidate, merge or transfer all or substantially all of our assets and the assets of our subsidiaries on a consolidated basis. If a change of control, as defined in the indenture governing the notes, were to occur, we will be obligated to make an offer to purchase the notes, in whole or in part, at a price equal to 101% of the aggregate principal amount of the notes, plus accrued and unpaid interest, if any, to the date of purchase. If a change in control were to occur, we may not have the financial resources to repay all of our obligations under the notes. For more information about the notes, see “Recent Developments” above.

Unlike our revolving credit facility, the financial covenants in the indenture governing the notes primarily limit our ability to incur additional debt, make distributions or engage in other actions rather than require us to maintain certain financial ratios or levels. Consequently, the covenants in the indenture

have not had a significant impact on our operations, financial condition and results of operations. However, in the future our ability to secure financing for our operations could be limited by these covenants, and if we are limited in our ability to obtain financing, our operations, financial condition and results of operations could be adversely affected.

In August 2006, we entered into interest rate swap agreements to hedge the floating rate interest expense on the notes. The swaps are fixed-for-floating and settle against the six month LIBOR rate. The fixed rates under the swaps range from 5.68% to 5.72%. The total notional amount of the interest rate swaps is \$130 million with an average term of five years. Prior to June 30, 2006 in anticipation of an offering of notes, MxEnergy entered into interest rate swap agreements for a total notional amount of \$80 million. These swap agreements were replaced by the interest rate swap agreements we entered into in August 2006 for a total notional amount of \$130 million. None of the interest rate swap agreements have been designated as a hedge under SFAS No. 133; accordingly, changes in the market value of the interest rate swaps have been and will be charged to earnings.

Sowood Credit Facility

MxEnergy Inc. entered into an amended and restated loan agreement with Sowood on November 14, 2003, which loan agreement was amended on March 22, 2004. We may borrow up to \$12.0 million under the Sowood credit facility. Amounts borrowed under the Sowood credit facility may be repaid and reborrowed from time to time.

Borrowings under the Sowood credit facility bear interest at a rate of 9% per annum. All outstanding borrowings under the Sowood credit facility will be due on May 14, 2009 or such later date as approved by Sowood in its sole discretion. Borrowings under the Sowood credit facility are secured by a pledge of substantially all of the assets of MxEnergy Inc. As of the date hereof, no amounts are outstanding under the Sowood credit facility.

The Sowood credit facility contains operating and financial covenants. These financial and operational covenants are based on definitions contained in the Sowood credit facility. The financial and operational covenants require MxEnergy Inc. to maintain minimum forward book values, minimum total asset values, minimum qualified accounts and minimum consolidated EBITDA.

As of June 30, 2006, MxEnergy Inc. was in compliance with the covenants under the Sowood credit facility. Because we have been in compliance with the covenants in the Sowood credit facility, these covenants have not had a material impact on our operations, financial condition and results of operations. However, in the future our ability to secure financing for our operations or otherwise pursue our business plan could be limited by these covenants, and if we are unable to obtain financing for our operations or otherwise pursuing our business plan, our growth may be impaired and our revenues may decline.

Other

Credit terms from our suppliers of natural gas and electricity often require us to post collateral against our energy purchases. In addition, many of the LDCs behind which we serve customers require that we provide collateral to secure our delivery obligations. We currently finance these collateral obligations with letters of credit under our revolving credit facility or from available cash. Increases in the amount of security we are required to post could adversely affect our liquidity. As of June 30, 2006, MxEnergy had \$7.1 million in letters of credit, \$0.3 million in restricted cash and \$0.1 million in deposits used as collateral in connection with LDC operating agreements or to support energy purchases.

Estimates for liquidity requirements are highly dependent on then current market conditions including forward prices for energy and market volatility. In determining our liquidity needs, we assume that we will not be provided with any unsecured credit from third parties.

Based upon our current plans, level of operations and business conditions, we believe that our restricted and unrestricted cash, cash generated from operations, availability under revolving credit facilities and the net proceeds from the offering will be sufficient to meet our capital requirements and working capital needs for the foreseeable future.

Employee Restructuring

In August 2006, we approved and announced to employees a plan to move certain of our operations to Houston, Texas in connection with the SESCO acquisition. The terms of the rationalization plan, which are specific to each employee affected, include various employee benefit cost components such as severance, retention bonuses and reimbursement of relocation costs. Certain of the employee benefit costs are contingent on future events, such as continued employment during defined transition periods. We estimate the maximum rationalization charges for the plan, all of which relate to employee severance and benefits, will amount to approximately \$1.6 million. We expect to record \$1.5 million and \$0.1 million of rationalization charges during 2007 and 2008, respectively. We expect to pay \$0.9 million and \$0.7 million of such employee severance and benefits during 2007 and 2008, respectively.

Summary of Contractual Obligations

The following table discloses aggregate information about MXenergy's contractual obligations and commercial commitments as of June 30, 2006 and the periods in which payments are due:

	<u>Outstanding</u>	<u>Less Than 1 Year</u>	<u>2-3 Years</u>	<u>3-5 Years</u>	<u>Thereafter</u>	<u>Total</u>
Old credit facility.....	\$—	\$—	\$—	\$—	\$—	\$—
Sowood credit facility	—	—	—	—	—	—
Operating leases.....	2.3	0.7	1.2	0.4	—	2.3
Unconditional purchase obligations(1).....	8.5	5.8	2.7	—	—	8.5
Redeemable convertible preferred stock(2)	29.4	—	—	29.4	—	29.4
Total.....	\$40.2	\$6.5	\$3.9	\$29.8	\$—	\$40.2

(1) Represents forward physical basis contracts and only the fixed portion thereof.

(2) Excludes annual dividends and does not give effect to redemption at the fair market value of the shares of our Series A Convertible Preferred Stock. The holders of our Series A Convertible Preferred Stock will have the right to "put" such stock to the Company after June 30, 2009. For a more detailed description, see Note 10 to MXenergy's consolidated financial statements included elsewhere in this Annual Report.

Critical Accounting Policies

The preceding discussion and analysis of our financial condition and operating results are based on our consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. Our significant accounting policies are more fully described in the notes to our consolidated financial statements contained in this Annual Report. The preparation of our financial statements require us to make difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. In applying these policies, management uses its judgment to determine the appropriate assumptions to be used in the determination of certain estimates. On an on-going basis, we evaluate our estimates which are based on historical

experience, weather data, terms of existing customer contracts, and various other assumptions that we believe to be reasonable under the circumstances. Our actual results may differ from these estimates and assumptions. The accounting policies discussed below are those that we consider to be critical to an understanding of our financial statements because their application places the most significant demands on our ability to judge the effect of inherently uncertain matters on our financial results. For all of these policies, we caution that future events rarely develop exactly as forecast, and the best estimates routinely require adjustment. This information should be read in conjunction with MXenergy's consolidated financial statements included elsewhere in this Annual Report.

Revenue Recognition

We recognize revenue from the sale of natural gas and electricity in the period in which the commodity is consumed by customers or, in certain circumstances, when titles passes upon delivery to LDCs. Our customers are billed monthly at various dates throughout the month. We accrue for revenues applicable to gas and electricity consumed by customers but not yet billed under the cycle billing method. These unbilled revenues are determined by estimating the volume consumed by comparing actual and normalized weather and multiplying by the average sales price per unit for each respective market area or customer class. These estimates are actualized in subsequent periods when the meters are read and any change in estimates is reflected in operations in the period determined. Due to the seasonality of our business, such estimates may vary significantly from quarter to quarter.

Allowance for Doubtful Accounts

For those customers where we assume the credit risk associated with non-payment, we provide an allowance for doubtful accounts based on the age of the receivable, payment history of the customer and past loss experience. We write-off receivable balances when accounts are transferred to outside collection agencies. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Customer Acquisition Costs

As of June 30, 2006, MXenergy had a net carrying value of \$10.8 million of customer acquisition costs representing the purchase price of customer contracts acquired through bulk acquisitions and from direct response marketing through independent third parties. These costs are capitalized and amortized over the estimated three year average life of a customer. Recoverability of customer acquisition costs is measured by a comparison of the carrying amount of the assets to the future net cash flows expected to be generated by the asset and by considering specific assumptions for customer attrition, per unit gross profit, and operating costs. These assumptions are based on our internal forecasts and our past historical experience. If an impairment were to be identified, it could result in additional expense recorded in our consolidated statement of operations.

Derivative and Hedging Activities

We utilize both physical and derivative financial instruments to reduce our exposure to fluctuations in the price of natural gas and electricity. Commodity derivatives used as hedges could include futures, forwards, swaps and options which can be either exchange-traded instruments or bilateral contracts with counterparties. Settlements on the derivative contracts are realized monthly, generally based upon the difference between the contract price and the settlement price as quoted on NYMEX or other published index. We account for such derivatives under the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended and interpreted. SFAS No. 133 requires all derivative instruments to be carried on the balance sheet at fair value. We have not

elected to designate any of the derivatives or hedges under SFAS No. 133, and accordingly, any changes in fair value must be adjusted through unrestricted losses (gains) from risk management activities in the consolidated statements of operations. The application of SFAS No. 133 results in increased volatility in earnings due to the impact market prices have on the market positions and financial instruments that we have entered into. In determining the fair value of these derivative/financial instruments we use quoted market prices, third party brokers' quotes, estimates, various assumptions, and management judgment. The amount of forward derivative instruments that do not have a quoted market price or a third party broker quote is not significant. We have implemented risk management controls and limits to monitor our risk position and ensure that hedging performance is in line with agreed upon objectives.

New Accounting Standards

The following new accounting standards were issued, but have not yet been adopted by MXenergy as of June 30, 2006.

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123R"), which requires the recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements and the measurement based on the grant-date fair value of the award. It also requires the cost to be recognized over the period during which an employee is required to provide services in exchange for the award (the vesting period). SFAS No. 123R replaces SFAS No. 123 "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25 and its related interpretations. MXenergy adopted SFAS No. 123R effective July 1, 2006.

As we currently utilize the minimum value method for pro forma disclosures under the original provisions of SFAS No. 123, we are required to adopt the provisions of SFAS No. 123R using the prospective method. Under the prospective method, we will continue to account for non-vested awards outstanding at the date of adoption of SFAS No. 123R in the same manner as we had been accounted for prior to adoption for financial statement recognition purposes. All awards granted, modified or settled after the adoption will be accounted for using the measurement, recognition and attribution provisions of SFAS No. 123R. As no awards have been granted subsequent to June 30, 2006, we have not yet determined the impact of adopting SFAS No. 123R on our financial statements.

In September 2006, the Financial Accounting Standards Board issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"), which provides guidance for using fair value to measure assets and liabilities. SFAS No. 157 also responds to investors' requests for expanded information about the extent to which a company measures assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS No. 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances.

Under SFAS No. 157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, SFAS No. 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, for example, the reporting entity's own data. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy.

The provisions of SFAS 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years (i.e., our fiscal year ended June 30, 2009). Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including any financial statements for an interim period within that fiscal year. We have not yet determined the impact of adopting SFAS No. 157 on our financial statements.

Inflation

We do not believe inflation has a significant effect on our operations.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Historically, we have used a variety of financial and physical instruments to manage our exposure to fluctuations in commodity prices against our fixed price portfolio of customers.

Commodity Price Risk

We are exposed to commodity price variability in natural gas and electricity to meet projected demand under fixed priced contracts. We utilize both physical and derivative financial instruments to reduce our exposure to fluctuations in the price of natural gas and electricity. Commodity derivatives used as hedges typically include swaps and options executed under the EMA and prospectively under the hedge facility. For a more detailed discussion of our use of derivatives, see Note 2 and Note 7 to MXenergy's consolidated financial statements included elsewhere in this Annual Report.

We have adopted a risk management policy to measure and limit market risk and credit risk associated with our fixed price portfolio. Our policy requires us to maintain a balanced position at all times and does not permit speculative trading. We have an independent risk management department within the Company responsible for monitoring and enforcement of such policies. The risk policy currently requires that any position exposure in excess of \$5.0 million for more than two days be promptly mitigated.

In addition, we utilize a "value-at-risk", or VAR, model to estimate a maximum potential loss in the fair value of our natural gas portfolio. The key assumptions for our VAR model include (1) higher of 10 and 30 day NYMEX volatility, (2) net open position for anticipatory hedges and (3) a 99.73% confidence interval. We also run VAR based on an assumed 10,000 RCE anticipatory hedge using the same assumptions.

The estimated maximum potential loss in our fixed price natural gas portfolio using our actual net open position and an assumed 10,000 RCE anticipatory hedge calculated using the VAR model as of the end of each month for the year ended June 30, 2006 was \$470,223 and \$872,331, respectively.

Credit Risk

We are exposed to credit risk in our risk management activities. Credit risk relates to the loss resulting from the nonperformance by a counterparty of its contractual obligations. Historically, MXenergy executed all of its fixed price positions under the EMA which includes a master netting agreement that mitigates the outstanding credit exposure. Under the new hedge facility, our risk management activities will be with an AA-/Aa2 rated financial institution. To the extent we purchase financial hedges or physical commodity from other counterparties, our risk policy provides for ongoing financial reviews, established credit limits as well as monitoring, managing and mitigating credit exposure.

Interest Rate Risk

We are exposed to fluctuations in interest rates under our revolving credit facility. As of June 30, 2006, no amounts were outstanding under our revolving credit facility.

**INDEPENDENT AUDITORS' REPORT AND CONSOLIDATED FINANCIAL STATEMENTS
AND EXHIBITS**

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Report of Independent Auditors

Board of Directors
MxEnergy Holdings Inc.

We have audited the accompanying consolidated balance sheets of MxEnergy Holdings Inc. (formerly MxEnergy Inc.) as of June 30, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended June 30, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of MxEnergy Holdings Inc. at June 30, 2006, and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended June 30, 2006, in conformity with accounting principles generally accepted in the United States.

/s/ Ernst & Young LLP

Stamford, Connecticut
September 29, 2006

MxEnergy Holdings Inc.
Consolidated Balance Sheets

	June 30	
	2006	2005
Assets		
Current assets:		
Cash	\$ 6,092,697	\$ 53,629,581
Restricted cash and short term investments	426,823	7,380,277
Accounts receivable, net of allowance for doubtful accounts of \$3,285,000 and \$1,899,000 in 2006 and 2005, respectively	31,575,429	18,572,820
Inventories	18,498,918	15,813,552
Current portion of unrealized gains from risk management activities	1,664,170	56,325,996
Income taxes receivable	5,535,210	-
Deferred income taxes	1,045,729	-
Security deposits and other current assets	2,677,979	5,399,627
Total current assets	67,516,955	157,121,853
Customer acquisition costs, net of accumulated amortization of \$19,173,000 and \$12,950,000 in 2006 and 2005, respectively	10,821,578	7,170,895
Fixed assets, net	8,637,342	4,755,292
Unrealized gains from risk management activities	1,272,080	21,358,731
Deferred income taxes	3,395,222	-
Deposit on SESCO asset purchase agreement and other capitalized costs	3,348,097	-
Other assets, net	2,977,431	1,185,647
Total assets	\$ 97,968,705	\$ 191,592,418
Liabilities, redeemable convertible preferred stock and stockholders' equity		
Current liabilities:		
Accounts payable and accrued expenses	\$ 14,898,075	\$ 10,947,693
Accrued commodity purchases	14,542,934	25,664,835
Current portion of unrealized losses from risk management activities	452,058	-
Loans payable	-	16,379,466
Deferred income taxes	-	21,648,113
Total current liabilities	29,893,067	74,640,107
Unrealized losses from risk management activities	3,324,996	-
Long-term debt	-	5,000,000
Deferred income taxes	-	6,675,117
Total liabilities	33,218,063	86,315,224
Redeemable convertible preferred stock (\$31 million redemption value)	29,357,367	29,357,367
Commitments	-	-
Stockholders' equity:		
Common stock, par value \$0.01, 10,000,000 shares authorized; 3,388,815 and 3,326,327 shares issued and outstanding in 2006 and 2005, respectively	33,888	33,263
Additional paid-in capital	17,355,102	18,113,744
Unearned stock compensation	(115,013)	(165,169)
Accumulated other comprehensive loss	(40,067)	(3,625)
Retained earnings	18,159,365	57,941,614
Total stockholders' equity	35,393,275	75,919,827
Total liabilities, redeemable convertible preferred stock and stockholders' equity	\$ 97,968,705	\$ 191,592,418

See accompanying notes.

MxEnergy Holdings Inc.
Consolidated Statements of Operations

	Year ended June 30		
	2006	2005	2004
Sales of natural gas and electricity	\$ 362,560,295	\$ 277,196,212	\$ 185,658,764
Cost of goods sold (excluding depreciation and amortization):			
Cost of natural gas and electricity sold	392,612,424	255,724,382	172,177,775
Realized gains from risk management activities	(82,983,362)	(37,607,616)	(15,892,181)
Unrealized losses (gains) from risk management activities	79,896,668	(16,004,086)	(46,360,263)
	<u>389,525,730</u>	<u>202,112,680</u>	<u>109,925,331</u>
Gross (loss) profit	(26,965,435)	75,083,532	75,733,433
Operating expenses:			
General and administrative expenses	22,623,530	17,937,066	11,597,085
Advertising and marketing expenses	2,095,749	2,359,461	407,643
Reserves and discounts	3,394,728	4,533,201	3,432,027
Depreciation and amortization	8,503,714	6,165,847	6,894,250
Total operating expenses	<u>36,617,721</u>	<u>30,995,575</u>	<u>22,331,005</u>
Operating (loss) profit	(63,583,156)	44,087,957	53,402,428
Interest expense—net of interest income of \$1,061,000, \$614,000 and \$110,000, respectively	3,200,194	2,857,501	3,108,748
(Loss) income before income tax benefit (expense)	(66,783,350)	41,230,456	50,293,680
Income tax benefit (expense)	27,001,101	(18,141,797)	(20,117,166)
Net (loss) income	<u>\$ (39,782,249)</u>	<u>\$ 23,088,659</u>	<u>\$ 30,176,514</u>

See accompanying notes.

MxEnergy Holdings Inc.
Consolidated Statements of Stockholders' Equity
Years Ended June 30, 2006, 2005 and 2004

	Common Stock Par Value	Additional Paid-in Capital	Unearned Stock Compensation	Accumulated Other Comprehensive Loss	Retained Earnings	Total Stockholders' Equity
Balance at June 30, 2003	\$ 28,529	\$ 8411,150	\$ (265,539)	\$ –	\$ 4,676,441	\$ 12,850,581
Issuance of common stock	4,229	2,602,914	–	–	–	2,607,143
Amortization of stock compensation	–	–	1,894,248	–	–	1,894,248
Warrants issued to employees	–	1,804,800	(1,804,800)	–	–	–
Warrants issued in financing agreements	–	2,104,834	–	–	–	2,104,834
Net income and comprehensive income	–	–	–	–	30,176,514	30,176,514
Balance at June 30, 2004	32,758	14,923,698	(176,091)	–	34,852,955	49,633,320
Issuance of common stock	1,115	796,451	–	–	–	797,566
Warrants issued to employees	–	2,022,150	(2,022,150)	–	–	–
Purchase and cancellation of treasury shares	(610)	(666,493)	–	–	–	(667,103)
Amortization of stock compensation	–	–	2,033,072	–	–	2,033,072
Warrants issued in connection with the offering of redeemable convertible preferred stock	–	368,000	–	–	–	368,000
Tax benefit on issuance of common stock from warrants	–	669,938	–	–	–	669,938
Comprehensive income:						
Net income	–	–	–	–	23,088,659	23,088,659
Foreign currency translation	–	–	–	(3,625)	–	(3,625)
Comprehensive income	–	–	–	(3,625)	–	23,085,034
Balance at June 30, 2005	33,263	18,113,744	(165,169)	(3,625)	57,941,614	75,919,827
Issuance of common stock	1,251	531,200	–	–	–	532,451
Unamortized stock compensation	–	860,570	(860,570)	–	–	–
Purchase and cancellation of treasury shares	(626)	(2,150,412)	–	–	–	(2,151,038)
Amortization of stock compensation	–	–	910,726	–	–	910,726
Comprehensive loss:						
Net loss	–	–	–	–	(39,782,249)	(39,782,249)
Foreign currency translation	–	–	–	(36,442)	–	(36,442)
Comprehensive loss	–	–	–	(36,442)	–	(39,818,691)
Balance at June 30, 2006	\$ 33,888	\$ 17,355,102	\$ (115,013)	\$ (40,067)	\$ 18,159,365	\$ 35,393,275

See accompanying notes.

MxEnergy Holdings Inc.
Consolidated Statements of Cash Flows

	Year ended June 30		
	2006	2005	2004
Operating activities			
Net (loss) income	\$ (39,782,249)	\$ 23,088,659	\$ 30,176,514
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:			
Unrealized losses (gains) from risk management activities	79,896,668	(16,004,086)	(46,360,263)
Non-cash stock compensation expense	910,726	2,033,072	1,894,248
Depreciation and amortization	8,503,714	6,165,847	6,894,250
Deferred tax (benefit) expense	(32,764,181)	6,552,213	19,729,572
Non-cash interest expense	1,057,270	348,871	207,374
Changes in assets and liabilities, net of effects of acquisition:			
Net inflow (outflow) in restricted cash and short term investments	6,953,454	2,194,998	(191,967)
Accounts receivable	(13,002,609)	3,271,285	1,976,258
Inventories	(2,685,366)	(72,258)	(970,495)
Option premiums	(1,834,000)		
Income taxes receivable	(5,535,210)		
Security deposits and other assets	2,645,608	894,648	(4,610,410)
Accounts payable and accrued expenses	(7,731,303)	2,821,145	2,645,855
Net cash (used in) provided by operating activities	<u>(3,367,478)</u>	<u>31,294,394</u>	<u>11,390,936</u>
Investing activities			
Purchase of Total Gas & Electric, Inc., net of cash acquired	–	(2,003,000)	(11,450,000)
Purchase of customer portfolio from Castle Power LLC	(3,149,926)	–	–
Deposit on SESCo asset purchase agreement and other capitalized costs	(3,348,097)	–	–
Customer acquisition costs	(6,149,100)	(3,842,822)	(3,150,927)
Purchases of fixed assets	(6,177,636)	(2,450,360)	(1,552,766)
Net cash used in investing activities	<u>(18,824,759)</u>	<u>(8,296,182)</u>	<u>(16,153,693)</u>
Financing activities			
Proceeds from loans	210,122,907	193,748,669	148,697,128
Repayments of loans	(226,502,373)	(190,390,103)	(149,274,123)
Debt financing costs	(2,346,594)	–	–
Proceeds from Sowood credit facility	–	–	8,200,000
Repayments of long-term borrowings	(5,000,000)	(1,000,000)	–
Repayments of Sowood credit facility	–	(8,200,000)	–
Issuance of common stock and exercise of warrants	532,451	797,566	95,228
Purchase of common stock for cancellation	(2,151,038)	(667,103)	–
Proceeds from note receivable, net of \$892,651 in issuance costs	–	30,107,349	–
Net cash (used in) provided by financing activities	<u>(25,344,647)</u>	<u>24,396,378</u>	<u>7,718,233</u>
Net (decrease) increase in cash	<u>(47,536,884)</u>	<u>47,394,590</u>	<u>2,955,476</u>
Cash at beginning of year	53,629,581	6,234,991	3,279,515
Cash at end of year	<u>\$ 6,092,697</u>	<u>\$ 53,629,581</u>	<u>\$ 6,234,991</u>
Supplemental cash flow information			
Income taxes paid	<u>\$ 12,222,841</u>	<u>\$ 11,473,152</u>	<u>\$ 72,723</u>
Interest paid	<u>\$ 3,709,601</u>	<u>\$ 3,182,525</u>	<u>\$ 2,701,419</u>

See accompanying notes.

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements

1. Organization and Business

MxEnergy Holdings Inc. (“Holdings”) was incorporated on January 24, 2005 as a Delaware corporation. Holdings was formed as part of a corporate reorganization which was completed in the year ended June 30, 2005. The two principal operating subsidiaries of Holdings are MxEnergy Inc. and MxEnergy Electric Inc. which are engaged in the marketing and supply of natural gas and electricity, respectively.

As part of the reorganization, the common and preferred stockholders of MxEnergy Inc. became stockholders of Holdings on a one-for-one basis. The purpose of the reorganization was to split the gas and electric businesses into separate entities. Since all transactions were between entities under common control, there was no accounting impact as a result of the reorganization.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Holdings and all operating and holding subsidiaries (collectively, the “Company”). All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Revenue Recognition

Revenues from the sale of natural gas and electricity are recognized in the period in which the commodity is consumed by customers or, in certain circumstances, when title passes upon delivery to local distribution companies (“LDC”). Sales of natural gas and electricity are generally billed by the local distribution companies, acting as the Company’s agents, on a monthly cycle basis. The billing cycles for customers do not coincide with the accounting periods used for financial reporting purposes. The Company follows the accrual method of accounting for revenues whereby revenues applicable to gas and electricity consumed by customers, but not yet billed under the cycle billing method, are estimated and accrued along with the related costs, and included in operations. Such estimates are refined in subsequent periods upon obtaining final information from the local distribution companies. Any change in estimates is reflected in operations in the period determined. Transportation and storage costs are included as a component of cost of goods sold. Unbilled accounts receivable were approximately \$4.7 million and \$3.4 million at June 30, 2006 and 2005, respectively. Revenues from the sale of natural gas and electricity are reflected net of any applicable sales tax.

Restricted Cash and Short Term Investments

Restricted cash and short term investments at June 30, 2006 and 2005 consist of cash, certificates of deposit with maturities ranging from 30 days to one year from the date of purchase and money market funds, the majority of which are held as security backing letters of credit and surety bonds which are required by several of the local distribution companies, utility commissions’ and pipelines’ tariffs and regulations. Certificates of deposit are stated at cost which approximates fair value due to the short-term maturity of the instruments. The Company has entered into a lockbox agreement with Virginia Power

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Energy Marketing Inc. (“VPEM”) whereby the cash on deposit is subject to withdrawal restrictions and has been pledged to VPEM (see Note 3). The Company must provide support to VPEM in order to obtain approvals for disbursements from this account.

Inventories

Inventories consist of natural gas held by third parties and are valued at the lower of cost or market on a weighted average cost basis.

Fair Value of Financial Instruments

The carrying amounts of the Company’s financial instruments (accounts receivable, accounts payable and loans payable) approximate fair value due to their short-term nature. Additionally, the fair values of the Company’s New York Mercantile Exchange (“NYMEX”) based derivative instruments are estimated based on quoted market prices. Fair values of basis swaps are based on quotes received from the Company’s primary supplier as no quoted published market exists for these derivative instruments. The carrying amount of long-term debt approximates fair value based on the commercial terms of the debt agreement.

Allowance for Doubtful Accounts

Many of the LDCs through which the Company delivers gas and electricity guarantee or purchase customer billings or amounts due for consumed gas and electricity. The guarantee or purchase discounts range from zero to 5% of billed accounts receivable and are charged to reserves and discounts in the consolidated statements of operations as revenue is recorded.

In markets where no such guarantees or purchases exist, the Company provides an allowance for doubtful accounts based on the age of the receivable, payment history of the customer and past loss experience. The Company writes off receivable balances when accounts are transferred to outside collection agencies.

At June 30, 2006 and 2005, the Company had gross accounts receivable where no guarantee of receivables exists of approximately \$13.7 million and \$7.2 million, respectively.

Concentration of Credit Risk

The Company, through its Energy Marketing Agreement (the “Agreement”) with VPEM engages in transactions with VPEM for the purchase of derivative instruments and physical natural gas purchases. The Agreement was exclusive in nature and, as a result, predominately all of the Company’s transactions were with VPEM. The Company is party to a master netting agreement which mitigates the exposure to credit risk as the Company has borrowings from VPEM under the Agreement (see Note 3).

Management continually evaluates the credit risk associated with all other counterparties. Credit risk associated with trade accounts receivable is limited as certain of the LDCs either guarantee customer billings or amounts due for delivered gas and electricity. In the market areas where the LDC does not guarantee the receivables, the Company maintains a provision for credit losses based upon the credit risk of its customers, historical trends and other information.

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

The Company operates in 30 market areas located in 11 states and the Province of Ontario. The Company's diversified geographic coverage mitigates its exposure to a single LDC, a regulatory jurisdiction, extreme local weather patterns or an economic downturn in any single geographic region.

Customer Acquisition Costs

Customer acquisition costs represent the purchase price of customer contracts acquired from independent third parties and through bulk acquisitions. These costs are capitalized and amortized over an estimated three year average life of a customer. In addition, beginning July 1, 2005 direct response advertising costs which consist primarily of hourly-based telemarketing costs associated with proven customer generation, are capitalized and amortized over the estimated average life of a customer in accordance with the provisions of Statement of Position No. 93-7 "Reporting on Advertising Costs." Net direct response advertising costs included in customer acquisition costs at June 30, 2006 were approximately \$4.1 million. All costs associated with servicing and maintaining customer accounts are expensed as incurred. Amortization expense relating to capitalized customer acquisition costs for the years ended June 30, 2006, 2005 and 2004 was \$6.2 million, \$5.0 million and \$6.4 million respectively. In 2003 and prior years, the Company amortized these costs over a seven year period. The change was made to conform the amortization to the estimated average life of a customer contract based on the most recent information available to the Company. The Company had accounted for this change as a change in estimate. The effect of the change is reflected in 2004 and resulted in an incremental charge of approximately \$4.6 million. The expected amortization expense on such costs is approximately \$5.8 million in 2007, \$3.6 million in 2008 and \$1.4 million in 2009.

Fixed Assets

Fixed assets are stated at cost, less accumulated depreciation. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets which range from three to five years.

Impairment of Long-Lived Assets

Management evaluates the recoverability of long-lived assets (including customer acquisition costs, which are evaluated monthly) by comparing the carrying value of such assets to their projected future cash flows. If there are indications that the carrying value of such assets may not be recoverable, the Company recognizes an impairment loss by a charge against current operations.

Income Taxes

The Company accounts for income taxes under the liability method as required by SFAS No. 109, "Accounting for Income Taxes." Under this method, deferred tax liabilities and assets are determined based upon the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the temporary differences are expected to reverse.

Derivatives and Hedging Activities

The Company utilizes derivative financial instruments to reduce its exposure to fluctuations in the price of natural gas. Commodity derivatives used as economic hedges could include futures, forwards, swaps and options which can be either exchange traded instruments or bilateral contracts with counterparties. In addition, certain contracts with customers are defined as derivatives. Settlements on the derivative contracts are realized monthly, generally based upon the difference between the contract price and the

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

closing price as quoted on the NYMEX or other published index. Market prices used to value derivative positions reflect management's best estimate considering various factors including closing exchange and over-the-counter quotations, parity differentials, time value, and volatility factors underlying the commitments. The values are adjusted to reflect the potential impact of liquidating the Company's position in the ordinary course of business over a reasonable period of time under present market conditions. The Company accounts for such derivatives under the provisions of SFAS No. 133, which requires all derivative instruments to be carried on the balance sheet at fair value. The Company has not elected to designate any of the derivatives as hedges under SFAS No. 133, and accordingly, any changes in fair value must be adjusted through unrealized losses (gains) from risk management activities in the consolidated statements of operations. The Company has implemented risk management controls and limits to monitor its risk position and ensure that hedging performance is in line with agreed-upon objectives.

Stock Based Compensation

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25") and related interpretations, in accounting for all stock options and warrants ("awards") granted to employees, rather than the alternative fair value method allowed under SFAS No. 123, "Accounting for Stock Based Compensation" ("SFAS No. 123"). APB No. 25 provides that compensation expense relative to the Company's employee stock and stock option grants be measured based on the intrinsic value of the stock or stock option at the date of grant.

The Company follows SFAS No. 123 and Emerging Issues Task Force ("EITF") No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services," for all awards granted to non-employees. The Company uses the Black-Scholes option-pricing model for estimating the fair value of non-employee grants. The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option-pricing models require the input of highly subjective assumptions, including the expected price volatility. Because the Company's stock options and warrants have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options.

The pro forma information regarding net (loss) income required by SFAS No. 123 has been determined as if the Company had accounted for all awards under the fair value method described in that statement. The fair value of the awards granted by the Company to employees was estimated at the date of grant using the minimum value pricing method.

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Significant assumptions related to the determination of the fair value of the options and their impact on earnings for the years ended June 30, 2006, 2005 and 2004 are as follows (dollars in millions):

	2006	June 30 2005	2004
Risk free interest rate for employee options	4.45%	3.60%-4.50%	3.07%-3.39%
Risk fee interest rate for non-employee options	-	3.69%-4.50%	3.29%-3.39%
Expected life of employee options (in years)	5	5-10	5-10
Expected life of non-employee options (in years)	-	5-10	5
June 30			
		June 30	
	2006	2005	2004
Net (loss) income as reported	\$ (39.8)	\$ 23.1	\$ 30.2
Add stock based compensation, net of income taxes	.5	1.1	1.0
Deduct total stock based compensation expense determined under fair value method for all awards, net of income taxes	(.6)	(1.3)	(1.2)
Pro forma net income	\$ (39.9)	\$ 22.9	\$ 30.0

The Company has issued warrants to purchase the common stock of the Company to certain employees which permit the employee to exercise such warrant for cash or by withholding from shares that would otherwise be issued upon exercise of the warrant that number of shares having a fair market value equal to the warrant exercise. As a result of such feature, a presumption exists that an employee will elect the cashless exercise and therefore such warrants are accounted for using variable plan accounting. Under variable plan accounting, compensation cost is measured as the amount by which the estimated fair value of the shares of the Company's common stock covered by such warrants exceeds the exercise price of the warrant. Prior to June 30, 2006 the Company estimated the fair value of its common stock using an internally developed pricing model validated by external transactions in the Company's common stock. At June 30, 2006, the Company obtained a valuation of its common stock from an independent valuation services firm. Compensation cost is accrued as a charge to expense over the vesting period of such warrants using the accelerated expense attribution method under Financial Accounting Standards Board ("FASB") Interpretation No. 28 "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans." Changes, either increases or decreases, in the estimated fair value of the Company's common stock between the date of grant and the exercise date result in a change in the measure of compensation for the award which is reflected in compensation expense in the period in which the changes in estimated fair value occur. Accrued compensation for an award that is forfeited or cancelled is adjusted by decreasing compensation expense in the period of forfeiture or cancellation. During the years ended June 30, 2006, 2005 and 2004, non-cash compensation expense relating to such warrants amounted \$.9 million, \$1.9 million and \$1.8 million respectively.

Recently Issued Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123R"), which requires the recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements and the measurement based on the grant-date fair value of the award. It also requires the cost to be recognized over the period during which an employee is required to provide services in exchange for the award (the vesting period). SFAS No. 123R replaces

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

SFAS No. 123 and supersedes APB No. 25 and related interpretations. The Company is required to adopt SFAS No. 123R effective for its fiscal year beginning July 1, 2006. As the Company currently utilizes the minimum value method for pro forma disclosures under the original provisions of SFAS No. 123, it is required to adopt the provisions of SFAS No. 123R using the prospective method. Under the prospective method, the Company will continue to account for non-vested awards outstanding at the date of adoption of SFAS No. 123R in the same manner as they had been accounted for prior to adoption for financial statement recognition purposes. All awards granted, modified or settled after the adoption will be accounted for using the measurement, recognition and attribution provisions of SFAS No. 123R. The Company has not yet determined the impact of adopting SFAS No. 123R on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"), which provides guidance for using fair value to measure assets and liabilities. SFAS No. 157 also responds to investors' requests for expanded information about the extent to which a company measures assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS No. 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances.

Under SFAS No. 157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, SFAS No. 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, for example, the reporting entity's own data. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy.

The provisions of SFAS 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years (i.e. the Company's fiscal year ended June 30, 2009). Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including any financial statements for an interim period within that fiscal year. The Company has not yet determined the impact of adopting SFAS No. 157 on its consolidated financial statements.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year's presentation.

3. Loans Payable and Long Term Debt

Through December 2005, the Agreement with VPEM provided, among other things, loans to the Company based on the level of its trade receivables and inventories. The terms of the loans varied but were generally due in either 60-day or 300-day increments for receivables and inventory. Inventory loans accrued interest at prime for the duration of the loan. Accounts receivable and extended invoice loans accrued interest at prime for the earlier of (i) 60 days or (ii) the margin withdrawal date; thereafter the rate is prime plus 2%.

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

3. Loans Payable and Long Term Debt (continued)

In addition to the loans, the Agreement provided for borrowings of up to \$6,500,000 (including third party guarantees) which were payable upon expiration of the Agreement and bore interest at a rate of 3% per annum. These funds were used as collateral for letters of credit or surety bonds issued to various utilities and regulatory agencies (see Note 2).

There were no borrowings under the Agreement at June 30, 2006. Outstanding borrowings under the Agreement amounted to \$5,000,000 at June 30, 2005. In 2005, the Company had drawn \$1,000,000 in the form of a third party guaranty. The loans and the borrowings under the Agreement were secured by a first lien on substantially all assets of the Company.

Interest on borrowings under the VPEM Agreement during the years ended June 30, 2006, 2005 and 2004 totaled \$2,222,000, \$2,882,000 and \$2,632,000, respectively. Administrative fees and other volumetric based expenses were also incurred under the facility.

In December 2005, the Company's principal operating subsidiaries entered into a three-year committed credit agreement with a banking syndicate (the "Credit Agreement"). The Credit Agreement, which replaced the financing component of the agreement with VPEM, provides for revolving working capital borrowing or issuance of letters of credit up to \$100 million (the "facility"). The availability of letters of credit and advances under the facility is limited by a borrowing base consisting primarily of the Company's unrestricted cash, accounts receivables and natural gas inventories. Letters of credit issued under the facility are charged fees of 1.50%, while loans bear interest at prime plus 0.375% or at the Company's option, LIBOR plus 1.625%. Commitment fees are payable on the unused portion of the facility at 0.375%.

As of June 30, 2006, the Company had \$7.1 million in outstanding letters of credit issued under the facility which serve as collateral for the performance risk associated with future delivery of natural gas. Total availability under the facility as of June 30, 2006 was \$39.2 million.

The Credit Agreement contains typical covenants that restrict certain activities including, among others, limitation on capital expenditures, disposal of property and equipment, additional indebtedness, issuance of capital stock and dividend payments. Financial covenants under the Credit Agreement include minimum tangible net worth, minimum working capital and interest coverage, each as defined in the Credit Agreement. The Credit Agreement also contains customary events of default. The Company is in compliance with the debt covenants under the Credit Agreement.

The Credit Agreement is secured by a first lien on substantially all assets and a second lien on customer contracts of MxEnergy Inc. and MxEnergy Electric Inc. On August 1, 2006, the Company amended and restated its existing credit facility (see Note 14).

4. Transactions with Related Parties

Credit Agreements with Sowood Commodity Partners Fund LP ("Sowood")

In July 2004, Lathi, LLC ("Lathi"), a significant stockholder of the Company, contributed its ownership interest and the financing agreements to Sowood. These financing agreements consist of a \$12 million line of credit negotiated in November 2003 and a \$9 million term loan facility negotiated in March 2004. Draws under the line of credit bear interest at 9% per annum and will be due May 14, 2009. Draws under the term loan facility bore interest at 14% per annum and matured on March 25, 2006. At June 30, 2006

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

4. Transactions with Related Parties (continued)

and 2005, there were no amounts outstanding under either credit agreement. Interest on loans from Sowood amounted to \$0 in 2006, \$0 in 2005 and \$0.6 million in 2004.

The Sowood credit agreements contain operating and financial covenants. These financial and operational covenants require the Company to maintain minimum forward book values, minimum total asset values, minimum qualified accounts and minimum consolidated earnings before interest, taxes, depreciation and amortization. The Company is in compliance with the debt covenants under the Sowood credit agreements.

In conjunction with the negotiation of the credit agreements in prior years, the Company and Lathi completed the following equity transactions:

- In November 2003, the Company converted a \$3 million term loan that was outstanding at June 30, 2003 into 378,788 shares of common stock. In addition, the line of credit was increased from \$2 million to \$12 million, upon which the Company granted Lathi 1,183,808 immediately vested warrants to purchase common stock of the Company at a weighted average exercise price of \$10.13 per share. The estimated fair value of the warrants attributable to the increase in the line of credit amounted to \$1,503,000 and was treated as a deferred financing cost and included in other assets in the consolidated balance sheets. Such cost is being amortized to interest expense over the 66-month term of the agreement.
- In March 2004, the Company granted Lathi 75,000 immediately vested warrants at an exercise price of \$15 per share in connection with the negotiation of the \$9 million term loan facility. The fair value of the warrants amounted to \$151,000 and was also treated as a deferred financing cost and included in other assets in the consolidated balance sheets. Such cost is being amortized to interest expense over the 24-month term of the agreement. The agreement provides for the issuance of 15,000 warrants with an exercise price of \$15 per share for each month there is an outstanding balance on the \$9 million term loan.

In July 2004, the Company amended the term of 1,469,736 outstanding warrants previously issued to Lathi such that the warrants all concurrently expire on March 29, 2009. This modification was made in connection with the issuance of preferred stock in fiscal 2004 (see Note 10). The estimated change in the fair value of the warrants attributable to the modification is approximately \$290,000 and was treated as an additional cost of issuance of preferred stock in 2005.

Consulting and Legal Services

In fiscal 2005, the Company entered into a consulting agreement with a stockholder. The agreement provides for a payment of a quarterly retainer of \$75,000 and additional fees contingent upon the successful completion of certain transactions specified in the agreement. The Company recorded general and administrative expenses of \$303,000 in 2006 and \$152,000 in 2005 pertaining to this agreement.

A member of the board of directors is a partner in a law firm that has provided legal services to the Company. Legal fees incurred with the law firm amounted to \$1,419,000 in 2006, \$174,000 in 2005 and \$176,000 in 2004.

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

4. Transactions with Related Parties (continued)

Other Transactions

In fiscal 2005, a member of the board of directors exercised options to acquire 68,800 common shares of the Company with a non-interest bearing promissory note for \$680,000 secured by the stock. The promissory note was fully paid prior to June 30, 2005. In connection with the issuance of preferred stock in fiscal 2004 (see Note 10), the Company paid a \$250,000 consulting fee (which was accrued in 2004) and issued 12,000 options to a non-employee Director. In addition, 3,000 options were issued to another non-employee director. The options have an exercise price of \$21.50 per share, vest ratably over three years and have a term of ten years. The consulting fee and the estimated fair value of the options, which amounted to \$78,000, were treated as cost of issuance of the preferred stock.

In fiscal 2006, certain employees exercised warrants to acquire common stock of the Company. The warrants contained a provision that provided for a net issuance of common stock which resulted in the issuance of 54,987 shares of common stock. In addition, the Company provided for withholding taxes to be satisfied with common stock withheld upon exercise of the warrants. The Company estimated the fair market value of the stock at the time of exercise using an internally developed valuation model.

5. Fixed Assets, Net

Fixed assets consist of the following (in thousands):

	June 30		Estimated Useful Lives
	2006	2005	
Computer equipment and software	\$ 11,808	\$ 5,736	3–5 years
Office furniture and equipment	1,019	913	3–5 years
	<u>12,827</u>	<u>6,649</u>	
Less accumulated depreciation	(4,190)	(1,894)	
Net	<u>\$ 8,637</u>	<u>\$ 4,755</u>	

Capitalized costs of software include the customer relationship management (“CRM”) system, which was implemented and operational by the fourth quarter of fiscal 2003, and is being depreciated over its estimated useful life of five years. The Company continues to make enhancements to the CRM system, which are being capitalized and depreciated over the remaining life of the system. Total capitalized cost of the CRM system at June 30, 2006 and June 30, 2005 amounted to \$4,052,000 and \$3,244,000, respectively.

During fiscal 2004, the Company contracted to purchase an electric power management system, which will enable the Company to improve forecasting regarding electricity demands of their customers. During fiscal 2006, the Company contracted to purchase a natural gas management system which will enable the Company to improve forecasting regarding natural gas demands of their customers. As of June 30, 2006 and 2005, capitalized costs for both the electric power and natural gas management systems totaled approximately \$713,000 and \$589,000, respectively of which \$185,000 and \$341,000 was incurred in fiscal 2006 and 2005, respectively.

In addition, the Company has capitalized costs totaling \$119,000 and \$55,000 at June 30, 2006 and 2005, respectively, related to the implementation of a new accounting system. This system became operational in fiscal 2006.

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

5. Fixed Assets, Net (continued)

During fiscal 2006, the Company contracted to purchase a risk management system to improve the Company's various risk management processes and analysis. As of June 30, 2006, capitalized costs totaled approximately \$2,017,000.

The Company follows Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," and SFAS No. 34, "Capitalization of Interest Costs." Total capitalized internal payroll and interest costs related to the implementation of the CRM system, which were all incurred in fiscal 2004, amounted to approximately \$75,000 and \$70,000, respectively.

Depreciation and amortization expense relating to all fixed assets for the years ended June 30, 2006, 2005 and 2004 was approximately \$2,296,000, \$1,205,000 and \$519,000 respectively. Amortization expense relating to capitalized computer software costs for the years ended June 30, 2006, 2005 and 2004 was approximately \$1,266,000, \$663,000 and \$295,000, respectively,

6. Acquisitions

On March 31, 2004, the Company acquired all of the issued and outstanding common stock of Total Gas & Electric, Inc. ("TG&E"). TG&E markets gas and electricity to commercial and residential customers in New York, New Jersey, Maryland and Florida. TG&E serves approximately 65,000 customers in 13 markets. The acquisition was

accounted for as a purchase business combination. The purchase price was \$7.0 million plus working capital at March 31, 2004 which was estimated to be \$5.5 million. As part of the agreement, the payment of \$1.0 million of the purchase price was deferred as of June 30, 2004 pending settlement of the following post-closing adjustments:

- Increase or decrease in working capital from the amount estimated,
- Increase or decrease in customers, and
- Decrease if the allowance for doubtful accounts for certain customers is greater than 1.65%.

At June 30, 2004, the purchase price was initially allocated based upon the estimated fair value of the net assets acquired at the date of acquisition. During 2005, the \$1.0 million deferred payment and the purchase price adjustments were finalized and settled for \$2,043,000 in cash. The finalization of the purchase price adjustments resulted in an increase in the total purchase price of \$1,043,000, which was allocated as a decrease to customer acquisition costs of \$2,147,000 and an increase in net working capital of \$3,190,000.

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

6. Acquisitions (continued)

The following table presents the initial and final allocation of purchase price (in thousands):

	Initial Allocation	Final Allocation
Hardware and software	\$ 704	\$ 704
Furniture and fixtures	25	25
Customer acquisition costs	6,271	4,124
Working capital:		
Cash	50	90
Accounts receivable	11,241	15,002
Inventory	2,838	3,350
Prepaid and other assets	965	1,436
Accounts payable and accrued liabilities	(9,594)	(11,188)
Net working capital	5,500	8,690
Total	\$ 12,500	\$ 13,543

The following unaudited pro forma financial information assumes the TG&E acquisition had occurred on July 1, 2003. The pro forma information is not necessarily indicative of the results that would have been obtained had the acquisition of TG&E occurred on such date nor is it necessarily indicative of future results (in thousands).

	2004
Sales of natural gas and electricity	\$ 247,500
Net income	28,200

On November 1, 2005, the Company acquired certain natural gas customer contracts of Castle Power LLC (“Castle”). Castle markets natural gas to small and mid-market commercial customers in New York and New Jersey. Castle served approximately 2,200 customers in five markets. The acquisition was accounted for as a purchase of intangible assets. The Company assumed the obligations to serve certain fixed-priced customers under contracts that extend to December 2006 that were at below-market prices as of the acquisition date, which liability was estimated to be \$3.6 million. Such amount is being adjusted through cost of natural gas and electricity sold as the Company makes deliveries under such contracts. As of June 30, 2006, the carrying value of the contract liability was approximately \$.4 million which is expected to be fully amortized by December 2006. The liability assumed by the Company represents the initial cost of the customer contracts acquired and was capitalized as customer acquisition costs and is being amortized over an estimated three-year life. In addition, a fee of \$0.07 per MMBtu will be paid to Castle over a four year term from the date of acquisition upon continued revenue generation and collection from the acquired customers (“Contingent Consideration”). The Contingent Consideration is payable on a quarterly basis in arrears and will be payable for volumes consumed and paid for on certain customer contracts acquired. The payment will be determined at the end of each quarter and capitalized as part of customer acquisition costs and amortized over the remaining customer life. As of June 30, 2006, Contingent Consideration payable to Castle was approximately \$130,000. No cash or other working capital assets were acquired as part of the acquisition. The results of operations associated with the customers acquired from Castle are included in the Company’s operating results from the date of acquisition.

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

6. Acquisitions (continued)

On May 12, 2006, the Company entered into an Asset Purchase Agreement (“APA”) with Shell Energy Services Company, L.L.C. (“SESCo”) pursuant to which the Company agreed to purchase substantially all of the assets of SESCO (the “Acquisition”). SESCO, a wholly owned subsidiary of Shell Oil Company, is a retail energy marketer that serves residential and small to mid-market commercial customers in Georgia and Ohio. The Acquisition will add approximately 290,000 accounts and Georgia to the list of states in which the Company operates. As of June 30, 2006, the Company had deposited \$3 million in escrow relating to the purchase and had capitalized approximately \$.3 million of costs directly related to the acquisition. On August 1, 2006, the Company consummated the Acquisition for aggregate consideration of approximately \$125.5 million with the proceeds of a bridge loan (see Note 14). The Acquisition will be accounted for as a purchase business combination and the results of operations of SESCO will be included in the Company’s operating results beginning on August 1, 2006. The Acquisition was initially financed by utilizing the proceeds from a \$190 million bridge loan which was repaid on August 4, 2006 from the proceeds received by the issuance of \$190 million senior unsecured floating rate notes (see Note 14).

At August 1, 2006, the preliminary purchase price was initially allocated based upon the estimated fair value of the net assets acquired at the date of acquisition. The final allocations will be based on independent valuations that have not yet been completed and will be subject to change when the valuations are completed during 2007. The following table presents the initial allocation of purchase price (in thousands):

	Initial Allocation
Accounts receivable	\$ 16,392
Inventory	33,501
Fixed assets	15,000
Customer acquisition costs	56,381
Customer contract assets	6,306
Customer contract liabilities	(2,050)
Total	\$ 125,530

The customer acquisition costs will be amortized over an estimated three year average life of a customer.

7. Derivatives and Hedging Activities

The Company’s risk management policy is to hedge 100% of the anticipated purchases required to meet expected customer demand (up to 110% in the winter months) for all accounts served on a fixed price contract. The Company utilizes NYMEX and basis price swap agreements to hedge the risk of variability in the cost of natural gas. The risk management policy employed is intended to insulate the Company from changes in the price of natural gas. The Company does not engage in speculative trading activities.

The Company has determined that certain fixed price customer contracts meet the definition of a derivative in accordance with SFAS No. 133. These contracts extend to June 2008 and have an unrealized gain of \$1 million.

The Company had 36,166,000 MMBtu NYMEX and 22,614,000 MMBtu basis swaps open as of June 30, 2006 and 33,360,000 MMBtu NYMEX and 23,771,000 MMBtu basis swaps open as of June 30, 2005. The total amount of unrealized (losses) gains from risk management activities was \$(0.8) million and

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

7. Derivatives and Hedging Activities (continued)

\$77.7 million at June 30, 2006 and 2005, respectively. Outstanding contracts as of June 30, 2006 extend to June 2009.

As of June 30, 2006 and 2005 the Company has forward physical contracts to purchase a total of 12,800,000 MMBtu and 8,301,000 MMBtu of natural gas for the months of July 2006 through May 2009 and July 2005 through April 2008, respectively. These contracts have a fixed basis component and a variable component determined based on market at purchase date. The amount of the fixed basis component was \$8.5 million and \$1.7 million at June 30, 2006 and 2005, respectively. All such contracts are considered normal purchases under SFAS No. 133.

8. Commitments

Operating Leases

The Company leases office space under non-cancelable operating leases, which contain escalation clauses and expire between June 2007 and March 2010 subject to extension at the option of the Company. Rental expense related to the above leased spaces was \$529,000, \$391,000 and \$169,000 for the years ended June 30, 2006, 2005 and 2004, respectively. Future annual minimum lease payments under these operating leases are as follows (in thousands):

Fiscal year:	
2007	\$ 731,000
2008	591,000
2009	607,000
2010	387,000
Total	<u>\$ 2,316,000</u>

Energy Trading & Risk Management System (“ETRM”)

In June 2005, the Company entered into a license agreement to install an energy trading and risk management system. The software license cost was approximately \$790,000 (which is included in the capitalized cost at June 30, 2006 (see Note 5)) with an additional \$160,000 in annual maintenance fees. The ETRM installation is expected to be fully operational by the end of 2007.

Capacity Charges

The Company enters into agreements to transport natural gas. Since the demand for natural gas in the winter is high, the Company agrees to pay for certain capacity for the transportation systems utilized generally for a twelve-month period. These agreements are take-or-pay in that if the Company does not use the capacity, it still must pay for capacity committed. The amount of the firm capacity committed to at June 30, 2006 was \$7.3 million. These agreements will expire in fiscal 2007.

In fiscal years 2006 and 2005, the Company incurred \$1.1 million and \$1.5 million in charges under take-or-pay agreements, which represented the capacity committed to as of June 30, 2005 and 2004, respectively.

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

9. Income Taxes

The Company files a consolidated U.S. Federal income tax return that includes all its domestic subsidiaries. Operations in Canada are not material.

Income tax (benefit) expense consists of the following (in thousands):

	Year ended June 30		
	2006	2005	2004
Current:			
Federal	\$ 5,595	\$ 8,517	\$ 244
State	168	3,072	143
	<u>5,763</u>	<u>11,589</u>	<u>387</u>
Deferred:			
Federal	(25,683)	5,137	16,144
State	(7,081)	1,416	3,586
	<u>(32,764)</u>	<u>6,553</u>	<u>19,730</u>
Total income tax (benefit) expense	<u>\$ (27,001)</u>	<u>\$ 18,142</u>	<u>\$ 20,117</u>

During 2004, the Company fully utilized its remaining tax loss carryforwards of \$8.5 million. In 2005, the Company used the Alternative Minimum Tax credit that it had available of \$179,000.

Income tax expense in fiscal 2005 includes \$563,000 of current income tax expense and \$125,000 of deferred income tax expense resulting from a change in the state apportionment factors used in fiscal 2005 in connection with the filing of the Company's fiscal 2004 income tax returns. In addition, the deferred tax balances were adjusted due to a change in the effective tax rate. The federal tax rate in fiscal 2005 increased to 35% from 34% due to higher levels of taxable income. The income tax expense differs from the amount computed by applying the statutory federal income tax rate to income before income tax expense, principally due to state income taxes, net of federal tax benefit.

State income tax expense in fiscal 2006 was positively impacted due to fiscal 2005 income tax provision to return adjustments made during 2006.

The provision for income taxes varied from income taxes computed at the statutory U.S. federal income tax rate as a result of the following:

	2006	2005	2004
Federal statutory rate	35.0%	35.0%	34.0%
State statutory rate, net of federal benefit	5.7	5.7	5.8
Total	<u>40.7</u>	<u>40.7</u>	<u>39.8</u>
Impact of prior year adjustments on current and deferred income taxes	0.1	3.0	-
Impact of permanent differences	(.4)	0.3	0.2
Effective tax rate	<u>40.4%</u>	<u>44.0%</u>	<u>40.0%</u>

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

9. Income Taxes (continued)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company expects to fully recognize its deferred tax assets recorded at June 30, 2006. The significant components of the Company's deferred tax assets and liabilities are as follows (in thousands):

	June 30	
	2006	2005
Deferred tax assets:		
Allowance for doubtful accounts	\$ 1,283	\$ 773
Deprecation and amortization	1,400	585
Unrealized losses on risk management activities	1,623	-
Stock compensation expense	642	1,738
Other reserves	55	217
Total deferred tax assets	5,003	3,313
Deferred tax liabilities:		
Accrued bonuses	\$ 29	\$ -
Unrealized gains on risk management activities	533	31,636
Total deferred tax liabilities	562	31,636
Net deferred tax asset (liability)	\$ 4,441	\$ (28,323)

10. Redeemable Convertible Preferred Stock

The Company is authorized to issue 5,000,000 shares of Series A convertible preferred stock ("Preferred Stock"). On June 30, 2004, the Company entered into a Purchase Agreement with Charterhouse Group Inc. and Greenhill Capital Partners LLC (collectively, the "Investors") for Preferred Stock. Under the terms of the agreement, the Company issued 1,451,310 shares of Preferred Stock for consideration of \$29,730,000 (net of offering expenses of \$1,270,000 of which \$887,000 was paid to the Investors). The shares were issued at a purchase price of \$21.36 per share. On June 30, 2004, the Company received consideration in the form of a promissory note from the Investors in the amount of \$30,113,000. The promissory note was paid in July 2004. The Company has reserved 1,451,310 common shares issuable upon conversion of the preferred stock.

Holders of the Preferred Stock are entitled to participate in any dividend paid on the Company's common stock on an "as converted" basis. In addition, dividends on the Preferred Stock accrue at a rate of 12% per annum of the purchase price per share if the increase in fair value of the Company's common stock does not provide the holders of the Preferred Stock an internal rate of return of at least 12%. Accrued dividends, if any, are payable in additional shares of Preferred Stock.

The Company has not accrued any dividends on the Preferred Stock for fiscal 2006 and 2005. Had the holders of the Preferred Stock converted the shares to common stock at June 30, 2006, the conversion would have been done on a one-for-one basis as the estimated fair value of the common stock results in an aggregate return greater than the 12% per annum dividend rate. The liquidation preference and conversion features of the Preferred Stock are defined below.

Holders of the Preferred Stock will be entitled to vote on all matters to be voted on by the Company's stockholders and shall vote on an as-converted basis as a single class with the Company's common stockholders.

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

10. Redeemable Convertible Preferred Stock (continued)

In the event of liquidation, each holder of Preferred Stock shall be entitled to receive an amount per share of Preferred Stock equal to the greater of:

1. the Convertible Preferred Liquidation Preference defined as the sum of:
 - a. the purchase price per share (as adjusted for any splits, stock dividends, combinations, recapitalization, or other similar event), and
 - b. all dividends accrued or declared and unpaid as of such date on the Preferred Stock, or
2. the amount per share of Preferred Stock (or its common stock equivalent) such holder would have received if it had converted its share of Preferred Stock into shares of the Company's Common Stock immediately prior to a liquidation.

As of June 30, 2006 and 2005, the preferred stockholders do not have a liquidation preference as the estimated fair value of the common stock would provide the holders with a return of greater than 12%.

Each holder of shares of Preferred Stock shall have the right at any time at the option of the holder ("Optional Conversion") to convert the holder's shares of Preferred Stock into the number of fully paid and non-assessable shares of the Company's common stock equal to the product of:

1. the number of shares of Preferred Stock being so converted and
2. the ratio of:
 - a. Purchase Price Per Share to
 - b. the Conversion Price (defined below) then in effect.
3. Notwithstanding the foregoing, if the fair market value of the Company's common stock as of the conversion date is at a level that would provide an internal rate of return ("IRR") of less than 12% to the majority of the purchasers of the Preferred Stock on their respective investments then the ratio set forth in clause (2) above shall be the ratio of:
 - a. the Convertible Preferred Liquidation Preference for such share to
 - b. the Conversion Price (defined below) then in effect.

The "Conversion Price" shall be set initially at an amount equal to \$21.36 per Preferred Share and shall be subject to certain anti-dilution provisions.

In the event of:

1. an underwritten public offering of shares of the Company at a total offering of not less than \$75 million and at a price per share (adjusted to reflect stock dividends, splits and similar events) not less than 1.5 times the Conversion Price through the first anniversary of the original issue date or 2.0 times the Conversion Price thereafter (a "Qualified Public Offering") or
2. the request of the holders of a majority of the then outstanding shares of the Convertible Preferred Stock voting as a separate class, all of the Preferred Stock will be automatically converted into the Company's common stock on the same basis as provided above under an Optional Conversion.

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

10. Redeemable Convertible Preferred Stock (continued)

At any time on or after the fifth anniversary of the issuance of the Preferred Stock, the Company may redeem all but not less than all of the outstanding shares of Preferred Stock in cash at a price per share equal to the Convertible Preferred Liquidation Preference, if the fair market value of the Company's common stock as of the date notice of redemption is at a level that would provide an IRR of not less than 40% to the majority of the purchasers of the Preferred Stock on their respective investments.

The holders of the Preferred Stock will have the right to "put" the Preferred Stock to the Company after the fifth anniversary of the issuance of the Preferred Stock, if the fair market value of the Company's common stock is at a level that would not provide such holders an annualized Internal Rate of Return of at least 25%.

The Company has reflected the redeemable convertible preferred stock outside of the equity section under the provisions of SEC Accounting Series Release 268 (Reg S-X 5-02.28) which require that redeemable equity securities be presented separately from stockholders' equity if they are redeemable at the option of the holder, or at a fixed date at a fixed price, or redemption is otherwise beyond the control of the issuer. This presentation is required even if the likelihood of the redemption event occurring is considered remote. As the Preferred Stock is redeemable at the option of the holder if the IRR over the five year period from the date of issuance is less than 25%, such amount has been reported separately from stockholders' equity at its fair market value at the date of issuance (\$29 million net of issuance costs). As the Preferred Stock is only contingently redeemable and it is not probable that the security will become redeemable, subsequent adjustment of its carrying value is not necessary until it is probable that the security will become redeemable in accordance with EITF Topic No. "D-98 Redeemable Securities Classification and Measurement."

11. Common Stock

Shares Reserved for Redeemable Convertible Preferred Stock

In connection with the Preferred Stock issuance, the Company has reserved 1,451,310 common shares issuable upon conversion of the Preferred Stock (see Note 10).

Options and Warrants

As described in Note 4, the Company has the following outstanding options and warrants (collectively, "Awards") issued in connection with existing credit facilities and other transactions with related parties:

- 1,183,808 immediately vested warrants held by Sowood to purchase common stock of the Company with a weighted average exercise price of \$10.13 per share in connection with the \$12 million line of credit.
- 75,000 immediately vested warrants held by Sowood with an exercise price of \$15 per share in connection with the \$9 million term loan facility.
- 15,000 options with an exercise price of \$21.50 per share, vesting ratably over a period of three years, with a term of ten years granted in 2005 to two non-employee directors in connection with the issuance of preferred stock.

In addition to the warrants issued to Sowood in connection with the credit facilities referred to above, Sowood holds 285,928 warrants that were previously issued by the Company to Lathi.

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

11. Common Stock (continued)

The Company reserved 366,500 shares of Common Stock as a pool for distribution to employees pursuant to the Company's 2001 Incentive Stock Option ("ISO") program. The 2001 ISO was established in February 2001 and approved by the Company's stockholders. The 2001 ISO allows for awards of stock or stock options by the Board of Directors up to the allocated number of shares in the pool. As of June 30, 2006 no shares were available under the 2001 ISO for future award.

The Company reserved 400,000 shares of Common Stock as a pool for distribution to employees and non-employees pursuant to the Company's 2003 ISO. The 2003 ISO was established in November 2003 and approved by the Company's stockholders. The 2003 ISO allows for awards of stock or stock options by the Board of Directors up to the allocated number of shares in the pool. As of June 30, 2006 6,580 shares were available under the 2003 ISO for future award.

In November 2005, the board of directors and stockholders adopted the 2006 Equity Incentive Compensation Plan (the "2006 Plan"). The 2006 Plan allows the Company to grant options, restricted stock, phantom shares, dividend equivalent rights, performance awards or stock appreciation rights, to employees, members of the board of directors, officers, consultants and other service providers. The purpose of the 2006 Plan is to attract and retain qualified employees, consultants and other service providers by providing them with additional incentives and opportunities to participate in the Company's ownership, and to create interest in the success and increased value of the Company. The 2006 Plan is administered by the compensation committee of the board of directors. The committee has the authority to determine and to establish guidelines and to delegate to management the determination of the persons to whom awards are to be granted, the time at which awards will be granted, the number of shares to be represented by each award, and the consideration to be received, if any. The committee also has the power to interpret the 2006 Plan and to create or amend its rules. A maximum of 750,000 shares of common stock may be issued pursuant to awards under the 2006 Plan. No awards have been issued to date under the 2006 Plan. The adoption of the 2006 Plan has no impact on 2001 and 2003 stock option plans.

During fiscal 2004, the Company granted 93,100 options to employees under the ISO plan. The options vest ratably over a three-year period and have a weighted average exercise price per share of \$8.00 and a weighted average fair value of \$3.75 per share at the date of grant. In addition, the Company granted 5,000 immediately vested warrants and 24,000 warrants which vest ratably over a three-year period to certain employees, which have a weighted average strike price per share of \$12.586 and a fair value of \$2.30 per share at the date of grant.

Pursuant to employment contracts entered into in fiscal 2005, the Company granted 7,500 immediately vested warrants and 22,500 warrants which vest ratably over a three-year period to employees, which have a weighted average exercise price per share of \$24.00 and a weighted average fair value of \$1.06 per share at the date of grant.

During fiscal 2005, the Company granted 357,720 options to employees under the Company's ISO plan. The options vest ratably over a three-year period and have a weighted average exercise price per share of \$24.09 and a weighted average fair value of \$6.15 per share at the date of grant.

Pursuant to employment contracts entered into in fiscal 2006, the Company granted 1,500 immediately vested warrants and 3,000 warrants which vest ratably over a three-year period to employees, which have a weighted average exercise price per share of \$32.50 and a weighted average fair value of \$11.72 per share at the date of grant.

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

11. Common Stock (continued)

Under the provisions of APB No. 25, the Company did not record any compensation expense relating to the options or warrants (except primarily for warrants with the cashless exercise provision as described in Note 2) granted to employees as the exercise price was greater than or equal to the estimated fair market value on the grant date.

Awards exercised for common stock totaled 132,967, 96,533 and 44,150 in 2006, 2005 and 2004, respectively, for aggregate proceeds of \$562,000, \$798,000 and \$95,000, respectively. The tax benefit derived by the Company of the exercise of warrants amounted to \$0, \$670,000 and \$0 in 2006, 2005 and 2004, respectively, and were recorded as a reduction of current tax liability and an increase to additional paid-in capital.

Awards forfeited and expired in fiscal year 2006, 2005 and 2004 totaled 30,133, 40,467 and 9,600, respectively.

The following is a summary of all Awards as of June 30:

	2006		2005		2004	
	Number of Awards	Weighted-Average Exercise Price	Number of Awards	Weighted-Average Exercise Price	Number of Awards	Weighted-Average Exercise Price
Outstanding at beginning of year	2,696,706	\$ 10.5352	2,430,986	\$ 8.1313	1,103,828	\$ 5.2134
Granted	4,500	32.50	402,720	23.9800	1,380,908	10.3083
Exercised	132,967	4.2291	96,533	8.2603	44,150	2.1576
Forfeited	30,133	25.4104	31,967	5.3932	9,600	13.4690
Expired	–		8,500	5.3524	–	–
Outstanding at end of year	2,538,106	10.7700	2,696,706	10.5352	2,430,986	8.1313
Weighted average fair value of grants during the year		\$ 11.72		\$ 5.7567		\$ 1.5800

Exercise Price	2006			2005		2004	
	Number of Awards Outstanding	Number of Awards Exercisable	Weighted Average Contractual Life Remaining	Number of Awards Outstanding	Number of Awards Exercisable	Number of Awards Outstanding	Number of Awards Exercisable
\$ 1.00	120,000	120,000	6 Years	126,500	126,500	136,500	91,000
2.16	132,450	132,450	1 Years	132,450	132,450	132,450	132,450
3.72–5.35	110,000	110,000	4 Years	220,000	215,000	281,600	253,267
6.99–9.12	1,229,663	1,199,196	3 Years	1,252,463	1,139,656	1,270,063	1,063,929
11.64–15.00	562,573	559,573	2 Years	562,573	556,573	610,373	601,373
21.50–25.00	239,020	89,507	8 Years	248,520	–	–	–
\$ 27.50	144,400	48,967	9 Years	154,200	–	–	–
	2,538,106	2,259,693		2,696,706	2,170,179	2,430,986	2,142,019

The weighted average remaining term for the awards outstanding and exercisable at June 30, 2006 was four and three years, respectively.

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

12. Employee Benefits

The Company sponsors an employee savings plan under Section 401(k) of the Internal Revenue Code for all full-time employees with at least three months of continuous service. Eligible employees may make pre-tax contributions up to 20% of their annual compensation not to exceed the annual 401(g) limitation for any plan year. The Company makes a matching contribution of up to 10% of each participating employee's compensation up to the maximum allowable under the plan. Employees are immediately 100% vested in all contributions. The Company made contributions totaling approximately \$553,000, \$352,000 and \$189,000 during the years ended June 30, 2006, 2005 and 2004, respectively. The increase was primarily due to increased staff levels.

13. Segment Information

The Company classifies its business interests into three reportable segments: residential and small commercial natural gas, mid-market commercial natural gas, and electricity. The Company has added the mid-market commercial natural gas segment with the acquisition of customers from Castle during the year (see Note 6).

Information as to the operations of the Company in each of its business segments is set forth below based on the nature of the products and services provided. The Company evaluates performance based on several factors, of which the primary financial measure is gross profit adjusted to exclude the effect of any unrealized gains or losses from risk management activities.

Sales (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Residential and small commercial natural gas	\$ 305,800	\$ 264,500	\$ 181,500
Mid market commercial natural gas	39,900	-	-
Electricity	16,900	12,700	4,200
Total	<u>\$ 362,600</u>	<u>\$ 277,200</u>	<u>\$ 185,700</u>

Cost of Goods Sold (excluding effect of unrealized gains or losses from risk management activities) (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Residential and small commercial natural gas (a)	\$ 259,800	\$ 206,900	\$ 152,900
Mid market commercial natural gas(a)	36,600	-	-
Electricity(a)	13,200	11,200	3,400
Total	<u>\$ 309,600</u>	<u>\$ 218,100</u>	<u>\$ 156,300</u>

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

13. Segment Information (continued)

Gross profit (excluding effect of unrealized gains or losses from risk management activities) (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Residential and small commercial natural gas	\$ 46,000	\$ 57,600	\$ 28,600
Mid market commercial natural gas (a)	3,300	—	—
Electricity	3,700	1,500	800
Total	<u>\$ 53,000</u>	<u>\$ 59,100</u>	<u>\$ 29,400</u>

(a) Cost of goods sold and gross profit include cost of natural gas sold and realized gains from risk management activities during the period.

Total segment gross profit is reconciled to (loss) income before income taxes for the fiscal years ended June 30, 2006, 2005 and 2004 as follows (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Total segment gross profit	\$ 53,000	\$ 59,100	\$ 29,400
Unrealized (losses) gains from risk management activities	(79,900)	16,000	46,300
Operating expenses	(36,700)	(31,000)	(22,300)
Interest expense—net	(3,200)	(2,900)	(3,100)
(Loss) income before income tax benefit (expense)	<u>\$ (66,800)</u>	<u>\$ 41,200</u>	<u>\$ 50,300</u>

Customer acquisition cost for the segments are outlined as follows (in thousands):

	Residential and small commercial natural gas	Mid market commercial natural gas	Electricity	Total
June 30, 2006				
Customer acquisition costs	\$ 25,200	\$ 3,700	\$ 1,100	\$ 30,000
Accumulated amortization	17,700	800	700	19,200
Net customer costs	<u>\$ 7,500</u>	<u>\$ 2,900</u>	<u>\$ 400</u>	<u>\$ 10,800</u>
June 30, 2005				
Customer acquisition costs	\$ 19,200	\$ —	\$ 900	\$ 20,100
Accumulated amortization	12,500	—	400	12,900
Net customer costs	<u>\$ 6,700</u>	<u>\$ —</u>	<u>\$ 500</u>	<u>\$ 7,200</u>

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

14. Subsequent Events

Bridge Loan

On May 12, 2006, in conjunction with the execution of the APA, the Company entered into a bridge loan commitment letter with an investment bank to provide up to \$200 million in senior unsecured notes to finance the Acquisition. On August 1, 2006 the Company utilized the bridge loan commitment for \$190 million to finance the Acquisition. Fees and interest associated with the bridge loan commitment and loan approximated \$.8 million. The Company, on August 4, 2006 repaid the \$190 million from the issuance of \$190 million senior unsecured floating notes and as a result the Company will write off the aforementioned costs as a charge to interest expense in 2007.

Senior Notes

On August 4, 2006, the Company issued \$190 million of senior unsecured floating notes (the "Senior Notes") at an original issue discount of 97.5%. The Senior Notes are due August 1, 2011 and bear interest at a rate equal to LIBOR plus 7.5% per annum. Interest is reset and payable semi-annually on February 1 and August 1 of each year. The Company may redeem up to 35% of the aggregate principal amount of the Senior Notes before August 1, 2009 at a price equal to 100% of the principal amount, plus a premium equal to the rate per annum on the notes outstanding on the date notice is give to redeem the notes and plus accrued and unpaid interest to the redemption date. If a change of control, as defined in the Senior Notes indenture, were to occur, the Company will be obligated to make an offer to purchase the Senior Notes, in whole or in part, at a price equal to 101% of the aggregate principal amount of the Senior Notes, plus accrued and unpaid interest, if any, to the date of purchase. If a change in control were to occur, the Company may not have the financial resources to repay all of its obligations under the Senior Notes.

Hedge Facility

On August 1, 2006, concurrently with the closing of the Acquisition, the Company entered into a committed exclusive hedge facility (the "Hedge Facility") with Société Générale.

The Hedge Facility has an initial term of two years with subsequent one year renewal terms. The Hedge Facility provides the Company with the ability to enter into NYMEX and basis swaps for a tenor of up to 39 months. Fees under the Hedge Facility include an annual management fee and a volumetric fee based on the tenor of the swap.

The Hedge Facility is secured by a first lien on customer contracts and a second lien on substantially all other assets of the Company. In addition, the Company provided a total of \$25 million as collateral (obtained from the proceeds of the Senior Notes) for potential negative mark-to-market changes in the value of the forward hedge position. Within the defined volumetric limits of the Hedge Facility, the Company will not be required to post additional collateral beyond the initial margin requirements.

Revolving Credit Facility

In connection with the Acquisition, on August 1, 2006, the Company amended and restated its existing credit facility (see Note 3). The amended and restated revolving credit facility provides up to \$300 million of borrowing availability (of which \$280 million has been committed to as to the date hereof and which may be increased to \$400 million under certain circumstances) and is secured by a second priority lien on customer contracts and a first

MxEnergy Holdings Inc.
Notes to Consolidated Financial Statements (continued)

14. Subsequent Events (continued)

priority lien on substantially all of the Company's and its subsidiaries' other existing and future assets. Borrowings under the Company's amended and restated revolving credit facility will generally bear interest at a fluctuating rate based upon a base rate or a Eurodollar rate plus an applicable margin. The applicable margin for base rate loans ranges from 0.5% to 1.375% and the applicable margin for Eurodollar loans ranges from 1.5% to 2.375%. All outstanding borrowings under the Company's amended and restated revolving credit facility will be due on December 19, 2008.

Sowood Credit Facility

In July 2006, the Company fully utilized its \$12 million revolving credit facility to secure letters of credit with pipelines and LDCs prior to closing the APA. On August 1, 2006, the Company repaid the Sowood credit facility with the proceeds of the Bridge Loan.

Interest Rate Swap

In August 2006, the Company entered into interest rate swaps to hedge the floating rate interest expense on the Senior Notes. The swaps are fixed-for-floating and settle against the six month LIBOR rate. The fixed rates under the swaps range from 5.68% to 5.72%. The total notional amount of the interest rate swaps is \$130 million with an average term of five years. The Company entered into \$80 million of notional interest swaps prior to June 30, 2006 in anticipation of the Senior Notes. The \$80 million of interest rate swaps outstanding at June 30, 2006 were replaced in August 2006 by the \$130 million of notional interest rate swaps. None of the interest rate swaps entered into prior or subsequent to June 30, 2006 have been designated as hedges under SFAS No. 133; accordingly, changes in the market value of the swaps have been and will be charged to earnings.

Restructuring

In August 2006, the Company approved and announced to employees a plan to move certain of its operations to Houston, Texas in connection with the acquisition of SESCo on August 1, 2006. The terms of the rationalization plan, which are specific to each employee affected, include various employee benefit cost components such as severance, retention bonuses and reimbursement of relocation costs. Certain of the employee benefit costs are contingent on future events, such as continued employment during defined transition periods. The Company estimates the maximum rationalization charges for the plan, all of which relate to employee severance and benefits, will amount to approximately \$1.6 million. The Company expects to record \$1.5 million and \$.1 million of rationalization charges during 2007 and 2008, respectively. The Company expects to pay \$.9 million and \$.7 million of such employee severance and benefits during 2007 and 2008, respectively.

Valuation and Qualifying Accounts
MxEnergy Holdings Inc.
For the years ended June 30, 2006, 2005 and 2004
(Dollars in thousands)

Description	Balance at beginning of period	Charged to costs and expenses	Deductions	Balance at end of period
For the year ended June 30, 2006:				
Allowance for doubtful accounts receivable	\$1,899	\$1,552	\$(166)	\$3,285
For the year ended June 30, 2005:				
Allowance for doubtful accounts receivable	\$1,401	\$3,168	\$(2,670)	\$1,899
For the year ended June 30, 2004:				
Allowance for doubtful accounts receivable	\$221	\$2,054	\$(874)	\$1,401

Computation of Ratio of Earnings to Fixed Charges
(Dollars in thousands)

The following tables sets forth MxEnergy Holdings Inc.'s computation of its ratio of earnings to fixed charges for the periods indicated.

	Year Ended June 30,				
	2006	2005	2004	2003	2002
Earnings before fixed charges:					
Income (loss) before income taxes	\$(66,783)	\$41,230	\$50,293	\$22,460	\$5,504
Interest and other debt expense	4,261	3,472	3,219	2,270	1,416
Estimated interest portion of rental expense	176	130	56	41	22
Earnings (loss) before fixed charges	<u>\$(62,346)</u>	<u>\$44,832</u>	<u>\$53,568</u>	<u>\$24,771</u>	<u>\$6,942</u>
Fixed charges:					
Interest and other debt expense	\$4,261	\$3,472	\$3,219	\$2,270	\$1,416
Estimated interest portion of rental expense	176	130	56	41	22
Total fixed charges	<u>\$4,437</u>	<u>\$3,602</u>	<u>\$3,275</u>	<u>\$2,311</u>	<u>\$1,438</u>
Ratio of earnings to fixed charges	–	12.47x	16.36x	10.72x	4.83x

CONTROLS AND PROCEDURES

As of the end of the period covered by this Annual Report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our "disclosure controls and procedures." Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in the financial statements is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. In making this evaluation, we have considered certain material weaknesses (as described below) identified by us and Ernst & Young, LLP, or E&Y, our independent registered accounting firm, and communicated to the audit committee of our board of directors. A material weakness is defined as a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective to ensure that information required to be disclosed by us in this Annual Report has been timely recorded, processed, summarized and reported within the time periods specified in the rules of the SEC.

In connection with the audit of MXenergy's financial statements for the year ended June 30, 2006, E&Y notified the audit committee of our board of directors that MXenergy has inadequate staffing levels in the accounting department which results in the lack of a proper segregation of duties at the Controller level and that the overall supervision and review of the daily accounting function and the accounting for transactions may not operate at a level which could detect errors of significance and that improved monitoring of transactions with the LDCs was appropriate. In addition, E&Y advised MXenergy's audit committee that the lack of formalization of MXenergy's policies and procedures pertaining to change management controls and logical security over its information technology systems results in an ineffective information technology general controls environment. Management further communicated to the audit committee that it had identified billing errors specific to one of MXenergy's customer relationship management systems. The billing errors affected customers within a variety of LDCs and principally related to under-billing customers during fiscal 2006. The billing errors arose due to improper controls surrounding the customer sales price renewal process.

In response to these identified control deficiencies, we have implemented certain disclosure control enhancements, policies and procedures, including:

- adding personnel to our accounting team, including a director of financial reporting, treasury manager, an accounts payable clerk, a tax manager, and an accounting systems manager, as well as the core group of well-qualified and experienced accounting personnel that joined us in connection with the SESCO acquisition;
- purchasing and implementing an accounting system designed to facilitate reconciliation and reporting of transactions;
- initiating a process whereby the Controller and/or the Chief Financial Officer sign-off on the review and approval of significant accounting entries;
- purchasing and implementing a risk management system designed to help better track our risks and to facilitate reconciliation and reporting of transactions and risks and, in the interim, centralizing the risk management reporting function to a risk manager and

initiating monthly meetings between supply and operations and the accounting team to ensure that all transactions are appropriately recorded;

- employing a risk oversight committee, chaired by a member of the board of directors, which has adopted policies and guidelines regarding the management of our supply portfolio and hedging instruments;
- implementing various controls throughout the customer sales price renewal process to timely identify and address pricing errors;
- initiating the process to add additional personnel to the office of the General Counsel; and
- implementing information technology policies and procedures, including increased regulation of network access, enhanced database management and added segregation of responsibilities.

Other than as described above, there have been no changes in our "internal controls over financial reporting" (as defined in Rule 3a-15(f) of the Exchange Act) during the period covered by this Annual Report that have materially affected, or that are reasonably likely to materially affect, our internal controls over financial reporting.

OTHER INFORMATION

On August 4, 2006 we entered into an employment agreement with Steve Murray pursuant to which Steven Murray will serve as our Chief Operating Officer. For a description of the material terms of the employment agreement, see "Directors and Executive Officers of the Registrant—Executive Employment Agreements."

DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Directors and Executive Officers

Our board of directors currently consists of seven members. All of our executive officers serve at the discretion of our board of directors, subject to their employment agreements described below under “—Employment Agreements.”

The following table sets forth the names and positions of the current directors and executive officers of the Company and their ages:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Jeffrey Mayer	54	President, Chief Executive Officer and Director
Steven Murray	46	Chief Operating Officer and Director
Carole R. (“Robi”) Artman-Hodge.....	55	Executive Vice President and Director
Chaitu Parikh.....	37	Vice President and Chief Financial Officer
Greg Taffet	52	Vice President and Chief Technology Officer
Emmett Capanna.....	68	Senior Vice President, Supply and Marketing
Tom Hartmann	51	General Counsel
Daniel Bergstein.....	63	Director
William Landuyt	51	Director
Stuart Porter.....	40	Director
John Stewart	64	Director

Set forth below is a brief description of the business experience of the directors and executive officers of the Company.

Jeffrey Mayer has served as President and Chief Executive Officer of MXenergy since 1999. From 1992 to 1999, Mr. Mayer worked for Sempra Trading Corporation, formerly AIG Trading Corporation, a subsidiary of AIG, where as a Managing Director he managed natural gas derivatives marketing and worked on the launch of a retail energy joint venture. Mr. Mayer also served as Chairman of AIG Clearing Corporation, the futures clearing arm of AIG Trading, as well as Chairman of AIG Securities Corporation, the securities affiliate of AIG Trading. Prior to joining AIG, Mr. Mayer worked at Goldman, Sachs & Co. where he managed the Energy Futures Department from 1989 to 1992, worked in the Futures Services Department from 1987 to 1989 and served as Chief Counsel of its J. Aron Commodities Division from 1984 to 1987. Mr. Mayer developed the Energy Traders Institute, a seminar on risk management sponsored by Infocast and heard by over 30 utilities and energy producers in North America. In 1988 Mr. Mayer was appointed by the Options Clearing Corporation to a Special Subcommittee of the Margin Committee investigating risk management procedures in response to the October 1987 stock market crash. Mr. Mayer received his J.D. from New York University in 1978 and his B.A. from Yale University in 1973. Mr. Mayer serves as Chairman of the Board of Finance of Westport, CT, an elected office in which he serves as chairman of the town’s municipal pension plans, reviews budgets and approves the tax rate.

Steven Murray has served as Chief Operating Officer of the Company since August 2006. Prior to joining MXenergy, Mr. Murray had a 25 year career with the Royal Dutch Shell group of companies, where he most recently served as Chief Executive Officer of SESCO from late 2001 to August 2006 and as the first President and Chief Executive Officer of Shell Trading US Co. from 1998 to late 2001. Mr. Murray previously served as Vice Chair of the National Energy Marketers Association as well as a member of the board of the Soapers and Detergents Association.

Carole R. (“Robi”) Artman-Hodge has served as Executive Vice President of MXenergy since 1999 and served as Chief Operating Officer from 1999 to August 2006. Prior to co-founding MXenergy, Ms. Artman-Hodge worked as senior managing director of the Project Finance unit of Bank of Ireland from 1997 to 1998, senior managing director of Risk Management and Origination for the Natural Resources unit of ING from 1989 to 1996, senior managing director of the Commodity Finance Treasury Marketing unit of Banque Paribas from 1981 to 1989, and Assistant Treasurer of the international banking unit of Harris Bank from 1977 to 1981.

Chaitu Parikh has served as Vice President and Chief Financial Officer of MXenergy since July 2004. Mr. Parikh previously served as the Vice President of Finance of MXenergy from December 2002 to July 2004. Prior to joining MXenergy, Mr. Parikh was Vice President and Controller of The New Power Company from October 2001 to December 2002 and the Chief Financial Officer of Alliance Energy Services from December 1996 to July 2001. Previously, Mr. Parikh worked in public accounting with KPMG from 1991 to 1996. Mr. Parikh holds a CA designation from the Canadian Institute of Chartered Accountants.

Greg Taffet has served as a Vice President of MXenergy since June 2000 and Chief Technology Officer of MXenergy since June 2004. Mr. Taffet previously served as an advisor to the Stamford school system on technology-related issues and assisted in the establishment of the Academy of Information Technology, a magnet high school for which Mr. Taffet currently serves on the advisory board. Mr. Taffet has been a director of Goodwill of Southwestern Connecticut since 1998.

Emmett Capanna has served as Senior Vice President, Supply of MXenergy since 2000. In 1994, Mr. Capanna co-founded US Energy Partners, a company that eventually became PSEG Energy Technologies, one of the first U.S. energy retailers and a wholly owned subsidiary of Public Service Electric & Gas, where he worked until 2000. Prior to joining US Energy Partners, Mr. Capanna was head of National Accounts Marketing for Amerada Hess from 1973 to 1982 and was Vice President of natural gas marketing for Energy Marketing Exchange, an affiliate of Elizabethtown Gas Company in New Jersey, from 1985 to 1991.

Tom Hartmann has served as General Counsel to MXenergy since January 2005. Prior to joining the Company, Mr. Hartmann served as the General Counsel of a national telecom and cable construction company from 2001 to 2004. Mr. Hartmann was an associate at Bryan Cave LLP from 1991 to 1995 and was employed at SBC Communications as General Counsel of SBC International, Inc., and SBC Telecom, Inc. from 1995 to 2001. Mr. Hartmann has been in the U.S. Air Force on active duty or as a reservist since 1977. He currently serves as a J.A.G. with the rank of Brigadier General in the U.S. Air Force Reserves.

Daniel Bergstein has served as a director of MXenergy since 2000 and is the chairman of the compensation committee. Since 1988, Mr. Bergstein has been a senior partner in the New York office of the international law firm Paul, Hastings, Janofsky & Walker LLP, where he is the Chairman of the firm’s global Telecommunications and Media practice. Mr. Bergstein is also a co-founder of Cequel III LLC; a director of Cequel Communications, LLC, the 8th largest U.S. cable company; he is also an advisory board member of Catalyst Investors I and II, L.P., two private equity investment funds specializing in telecom and media investments; a board member of SR. Teleperformance, S.A., a Paris stock exchange listed company; and a trustee and board member of The Foundation Fighting Blindness.

William Landuyt has served as a director of MXenergy since 2004 and is the chairman of the audit committee. Mr. Landuyt is a senior partner at Charterhouse Group, Inc., a position he has held since December 2003. From October 1996 until July 2003, Mr. Landuyt served as the Chief Executive Officer and Chairman of the Board of Millennium Chemicals, Inc. Mr. Landuyt was previously employed by

Hanson Industries where he served as President and Chief Executive Officer from June 1995 until October 1996, as Finance Director from 1992 until May 1995, as a Director from 1992 until October 1996 and as Vice President and Chief Financial Officer from 1988 to 1992. Mr. Landuyt serves as a member of the boards of directors, audit committees and compensation committees of each of Charter Lason, Inc., and Charter Towne, LLC, and certain subsidiaries of each of the foregoing.

Stuart Porter has served as a director of MXenergy since 2000 and is chairman of the risk oversight committee. Mr. Porter has been a Managing Partner of Sowood Capital Management LP since July 2004 and serves as Chief Investment Officer for Sowood's private investment activities. From 1996 to July 2004, Mr. Porter was employed as a Vice President and Portfolio Manager at Harvard Management Company, Inc. where he focused on relative value transactions in commodities and structured private transactions in the commodity sector. Mr. Porter received a Bachelor of Arts degree in Economics from the University of Michigan in 1987 and his Master of Business Administration degree from the University of Chicago Graduate School of Business in 1994.

John Stewart has served as a director of MXenergy since 2000. Mr. Stewart is an attorney in private practice since 1981. Mr. Stewart serves on the boards of directors of P&B Woodworking and Amity Art Foundation. In addition, Mr. Stewart serves as the chairman of the Library Commission of Woodbridge, Connecticut.

Committees

Audit Committee. Our board of directors has an audit committee, a compensation committee and a risk oversight committee. The audit committee is chaired by William Landuyt who also serves as the audit committee financial expert. The audit committee makes recommendations to the board of directors regarding the selection of independent accountants, reviews the results and scope of audit and other services provided by our independent accountants and reviews and evaluates our audit and control functions.

Compensation Committee. The compensation committee is chaired by Daniel Bergstein. The compensation committee administers our employee stock and other benefit plans and makes decisions concerning salaries and incentive compensation for our employees.

Risk Oversight Committee. The risk oversight committee is chaired by Stuart Porter. The risk oversight committee oversees the company's risk management policies.

Director Compensation

Our directors do not currently receive any cash compensation from us for their services as members of our board of directors. We reimburse our directors for travel and lodging expenses in connection with their attendance at board and committee meetings. We have, in the past, granted options to purchase shares of our common stock to non-employee directors.

Executive Employment Agreements

Chief Operating Officer

MxEnergy Inc. has entered into an employment agreement with Mr. Murray pursuant to which he will serve as Chief Operating Officer. The following is a summary of the material terms of such employment agreement.

Term. The initial term of Mr. Murray's employment agreement is three years commencing on August 4, 2006. The agreement is automatically renewed for successive one-year terms until terminated.

Compensation. The agreement provides that Mr. Murray will receive a base salary of \$450,000 and a signing bonus of \$150,000. Pursuant to the agreement, Mr. Murray will be granted an option to purchase 150,000 shares of our common stock. Mr. Murray may also earn a yearly performance bonus of up to 100% of his base salary if both he and MXenergy meet the objectives set by our board of directors. Mr. Murray may also earn an additional bonus of up to 20% of his base salary for any extraordinary performances by him connected with a significant business event, such as an initial public offering.

Severance. If Mr. Murray is terminated involuntarily and without business reasons, a constructive termination occurs, or in the event that Mr. Mayer ceases to be the Chief Executive Officer of MXenergy and Mr. Murray is not offered such position, he will receive (i) his base salary, paid time off, and any unearned and unpaid annual bonus accrued through his termination date, and any expense reimbursements or other benefits due to him; (ii) a lump sum equal to the greater of his base salary for a period of 12 months following his termination or his base salary for the remainder of his current employment term; (iii) a lump sum equal to 75% of his bonus for the fiscal year in which his termination occurs, 75% of his bonus for any full fiscal year remaining during his employment term, and a pro rata portion of 75% of his bonus being paid for the final fiscal year that begins during the employment term; (iv) and accelerated vesting of his stock options, with any unexercised options being cancelled in consideration of our payment to Mr. Murray of the excess of the fair market value of the option shares over the exercise price.

For purposes of this agreement, our change in control includes any person acquiring more than 50% or more of the combined voting power of our then outstanding securities, a change in the membership of a majority of the board during a two-year period, our merger or combination with or into a third party, or the sale of substantially all of our assets. For purposes of this employment agreement, a termination "without business reasons" means a termination for reasons other than (i) gross negligence, willful misconduct or other willful malfeasance, (ii) a felony conviction of nolo contendere, (iii) an act involving moral turpitude, fraud or misrepresentation with respect to Mr. Murray's duties to us, (iv) Mr. Murray's failure to follow directions of the board of directors or the Chief Executive Officer and subsequent failure to correct or (v) or Mr. Murray's material breach of his employment agreement. For purposes of this agreement, "constructive termination" means Mr. Murray's position has changed so that he is no longer serving as our Chief Operating Officer, Mr. Murray is required to relocated more than 50 miles from our Houston office, there is a reduction in Mr. Murray's base salary and bonus (other than a reduction consistent with general pay reductions), or we commit a material breach of his employment agreement.

Confidentiality. Both during and after the term of his employment, Mr. Murray is prohibited from disclosing confidential information of MXenergy to unauthorized persons without the written consent of MXenergy's board of directors, except in the course of performing his duties under the employment agreement.

Non-Competition. During the term of his employment agreement and for the remainder of the term of such agreement in effect at the date of termination of Mr. Murray's employment, Mr. Murray is prohibited from (i) directly or indirectly owning, managing, controlling, participating in, consulting with, rendering strategic, executive, managerial, sales, marketing, investment, financial, or other non-administrative services for, or in any manner engaging in any business competing with MXenergy, any of its subsidiaries or any business of MXenergy or its subsidiaries that are in process of development on the date of termination of Mr. Murray's employment, (ii) directly or indirectly inducing any employee of MXenergy or any subsidiary thereof to leave MXenergy or such subsidiary, (iii) hiring directly or through

another entity any person who was an employee of MXenergy or any subsidiary thereof at any time during the then preceding 12 months, (iv) directly or indirectly inducing any customer, supplier, licensee or other business relation of MXenergy or any subsidiary thereof to cease doing business with MXenergy or such subsidiary, or in any way interfere with the relationship between any such customer, supplier, licensee or business relation and MXenergy or any such subsidiary, or (v) disparage MXenergy, its executive officers, or its directors.

Other Executive Officers

MxEnergy Inc. has entered into employment agreements with Mr. Mayer, Ms. Artman-Hodge, Mr. Parikh, Mr. Capanna and Mr. Hartmann pursuant to which they will serve in the respective positions set forth across from their names in the management table above. The following is a summary of the material terms of such employment agreements.

Term. The initial terms of Ms. Artman-Hodge and Mr. Mayer's employment agreements are five years commencing on April 1, 1999. Both agreements are automatically renewed for successive five-year terms until terminated. Messrs. Capanna, Parikh, Taffet and Hartmann are employed at will and there are no set terms under their respective employment agreements.

Compensation. The executive officers will receive annual salaries ranging between \$215,000 and \$550,000 per year. Pursuant to their respective employment agreements, the executive officers can participate in benefits generally available to senior employees including year-end bonus and the Company's Incentive Stock Option Plan.

Severance. The severance payment amounts for termination without cause range from six months of base salary then in effect to 36 months of base salary then in effect. If an executive is terminated without cause, any of his unvested warrants or options will vest immediately on the next vesting date after such employee's termination.

Confidentiality. Both during and after the terms of their respective employments, Mr. Mayer, Mr. Capanna, Ms. Artman-Hodge, Mr. Parikh, Mr. Taffet and Mr. Hartmann are prohibited from, directly or indirectly, disclosing confidential information of MXenergy to unauthorized persons and from, directly or indirectly, using confidential information of MXenergy in connection with any other business activity.

Non-Competition. During the terms of their respective employment agreements and for a period ranging between three months and one year after the expiration or termination thereof, Mr. Mayer, Mr. Capanna, Ms. Artman-Hodge, Mr. Parikh, Mr. Taffet and Mr. Hartmann are prohibited from inducing other MXenergy employees to leave the Company.

Executive Compensation

Information relating to executive compensation will be provided by supplement to this Annual Report.

Code of Ethics

Although we have not yet adopted a code of ethics, we intend to prepare and adopt a Code of Business Conduct and Ethics, which will meet the definition of a "code of ethics" under Item 406 of the Regulation S-K promulgated under the Securities Act. Once adopted, the Code of Business Conduct and Ethics will apply to and be binding upon all of our employees (including the principal executive officer,

principal financial officer, principal accounting officer or controller, or persons performing similar functions).

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth, as of September 22, 2006, information with respect to shares of common stock beneficially owned by (i) each of the executive officers named in the table under “Directors and Executive Officers of the Registrant,” (ii) each director, (iii) all executive officers and directors as a group and (iv) each person who we know to be the beneficial owner of more than five percent of our outstanding shares of common stock.

The percentages of common stock and Series A preferred stock beneficially owned are reported on the basis of regulations of the SEC governing the determination of beneficial ownership of securities. Under the rules of the SEC, a person is deemed to be a “beneficial owner” of a security if that person has or shares “voting power,” which includes that power to vote or to direct the voting of such security, or “investment power,” which includes the power to dispose of or to direct the disposition of such security. A person is also deemed to be a beneficial owner of any securities of which that person has a right to acquire beneficial ownership within 60 days. All persons listed have sole voting and investment power with respect to their shares (subject to community property laws where applicable) unless otherwise indicated.

	<u>Common Stock(1)</u>	
	<u>Number</u>	<u>Percentage of Class</u>
Executive Officers and Directors		
Jeffrey Mayer(2).....	709,492	17.3%
Steven Murray(3)	–	–
Carole R. (“Robi”) Artman-Hodge(4)	418,075	11.0%
Chaitu Parikh(5)	79,300	2.3%
Greg Taffet(6).....	89,082	2.6%
Emmett Capanna(7).....	109,149	3.1%
Tom Hartmann(8).....	10,000	0.3%
Daniel Bergstein(9)	340,613	9.1%
John Stewart(10).....	64,641	1.9%
William Landuyt(11).....	1,274,931	27.3%
Stuart Porter(12)	2,841,724	45.6%
All directors and executive officers as a group (11 persons)	5,937,007	63.7%
5% Stockholders		
Sowood Commodity Partners Fund LP(12)		
500 Boylston Street, 17th Floor Boston, MA 02116	2,841,724	45.6%
Charter Mx LLC(11)		
1105 Market Street, Suite 1300 Wilmington, DE 19899.....	1,274,931	27.3%
Greenhill Capital Partners, L.P. and its affiliated funds(13)		
300 Park Avenue, 23rd Floor New York, NY 10022	245,179	6.7%
Pequot Enterprises LLC(14)		
26 Pequot Trail, Westport, CT 06880	594,000	14.9%
JED Communications Associates, Inc.(15)		
c/o Paul, Hastings, Janofsky & Walker LLP, 75 E. 55th Street, New York, NY 10022	320,313	8.6%
Carole R. Artman Hodge 2005 7 Yr. GRAT(16)		
c/o Carole R. Artman Hodge 61 Rye Road, Rye, NY 10580.....	312,216	8.4%

- (1) The percentage of beneficial ownership is based on 3,388,814 shares of our common stock outstanding as of September 22, 2006.
- (2) Includes (i) 91,233 shares of our common stock issuable upon the exercise of stock options that are either currently exercisable or become exercisable during the next 60 days and (ii) 594,000 shares of common stock held by

Pequot Enterprises LLC, a limited liability company owned 23% by Mr. Mayer and for which Mr. Mayer, as manager, has both voting and disposition power. Does not include 35,517 shares of our common stock issuable upon the exercise of options that are currently not exercisable and will not become exercisable within the next 60 days.

- (3) Does not include 150,000 shares of our common stock issuable upon the exercise of options that are currently not exercisable and will not become exercisable within the next 60 days.
- (4) Includes (i) 91,233 shares of our common stock issuable upon the exercise of stock options that are either currently exercisable or become exercisable during the next 60 days and (ii) 312,216 shares of our common stock owned by the Carole R. Artman-Hodge 2005 7 Yr. GRAT for which Ms. Artman-Hodge has both voting and disposition power. Does not include 35,517 shares of our common stock issuable upon the exercise of options that are currently not exercisable and will not become exercisable within the next 60 days.
- (5) Includes (i) 49,300 shares of our common stock issuable upon the exercise of stock options that are either currently exercisable or become exercisable during the next 60 days and (ii) 20,000 shares of our common stock issuable upon the exercise of warrants that are either currently exercisable or become exercisable during the next 60 days. Does not include 29,900 shares of our common stock issuable upon the exercise of options that are currently not exercisable and will not become exercisable within the next 60 days.
- (6) Includes (i) 66,100 shares of our common stock issuable upon the exercise of stock options that are either currently exercisable or become exercisable during the next 60 days and (ii) 5,000 shares of our common stock issuable upon the exercise of warrants that are either currently exercisable or become exercisable during the next 60 days. Does not include 12,500 shares of our common stock issuable upon the exercise of options that are currently not exercisable and will not become exercisable within the next 60 days.
- (7) Includes (i) 58,000 shares of our common stock issuable upon the exercise of stock options that are either currently exercisable or become exercisable during the next 60 days and (ii) 30,000 shares of our common stock issuable upon the exercise of warrants that are either currently exercisable or become exercisable during the next 60 days. Does not include 9,800 shares of our common stock issuable upon the exercise of options that are currently not exercisable and will not become exercisable within the next 60 days.
- (8) Includes (i) 5,000 shares of our common stock issuable upon the exercise of stock options that are either currently exercisable or become exercisable during the next 60 days and (ii) 5,000 shares of our common stock issuable upon the exercise of warrants that are either currently exercisable or become exercisable during the next 60 days. Does not include (i) 10,000 shares of our common stock issuable upon the exercise of options that are currently not exercisable and will not become exercisable within the next 60 days and (ii) 5,000 shares of our common stock issuable upon the exercise of warrants that are not exercisable and will not become exercisable within the next 60 days.
- (9) Includes (i) 17,800 shares of our common stock issuable upon the exercise of stock options that are either currently exercisable or become exercisable during the next 60 days and (ii) 320,313 shares of our common stock owned by JED Communications Associates, Inc., a corporation 100% owned by Mr. Bergstein and members of his immediate family. Does not include 4,000 shares of our common stock issuable upon the exercise of options that are currently not exercisable and will not become exercisable within the next 60 days.
- (10) Includes (i) 11,800 shares of our common stock issuable upon the exercise of stock options that are either currently exercisable or become exercisable during the next 60 days, (ii) 42,341 shares of our common stock held by the Stewart Family Trust, of which Mr. Stewart is the beneficiary, and for which Mr. Stewart may be deemed to have beneficial ownership, (iii) 2,500 shares of our common stock held in an IRA for Mr. Stewart for which he has both voting and disposition power, (iv) 3,000 shares of our common stock held by Mr. Stewart's spouse, for which Mr. Stewart may be deemed to have indirect beneficial ownership, and (v) 2,500 shares of our common stock held in an IRA account belonging to Mr. Stewart's spouse, for which Mr. Stewart may be deemed to have indirect beneficial ownership. Mr. Stewart disclaims beneficial ownership of the shares held by his spouse and by his spouse's IRA account except to the extent of his pecuniary interest therein. Does not include 1,000 shares of our common stock issuable upon the exercise of options that are currently not exercisable and will not become exercisable within the next 60 days.
- (11) Includes 1,217,228 shares of our common stock issuable upon the conversion of 1,217,228 shares of our Series A preferred stock. Charter Mx LLC is wholly owned by Charterhouse Equity Partners IV, L.P. The general partner of Charterhouse Equity Partners IV, L.P. is CHUSA Equity Investors IV, L.P., whose general partner is Charterhouse Equity IV, LLC, a wholly owned subsidiary of Charterhouse Group, Inc. As a result of the foregoing, all of the shares held by Charter Mx LLC would be deemed to be beneficially owned by Charterhouse Group, Inc. William Landuyt is an executive officer of Charterhouse Group, Inc. Mr. Landuyt disclaims beneficial ownership of the shares held by Charter Mx LLC.

- (12) Includes 1,544,736 shares of our common stock issuable upon the exercise of warrants that are either currently exercisable or become exercisable during the next 60 days. The shares of our common stock and the warrants are held by Sowood Commodity Partners Fund LP.
- (13) Includes (i) 6,847 shares of our common stock held by Greenhill Capital Partners, L.P., (ii) 979 shares of our common stock held by Greenhill Capital Partners (Cayman), L.P., (iii) 1,081 shares of our common stock held by Greenhill Capital Partners (Executives), L.P., (iv) 2,190 shares of our common stock held by Greenhill Capital, L.P., (v) 144,440 shares of our common stock issuable upon the conversion of 144,440 shares of our Series A preferred stock held by Greenhill Capital Partners, L.P., (vi) 20,639 shares of our common stock issuable upon the conversion of 20,639 shares of our Series A preferred stock held by Greenhill Capital Partners (Cayman), L.P., (vii) 22,797 shares of our common stock issuable upon the conversion of 22,797 shares of our Series A preferred stock held by Greenhill Capital Partners (Executives), L.P. and (viii) 46,206 shares of our common stock issuable upon the conversion of 46,206 shares of our Series A preferred stock held by Greenhill Capital, L.P. GCP Managing Partner, L.P., the managing general partner of Greenhill Capital Partners, L.P., Greenhill Capital Partners (Cayman), L.P., Greenhill Capital Partners (Executives), L.P. and Greenhill Capital, L.P. (the "Funds"), as well as Greenhill Capital Partners, LLC, which controls the managing general partner, and Greenhill & Co., Inc., the sole member of Greenhill Capital Partners, LLC, may be deemed to beneficially own the shares held by the Funds. We have been advised by the Funds that all decisions regarding investments by the Funds are made by an investment committee whose composition may change. No individual has authority to make any such decisions without the approval of the investment committee. The current members of the investment committee are Robert H. Niehaus, Scott L. Bok, Robert F. Greenhill, Simon A. Borrows and V. Frank Pottow, each of whom disclaims beneficial ownership in the shares held by the Funds except to the extent of his pecuniary interest therein.
- (14) Pequot Enterprises LLC is a limited liability company owned 23% by Jeffrey Mayer and for which Mr. Mayer, as manager, has both voting and disposition power.
- (15) JED Communications Associates, Inc. is a corporation owned 100% by Daniel Bergstein and members of his immediate family and for which Mr. Bergstein has both voting and disposition power.
- (16) The Carole R. Artman-Hodge 2005 7 Yr. GRAT is a grantor retained annuity trust of which Carole R. "Robi" Artman-Hodge is the beneficiary and the trustee and for which Ms. Artman-Hodge has both voting and disposition power.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Stockholders' Agreement

We have entered into a stockholders' agreement with holders of our common and preferred stock. The stockholders' agreement contains, among other things, the agreement among our stockholders to restrict their ability to transfer our stock as well as rights of first refusal, tag-along rights and drag-along rights. Pursuant to the stockholders' agreement, certain of our stockholders have, subject to certain exceptions, preemptive rights on future offerings of equity securities by us. In addition, if we issue or sell shares of our common stock below a certain price, we must offer to sell such common stock to certain of our existing stockholders at a similarly low price.

Pursuant to the stockholders' agreement, the consent of Jeffrey Mayer and the holders of 10% of more of our common stock on a fully diluted basis are required for various transactions including our liquidation, dissolution, merger, sale of all or substantially all of our assets as well as the issuance of our securities in connection with certain acquisitions and joint ventures. The consent of our board of directors (including the consent of the director appointed by the holders of our outstanding series A preferred stock) is required for certain actions including our incurrence of debt in excess of \$2.0 million.

Registration Rights Agreement

We entered into a registration rights agreement with certain of our stockholders, dated as of June 25, 2004. Pursuant to the terms of the registration rights agreement, Sowood and certain affiliates of Charterhouse and GCP will have the right from time to time, subject to certain conditions, to cause us to register shares of our common stock held by them under the Securities Act. In addition, if at any time we register shares of our common stock, certain holders of our common stock, including Sowood, certain affiliates of Charterhouse and Greenhill, Jeffrey Mayer, Carole R. ("Robi") Artman-Hodge and Daniel Burke, will be entitled to include their registrable securities in the registration statement relating to that offering. Jeffrey Mayer and Carole R. ("Robi") Artman-Hodge are directors of MXenergy. Under the registration rights agreement, except in limited circumstances, we are obligated to pay all expenses in connection with such registration.

Sowood Credit Facility

We entered into a loan agreement for a \$12.0 million subordinated line of credit with Sowood which expires on May 14, 2009. For a description of the material terms of the Sowood credit facility, see "Management's Discussion and Analysis of Financial Condition and Results of Operations." We believe that the terms of the Sowood credit facility are no less favorable to us than those provided to Sowood's other clients.

Legal Services

Daniel Bergstein, a director and significant stockholder of MXenergy, is a senior partner of Paul, Hastings, Janofsky & Walker LLP, a law firm which provides legal services to us. During the fiscal year ended June 30, 2006, we incurred \$1,419,000 of legal services provided by Paul, Hastings, Janofsky & Walker LLP, or Paul Hastings. We expect that Paul Hastings will continue to provide legal services to us in 2007. We believe that these legal services were provided on terms no less favorable to us than those provided to Paul Hastings' other clients.

Consulting Services and Option Grants

On June 30, 2004, Daniel Bergstein received \$250,000 in consulting fees and 12,000 options to purchase shares of our common stock and John Stewart received 3,000 options in connection with the issuance of preferred stock on that date. The options have an exercise price of \$21.50 per share, vest ratably over three years and have a term of ten years. The estimated aggregate fair value of the options was \$78,000. We do not expect to contract for consulting services with Daniel Bergstein in 2007.

Financial Advisory Services

GCP serves as a financial advisor to the Company under a retainer arrangement, executed January 20, 2005, under which we pay \$75,000 per quarter. We recorded \$303,000 and \$152,000 during the years ended June 30, 2006 and 2005, respectively, for financial advisory services provided by GCP. The retainer arrangement with GCP expired on September 20, 2006.

Promissory Note

On May 12, 2005, Daniel Bergstein exercised options to acquire 68,800 shares of our common stock with a non-interest bearing promissory note for \$680,000 secured by such stock. The promissory note was paid in full on June 25, 2005.

PRINCIPAL ACCOUNTANT FEES AND SERVICES

For the fiscal years ended June 30, 2006 and 2005, professional services were performed by Ernst & Young LLP. Audit and audit-related fees aggregated \$1,450,000 and \$424,002 for the fiscal years ended June 30, 2006 and 2005, respectively, and were composed of the following:

- **Audit Fees:** The aggregate fees billed for the audit of our annual financial statements for the fiscal years ended June 30, 2006 and 2005 were \$700,000 and \$389,000, respectively.
- **Audit-Related Fees:** The aggregate fees billed for audit-related services for the fiscal years ended June 30, 2006 and 2005 were \$750,000 and \$37,000, respectively. These fees relate to assurance and related services performed by Ernst & Young that are reasonably related to the performance of the audit or review of our financial statements.
- **Tax Fees:** The aggregate fees billed for tax services for the fiscal years ended June 30, 2006 and 2005 were \$76,000 and \$17,000, respectively. These fees relate to professional services performed by Ernst & Young with respect to tax compliance, tax advice and tax planning.