ENDURING STRENGTHS

Annual Report 2011

CAPSTONE
INFRASTRUCTURE

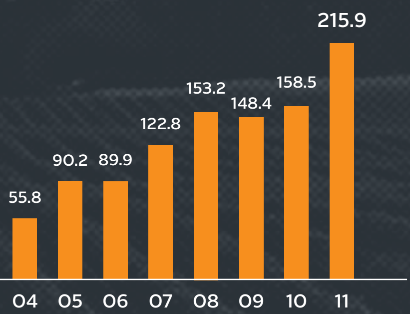
2011 HIGHLIGHTS

Infrastructure is the backbone of our economy and society, from the electricity that lights or heats our homes to the water we drink to the roads we travel. Capstone offers investors the unique opportunity to participate in this growing and attractive asset class.

HISTORICAL REVENUE (in millions of dollars)(2)

21.3%

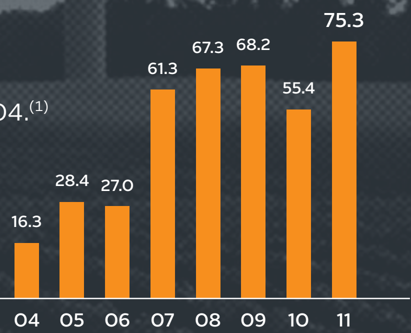
CAGR in revenue since 2004.



ADJUSTED EBITDA (in millions of dollars)(1)(2)

24.4%

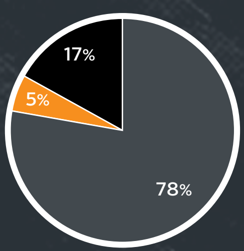
CAGR in Adjusted EBITDA since 2004.(1)



(1) Excludes internalization costs.
(2) Figures presented for 2004 to 2009 reflect Canadian Generally Accepted Accounting Principles ("GAAP").

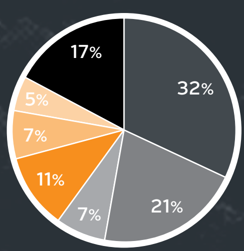
ADJUSTED EBITDA IN 2011 BY GEOGRAPHY(3)

- Canada
- Sweden
- United Kingdom



ADJUSTED EBITDA IN 2011 BY BUSINESS(3)

- Gas Cogeneration Power
- Wind Power
- Biomass Power
- Hydro Power
- Solar Power
- District Heating
- Water Utility



(3) Chart illustrates contribution for the businesses and excludes corporate component.

Capstone's mission is to build and responsibly manage a high quality portfolio of infrastructure businesses in Canada and internationally in order to deliver a superior total return to shareholders by providing reliable income and capital appreciation.

Today our portfolio includes power infrastructure and utilities businesses and is fortified by three enduring strengths that equip us to execute our mission:

- An active management approach that drives stable performance
- A disciplined approach to growing our portfolio with a focus on enhancing returns
- Capabilities and relationships that span the infrastructure sector

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MESSAGE TO SHAREHOLDERS

The quality and stability of our portfolio is a fundamental strength of our company and is central to our value proposition for investors.

MICHAEL BERNSTEIN
President and Chief Executive Officer

Dear Fellow Shareholders,

Fiscal 2011 was a busy year for Capstone. It was marked by significant accomplishments that establish a solid platform for the future and by some near- and longer-term challenges that we are working hard to address.

Executing Our Strategy

Over the past three years, we have worked to mitigate the most significant risk in our portfolio, which is the expiry of the Cardinal gas cogeneration facility's power purchase agreement (PPA) at the end of 2014. Apart from directly engaging with our contract counterparty and other related stakeholders to position Cardinal as best we can for a favourable outcome, we have focused on creating long-term value in the following ways:

- Maximizing the operating performance of our businesses, which means there is little variability in operating results from year to year and that we have a sound underlying base to support dividends for our shareholders.
- And diversifying our portfolio by infrastructure category, asset type and geographic location in order to match the steady cash flow of our contractually defined but largely limited life power generation facilities with the perpetual and growing cash flow typically generated by other types of core infrastructure businesses such as utilities.

On the first strategy, in 2011 we achieved improved operational and financial results in line with or slightly ahead of our expectations, after excluding costs related to the internalization of management in April. We recorded higher overall availability at our power businesses and growth in Adjusted EBITDA and AFFO, which underlines the steady cash flow profile of our portfolio.

On the second strategy, in March we concluded an investment in Värmevärden, a utility-like district heating business in Sweden with a strong competitive position and long-term, stable cash flows. In June, we concluded our first development project in Ontario with the start of commercial operations at the Amherstburg solar power facility, rounding out our renewable power mix. In October, we acquired a majority interest in Bristol Water, a regulated water utility in the United Kingdom that features perpetual cash flow and an organic growth profile.

We are particularly pleased with the contribution of our three newest businesses – all of which are proving our investment thesis – to our 2011 results. Moreover, these investments, particularly Bristol Water, increase Capstone's size, scope and value while broadening our reach internationally and into a new category of infrastructure. They are expected to significantly extend the stability of Capstone's cash flow and over time to contribute to increased cash available to pay dividends to shareholders. As a result, these acquisitions should elevate the long-term stability and investment quality of our company for investors.

Enduring Strengths

Active Management

We actively manage our businesses to maximize their long-term value by working closely with each asset to drive continuous improvement, direct capital management initiatives and establish strategic plans. The result is sustained operating performance.

Disciplined Approach

Capstone is disciplined in its approach to selecting growth opportunities to pursue. This approach is defined by the targeted 10% to 14% post-tax, levered return that we seek on our investments.

Exceptional Capabilities

Collectively, our team has decades of experience in financing and managing infrastructure businesses along with strong relationships across the sector in Canada and internationally, including power generation; distribution and transmission; renewable energy; toll roads and transportation; utilities; and public-private partnerships.

Beyond these strategic endeavours, we started 2011 by converting from an income fund to a corporation and adopting International Financial Reporting Standards. In April, we transitioned smoothly from an external management structure to being an independent company ready for the next phase of its evolution.

Our Challenges

Our achievements in 2011 were tempered by some challenges.

First, we are continuing to work towards securing a new PPA for Cardinal with the Ontario Power Authority (OPA) during 2012. We believe the argument for re-contracting Cardinal is compelling given its role in the stability of Ontario's electricity grid, its contribution to the local economy and community, and its relationship with its industrial steam host, Canada Starch Operating Company (Casco). While we are working for the best possible outcome, the timing and process of negotiations is directed by the OPA.

Second, in December we updated our financial outlook for Adjusted EBITDA and payout ratio in 2012 and our future dividend policy in response to challenges in our businesses and the external environment. These primarily included significantly increased rates to transport gas to Cardinal under our agreement with TransCanada Pipelines Limited (TCPL), increased volatility in the capital markets and higher than anticipated costs at some of our power facilities.

We expect the impact of these factors to be largely confined to 2012 and believe that there is the potential for relief on TCPL tolls later this year. However, in view of these factors and facing the prospect of reduced cash flow from Cardinal starting in 2015, we have made the decision to re-evaluate our dividend policy in the first half of 2012.

Our portfolio is increasingly diversified by asset category, fuel source and geographic location. See how Capstone has evolved at: *www.capstoneinfrastructure.com/About/AtaGlance.aspx*

"OUR INCREASINGLY DIVERSIFIED PORTFOLIO OFFERS THE POTENTIAL FOR SIGNIFICANT ORGANIC GROWTH."

Priorities for 2012

Our mission at Capstone is to build and responsibly manage a high quality portfolio of infrastructure businesses in Canada and internationally in order to deliver a superior total to shareholders by providing reliable income and capital appreciation. We intend to advance that mission in 2012 by focusing on the following strategic imperatives.

"IN 2012, A KEY STRATEGIC PRIORITY IS TO IMPROVE OUR FINANCIAL STRENGTH AND FLEXIBILITY."

We will continue to build our platforms for growth and diversification in a disciplined manner.

First, we will improve our financial strength and flexibility. On February 21, 2012, we completed the recapitalization of Värmevärden, thereby enabling us to repatriate approximately $46 million with the potential to repatriate up to an additional approximately $4 million. We used this capital to repay a portion of the $78 million outstanding on our senior credit facility. As a result, approximately $150 million of debt remains to be financed in 2012, including $119 million on the CPC-Cardinal facility and the balance of the senior credit facility, which are due in June and October, respectively. We are currently focused on establishing a new debt facility at our hydro power businesses by the end of the first quarter or early April. We are also continuing to explore additional financing and other initiatives that allow us to refinance these maturities and reposition Capstone for growth.

Second, we will work to secure a new PPA for Cardinal. Our goal is to obtain a fair outcome on Cardinal that recognizes the value of the facility and its industrial, economic, social and community importance. We anticipate that we will have better clarity on Cardinal's future profile in the first half of 2012 as negotiations with the OPA move forward. Given current Ontario power market and fiscal dynamics, cash flow from Cardinal will be lower post-2014. However, Cardinal is a high quality facility and we believe it will have a long life.

Third, we intend to establish a new dividend policy. With better clarity on Cardinal's future cash flow profile and the refinancing of 2012 debt maturities, we expect to establish and implement our new dividend policy in the first half of 2012. Our goal will be to strike a balance between near-term income for shareholders and long-term value creation, with a view to establishing a sustainable dividend that can grow over time.

Fourth, we will maximize performance by strengthening our existing businesses. We work side by side with the management teams at our businesses to determine how we can further enhance the efficiency and quality of our operations and generate additional cash flow. For example, a key focus in 2009 and 2010 was correcting a turbine vibration at our Whitecourt biomass facility. The result was an overall improvement in operations that has directly contributed to Whitecourt's exceptional production in 2011 – its highest ever. Whitecourt also recently signed a contract to sell renewable energy credits, a first in our company's history, which will enhance revenue over the next few years. We are currently exploring similar opportunities at our hydro power facilities. At Bristol Water, we are increasing the value of the business through a substantial capital investment program, wholly funded internally at the Bristol Water level, to maintain and expand its water treatment and delivery system. This capital program will lead to a growing rate base for Bristol Water and increased value for our shareholders.

Our overall approach to managing our businesses is intertwined with corporate responsibility and the principles of honesty, transparency and respect. Across our businesses, workplace safety is a priority for all employees and contractors. Environmental and social consciousness is also an integral element of our business strategy and fundamental to sustained financial performance.

Fifth, we will continue to build our platforms for growth and diversification in a disciplined manner. Once we successfully complete our refinancings and set a new dividend, we will seek to create value by building upon our existing platforms in power infrastructure

Building a Solid Platform

96.6%

Availability achieved by Whitecourt in 2011, reflecting the facility's successful maintenance program and high efficiency.

Demand for electricity in Canada is expected to increase by 15% over 2010 to 2030, potentially creating new investment opportunities for Capstone.

32.9%

Increase in Adjusted EBITDA, excluding internalization costs, reflecting the enduring quality and growth of our portfolio.

and utilities and exploring additional categories of infrastructure that meet our investment criteria and return requirements. We believe that the lower risk and inflation-adjusted cash flows of the type of infrastructure businesses we seek offer a compelling opportunity for our investors, particularly in these turbulent economic times.

Our team is composed of seasoned asset and investment management professionals with deep expertise across infrastructure categories, including power generation, distribution and transmission; utilities; transportation and roads; and public-private partnerships. This team represents an important competitive advantage for Capstone as we execute our growth strategy.

That strategy encompasses both operating infrastructure businesses and selective development projects in Canada and internationally in fellow member countries of the Organization for Economic Cooperation and Development (OECD), primarily focusing on the United States, Western Europe and Australia. Our strategy may also evolve to include the pursuit of opportunities through a strategic relationship with a like-minded partner. We expect to focus primarily on businesses that feature long-term cash flow growth and predictability to support steady and growing dividends to investors for years to come – even if that means a lower initial income in the early years of an investment.

With Thanks

While we faced some challenges during the year, Capstone's core strengths are enduring and position us to successfully deliver on the strategic objectives we have set for 2012. I am confident that our team is capable, dedicated and up to the task of transforming Capstone into Canada's pre-eminent diversified infrastructure company.

As an asset class, infrastructure businesses have historically exhibited low volatility relative to the broader equity market due to the consistent demand, high barriers to entry, inflation-linked cash flow, regulatory or contractual framework, and long life that infrastructure assets enjoy. We are seeking to harness these compelling characteristics to provide shareholders with an attractive total return.

I would like to thank our Board of Directors for their continuing guidance and counsel and our employees for their commitment to Capstone.

I would also like to thank our shareholders for their investment in Capstone and for providing their feedback, views and ideas to management throughout the year. We appreciate your insight and are working hard to reward your trust.

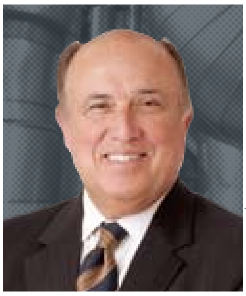
We look forward to updating you on our progress as we execute our strategy.

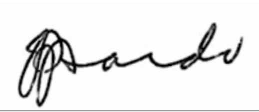
Sincerely,

MICHAEL BERNSTEIN
President and Chief Executive Officer

MESSAGE FROM THE CHAIRMAN

The Board of Directors' mandate includes oversight and guidance of management to establish Capstone's strategy and objectives, approving significant decisions that affect Capstone and its results, monitoring Capstone's financial performance, setting the dividend policy and overseeing Capstone's stakeholder relationships and reporting obligations.





V. JAMES SARDO
Chairman of the Board of Directors

Dear Fellow Shareholders,

Fiscal 2011 was a year of change for Capstone, starting with our conversion to a corporation from an income fund in January and the subsequent internalization of management in April and change in name from Macquarie Power and Infrastructure Corporation to Capstone. We similarly saw change in our portfolio, including the acquisition of two high quality businesses in new jurisdictions that now form the core of our evolving utilities platform as well as the growth of our renewables footprint in Canada.

While our portfolio continued to perform well and the fundamentals of our business remained unchanged, near-term challenges that emerged late in the year required us to adjust our outlook for 2012 and the company's dividend policy. Working with the management team, in the weeks ahead we intend to re-set our dividend to a long-term sustainable level that will allow for growth in the years ahead as our portfolio expands and prospers – as I am confident it will. Our objective is to find the optimal balance between delivering income to shareholders and retaining cash so that we have better flexibility to make investments that will strengthen and enhance our long-term value proposition.

One of Capstone's core values is to strive for excellence in all we do. This includes continuously improving our operations and management approach as well as to enhancing and strengthening our corporate governance policies and practices.

Following investor feedback at our last shareholders' meeting, we decided to offer shareholders the opportunity to vote on the election of directors individually rather than as a slate. This change takes place with our upcoming annual shareholders' meeting on June 5, 2012. Our revised corporate governance guidelines are available on our website at www.capstoneinfrastructure.com/About/Governance.aspx.

Finally, we have also taken steps to further align the interests of management and directors with those of shareholders.

Upon internalization, we established a new management compensation structure that balances the need for retention and fair compensation for Capstone's senior management team with the company's actual performance and the creation of shareholder value. As a result, the leadership team has a deeply personal interest in Capstone's success, with a significant portion of compensation being share-based. This structure reinforces the team's drive to perform and make prudent long-term decisions that are in the interests of shareholders.

“ALTHOUGH OUR SHARE PRICE PERFORMANCE IN 2011 WAS CLEARLY DISAPPOINTING, OUR PORTFOLIO IS SOUND OPERATIONALLY AND RUNNING AS IT SHOULD.”

For directors, in January 2011, Capstone introduced a new common share ownership policy under which all directors are required to own the equivalent of three years' annual cash retainer in the form of shares or deferred share units (DSUs) within five years of becoming a director. This policy encourages and rewards decisions that benefit the company over the long term.

The overarching theme of these initiatives is that we are committed to being responsive to and aligned with our shareholders. Our governance practices will continue to evolve in step with the business and regulatory environments in which we operate.

I would like to take this opportunity to thank our shareholders for their continuing support.

Although our share price performance in 2011 was clearly disappointing, our portfolio is sound operationally and our businesses are running as they should. We believe that our strategy of portfolio diversification across infrastructure categories is the right path for us to pursue and that our efforts to shift the mix and cash flow characteristics of the businesses we own will bear fruit for our shareholders in the years ahead in the form of steady dividends and capital appreciation.

I would also like to thank James Cowan for his contribution to Capstone. Under our internalization agreement with Macquarie Group Limited, James joined the Board of Directors last spring for a 12-month term and has decided not to stand for re-election at our upcoming annual general meeting of shareholders in June. We deeply appreciate his service and wish him well in his future endeavours.

When people ask why I believe in the future of our company, and why we will be successful in realizing our vision, the answer is not based on Capstone's strengths alone but also on the massive investment required in Canada and internationally to maintain, rejuvenate and build the critical, essential infrastructure upon which economic growth and quality of life depends: power, water, roads, transportation and more. We are dedicated to pursuing this opportunity and to serving shareholders' interests with integrity, discipline and transparency as we build Capstone into Canada's pre-eminent diversified infrastructure company.

Sincerely,

V. JAMES SARDO
Chairman of the Board of Directors

Shareholders can access information about management compensation and governance practices on our website. Please visit: *www.capstoneinfrastructure.com/About/Governance.aspx*

POWERING STABILITY

Our power businesses feature stable cash flow and a relatively low risk profile, providing a solid foundation from which to diversify our portfolio across infrastructure categories.

Our power generation businesses represent 370 megawatts of installed capacity and generate enough electricity every year to meet the needs of nearly 190,000 homes. Our power portfolio, which is operated by 60 dedicated and skilled employees, is diversified by asset type, geographic location and fuel source, including natural gas, wind, hydro, biomass and solar energy.

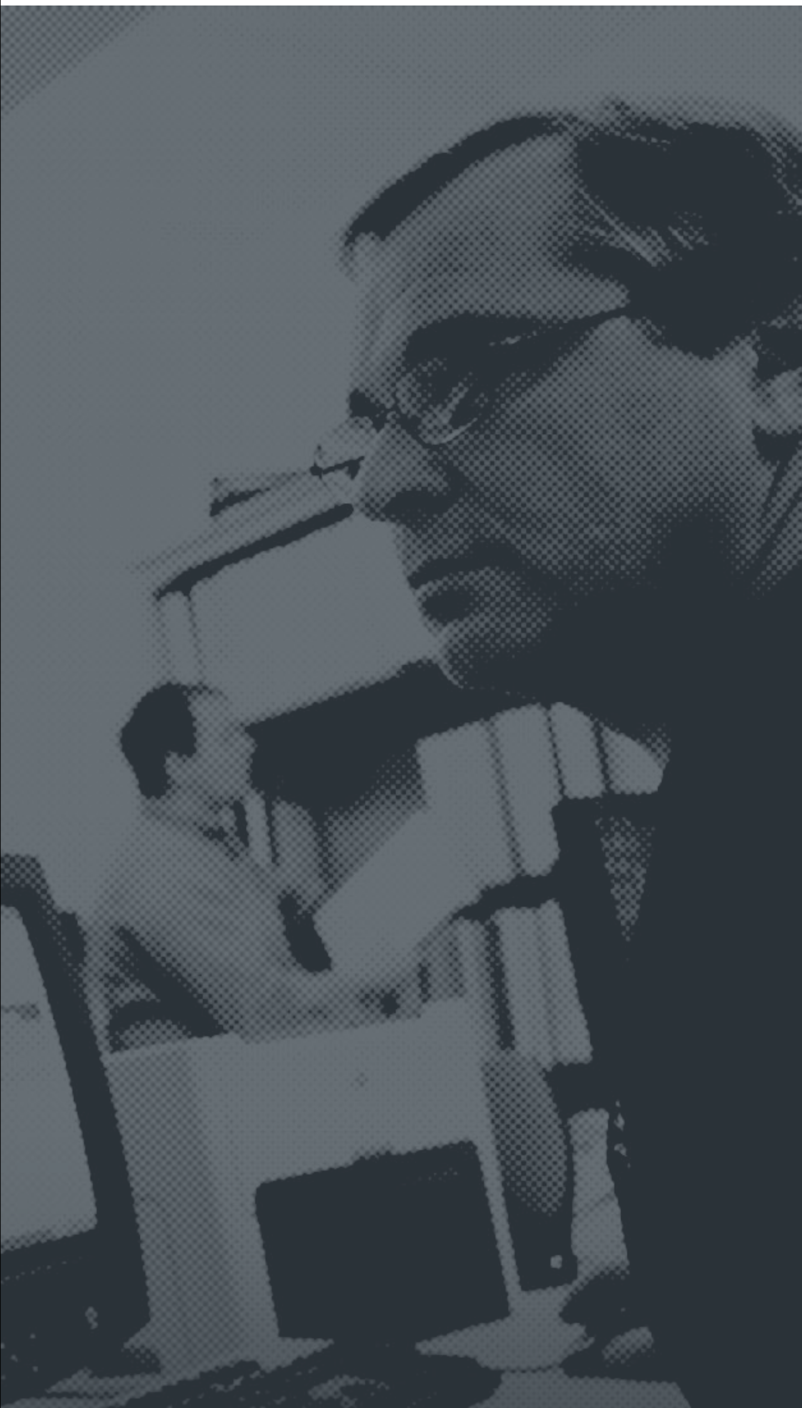
All of our power businesses enjoy demand certainty as a result of power purchase agreements with creditworthy counterparties, resulting in predictable revenue. The terms of our PPAs for Cardinal and Erie Shores and the Sechelt, Wawatay and Dryden hydro power facilities also contain provisions such that revenue and cost escalations are linked, typically resulting in incremental cash flow growth from year to year.

As physical assets, our power facilities have defined lives and are not generally subject to abrupt technological changes or rapid physical deterioration. With relatively few moving parts, our hydro and solar power facilities in particular offer the prospect of long lives beyond the end of their current PPAs.

Did you know that the Amherstburg Solar Park achieved commercial operations on time and on budget? Read about it at: *www.capstoneinfrastructure.com/OurBusiness/PowerInfrastructure/Solar/AmherstburgSolarPark.aspx*

Across our renewable portfolio, low operating costs support low variability of cash flow, subject to the availability of wind, water and sunlight. At the same time, these renewable energy sources eliminate volatility related to fuel prices. Cardinal purchases natural gas under a long-term contract, which provides for price certainty, while the wood waste used by Whitecourt in its operations is free of charge, although Whitecourt pays to transport the fuel to the site. We also plan in advance for major maintenance and capital expenditures, which ensures that our facilities operate smoothly and that the cash flow they generate is reliable.

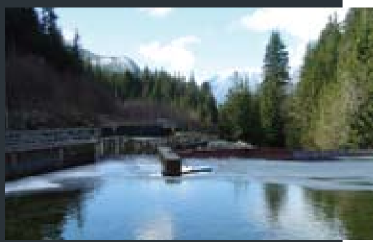
Collectively, these attributes are expected to power Capstone's continuing stability.



Key Proof Points

The Cardinal gas cogeneration facility is staffed by 18 skilled employees, 10 of whom have worked at the plant since the start of operations in 1994.

Wind power facilities are designed to last for 25 years or longer, providing steady cash flow, subject to wind conditions, along with green energy and other environmental benefits.



Unplanned outage rates for hydro power facilities are among the lowest in the electricity industry. In addition, with proper maintenance, hydro power facilities can have lives of up to 100 years.

The average availability of Capstone's power facilities in 2011 was 97.1%. Availability is an important measure of quality and reliability because it represents the percentage of time that a facility is able to produce power.

OUR POWER BUSINESSES ARE STABLE CASH FLOW GENERATORS

GROWING ORGANICALLY

Bristol Water has a history of achieving or outperforming its regulatory targets and is poised for rapid growth over the next 25 years.

Bristol Water is a regulated business with a secure competitive position in a stable OECD country. It has an attractive organic growth profile that complements the contractual nature of Capstone's power portfolio.

Bristol Water's revenues have historically increased in line with its regulatory allowance and feature a real as well as an inflation component, thereby offering a natural inflation hedge. The company has proven its ability to achieve or outperform regulatory targets, deliver strong financial performance and generate stable cash flow.

As the sole regulated water utility in one of the most economically vibrant regions of the United Kingdom, Bristol Water is poised for rapid growth over the next 25 years.

Bristol Water plans to execute a significant capital expenditure program in the years ahead, using its existing cash on hand and re-investing operating cash flows. This program is designed to maintain and improve Bristol Water's infrastructure and operations, to continue to meet water quality requirements and to support growth arising from an increasing population and expanded business activity in the region.

As a result, over the current regulatory period, which runs from 2010 to 2015, the company's real regulated rate base is anticipated to grow by approximately 26% compared with an industry average of approximately 8%. This considerable growth in just a five-year period is expected to create significant value for shareholders.

Bristol Water is a platform investment in the water infrastructure sector alongside a world-class partner in Sociedad General de Aguas de Barcelona (Agbar), a subsidiary of Suez Environnement. We believe that Capstone is well positioned to capitalize on the opportunities that are emerging globally in this space.

The regulatory framework for water utilities in the United Kingdom provides for recovery of operating costs and allowance for a fair return.

5th

Bristol Water's ranking out of 21 companies on the regulator's Service Incentive Mechanism, reflecting its attention to service and quality.

Did you know that Bristol Water is the sole water provider in the Bristol region, serving a population of 1.1 million people? Learn more at: *www.capstoneinfrastructure.com/OurBusiness/Utilities/WaterUtility/BristolWater.aspx*

BRISTOL WATER WILL BE A KEY CONTRIBUTOR TO CAPSTONE'S LONG-TERM CASH FLOW AND OF THE OVERALL VALUE OF OUR COMPANY

Bristol Water is one of 11 regulated water-only companies in England and Wales and is the sole water supplier in the Bristol region.

165 years

Number of years Bristol Water has been in operation, reflecting the essential nature and longevity of water utilities.

INFRASTRUCTURE OPPORTUNITY

Modern and efficient infrastructure is vital to the movement of goods, services and people, and to the quality and security of life that we enjoy. In fact, the condition of a country's infrastructure drives its economic productivity – or prevents it from reaching its full potential.

Global infrastructure requirements for transport, energy, water and communications to 2030 are estimated at more than US$30 trillion. This massive spending requirement is too great for governments to bear alone, particularly at a time of fiscal austerity and ballooning deficits. At the same time, governments are striving to reach sustainability objectives, including economic development and environmental restoration along with a multitude of other competing priorities such as health care, education and social programs. Innovative ways of approaching the financing, funding and delivery of infrastructure will be needed to meet these challenges.

The private sector has a vital role in improving and building the new, more sustainable critical infrastructure that is required to unleash renewed economic growth in Canada and internationally: better roads; greener power generation facilities; higher quality and modern water systems; and more efficient public transportation.

CANADA'S PUBLIC INFRASTRUCTURE HAS USED UP 79% OF ITS SERVICE LIFE

Quick Stats

$400B

Projected total infrastructure deficits from all governments in Canada by 2020.

A 2010 OECD study on the Toronto region identified transportation infrastructure as the leading drag on the city's global competitiveness.

$772B

The estimated average annual global investment needed by 2015 to repair, maintain, improve and build new water and wastewater infrastructure.

Did you know that in 2006 the Canadian wind industry, including Erie Shores, contributed $1.6 billion to Canada's GDP? According to the Canadian Wind Energy Association, the economic contribution of wind energy is continuing to grow. Learn more at: *www.capstoneinfrastructure.com/OurBusiness/PowerInfrastructure/Wind/ErieShoresWindFarm.aspx*

STRENGTHENING OUR COMMITMENT TO STAKEHOLDERS

Our infrastructure businesses have an impact on resources such as water, energy and other raw materials as well as on our employees, customers, investors and the communities we serve. We endeavour to manage that impact responsibly.

The physical nature of our infrastructure businesses and the essential profile of the services they provide mean that we must have close ties to the communities in which our businesses operate. We provide power to regional electricity grids; provide employment in our facilities and work for local contractors, businesses and other vendors; and support community initiatives. Our newest business, Bristol Water, serves a population of 1.1 million people and is actively engaged in promoting water resource management and conservation in the community, educating students in the region on the water cycle, and supporting biodiversity and environmental initiatives.

Cardinal provides the adjacent Benson Public School with free heat.

Social Sustainability

We seek to maintain strong relationships with each of our communities, including donating our time, skills, ideas and financial resources in 2011 to help with many local initiatives:

- Cardinal supported a range of community programs, including Christmas is for Kids, a holiday celebration for local children in need, and Cardinal in Bloom, an annual beautification program of flower baskets and gardens initiated by the facility for the town of Cardinal and tended by volunteers.
- Erie Shores provided financial support for the Tour de Norfolk, a recreational bicycle tour of Norfolk County that helps to promote local tourism while raising funds for bicycles and helmets for children in the county.
- Cardinal provided two bursaries for high-achieving secondary school students as well as the Science and Technology Award at Benson Public School. The facility also created internship opportunities and an invaluable learning experience for two students working towards 4th Class Power Engineering certification.

- Whitecourt created a summer employment opportunity for a local secondary school student planning to pursue post-secondary education in power engineering.

Our commitment to socially sustainable practices includes concern and respect for employees. All of our businesses have robust health and safety practices as well as training programs to protect employees and encourage ongoing professional development. Employees at our power businesses received an average of 103 hours of training in 2011 across a range of topics, including fall protection, low and high voltage electrical safety, violence in the workplace, first aid, site security awareness, environmental compliance, breaker operation, and equipment maintenance and operation. In 2011, there was no lost time due to injuries across the power facilities. Notably, the Cardinal facility achieved its 15th consecutive year without any lost-time injuries.

Environmental Sustainability

Our infrastructure businesses also have an impact on resources such as water, energy and other raw materials. We endeavour to manage that impact responsibly and to enhance the local environment wherever possible. In 2011, we:

- Generated enough renewable energy from our wind, hydro, biomass and solar power facilities, which provide a clean, safe low-carbon alterative to fossil fuels, to power the equivalent of approximately 62,000 households.
- Maintained a salmon spawning channel at the Sechelt hydro power facility by ensuring a constant supply of water and removal of debris.
- Sold renewable energy credits created at Whitecourt and certified under the federal government's EcoLogo program to a third party seeking to reduce its carbon footprint – simultaneously creating a new revenue stream at Whitecourt.

Our newest business, Bristol Water, outperformed the water industry average across a range of measures, including drinking water quality, leakage, supply interruptions, wildlife protection, waste management and pollution prevention.

Salmon spawning channel maintenance by staff at the Sechelt hydro power facility.

In 1997, Whitecourt became the first power generation facility in Canada to earn an EcoLogo designation.

Our Values

As we manage and grow our portfolio, it is a priority that we foster a positive culture that is respectful of our many stakeholders. We are guided by the following values:

Integrity

In all we do, we act honestly, ethically and fairly, abiding by both the spirit and letter of our commitments as well as our Code of Business Conduct. We are accountable for our decisions and seek to communicate with transparency.

Commitment

We are committed to managing Capstone in the best interests of our investors, which includes acting as a good corporate citizen in the communities where our businesses operate.

Fulfillment for our People

We foster a professional work environment where our people have the tools and resources to excel and be successful and where they are recognized for their service and contributions.

Teamwork

As a team, we work cooperatively and constructively to build Capstone's business and share a focus on achieving optimal performance.

Highest Standards

We strive for excellence, innovation and creativity in the management and growth of our businesses.

Strive for Profitability

We seek to manage and grow our businesses profitably so that we can deliver an attractive total return to our investors.

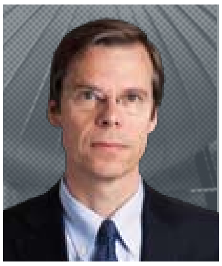
Our Business Code of Conduct outlines our commitment to respecting our stakeholders and to communicating with transparency. Read it online at: *www.capstoneinfrastructure.com/About/Governance.aspx*

BOARD OF DIRECTORS

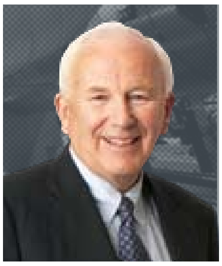
DEREK BROWN
is a director of SNP Split Corp. and Sixty Split Corp. He was previously a director of DALSA Corporation. From 1996 to 2005, Mr. Brown was a Professor of Finance (adjunct) at the University of Toronto, prior to which he was a Vice President and Director of RBC Dominion Securities Inc. From 1997 to 2003, Mr. Brown was a Commissioner of the Ontario Securities Commission. From 1998 to 2003, he served as a Governor of the Canadian Institute of Chartered Business Valuators. Mr. Brown is also a member of the finance committee of the Canadian Opera Foundation.

FRANÇOIS R. ROY
is a director or trustee (as applicable) and a member of the audit committees of Fibrek Inc., Transcontinental Inc., the Caisse de dépôt et placement du Québec and Noranda Operating Trust. He was the Vice-Principal (Administration and Finance) of McGill University from June 2007 to June 2010. Mr. Roy was the Chief Financial Officer of Telemedia Corporation between 2000 and 2003. He also serves on the boards of several not-for-profit organizations, including Canada's National Arts Centre Foundation and the Foundation of Greater Montreal.

V. JAMES SARDO
is a director of New Flyer Industries Inc. Previous directorships include Hydrogenics Corporation, Countryside Power Income Fund, UE Waterheater Income Fund, Custom Direct Income Fund, SonnenEnergy Corp., Northstar Healthcare Inc. and Consolidated Thompson Iron Mines Limited. From 2004 to 2005, Mr. Sardo served as interim Chief Executive Officer and a director of Royal Group Technologies Limited. He was formerly President of the Canadian Operations of Moore Corporation Limited, a business forms and communications company, from 1999 to 2001 and President and Chief Executive Officer of SMK Speedy International Inc., an international automotive repair company, from 1997 to 1999. Mr. Sardo was Chief Executive Officer of Amre Inc., a Dallas-based marketer of home improvement products, from 1994 to 1995, and Chief Executive Officer of SNE Inc., a manufacturer and marketer of windows and doors, from 1991 to 1994. Previously, he was Chairman and Chief Executive Officer of Firestone Canada Inc. Mr. Sardo is a member of the Institute of Corporate Directors and holds the ICD.D designation.



JAMES COWAN
is a managing director and president of the Canadian operations of Macquarie Infrastructure and Real Assets, a division of Macquarie Group Limited ("Macquarie"). Since joining Macquarie in 2000, Mr. Cowan has advised clients and Macquarie-managed funds on a number of Canadian, U.S. and U.K. transactions, including investments, financings and divestments in the transportation and utility sectors. Prior to joining Macquarie, Mr. Cowan worked for TD Securities and Hambros Bank in the areas of government and infrastructure finance.



PATRICK J. LAVELLE
is the Chairman and Chief Executive Officer of Patrick J. Lavelle and Associates, a strategic management consulting firm that he established in 1991. Mr. Lavelle is also the Chairman and a director or trustee, as applicable, of each of the Ontario Financing Authority, Catalyst Capital Group Inc. and Retrocom Mid-Market Real Estate Investment Trust. Mr. Lavelle has served as Chairman and Chief Executive Officer of Unique Broadband Systems Inc., Chairman of Specialty Foods Group Income Fund, Chairman Export Development Canada and Chairman of the Board of the Business Development Bank of Canada.

Legal Notice

This annual financial report is not an offer or invitation for subscription or purchase of or a recommendation of securities. It does not take into account the investment objectives, financial situation and particular needs of the investor. Before making an investment in Capstone Infrastructure Corporation (the “Corporation” or “Capstone”), the investor or prospective investor should consider whether such investment is appropriate to their particular needs, objectives and financial circumstances and consult an investment advisor if necessary.

Caution Regarding Forward-Looking Statements

Certain of the statements contained within this document are forward-looking and reflect management’s expectations regarding Capstone Infrastructure Corporation’s (the “Corporation”) future growth, results of operations, performance and business based on information currently available to the Corporation. Forward-looking statements and financial outlook are provided for the purpose of presenting information about management’s current expectations and plans relating to the future and readers are cautioned that such statements may not be appropriate for other purposes. These statements use forward-looking words, such as “anticipate”, “continue”, “could”, “expect”, “may”, “will”, “estimate”, “believe” or other similar words, and include, among other things, statements found in “Strategic Overview” and “Results of Operations”. These statements are subject to known and unknown risks and uncertainties that may cause actual results or events to differ materially from those expressed or implied by such statements and, accordingly, should not be read as guarantees of future performance or results.

The forward-looking statements and financial outlook within this document are based on information currently available and what the Corporation currently believes are reasonable assumptions, including the material assumptions for each of the Corporation’s assets set out in the management’s discussion and analysis of the results of operations and the financial condition of the Corporation (“MD&A”) for the year ended December 31, 2011 under the heading “Results of Operations” (such documents are available under the Corporation’s profile on www.sedar.com). Other material factors or assumptions that were applied in formulating the forward-looking statements and financial outlook contained herein include the following: that the business and economic conditions affecting the Corporation’s operations will continue substantially in their current state, including, with respect to: industry conditions, general levels of economic activity, regulations, weather, taxes and interest rates; a full year of contribution from the Corporation’s Amherstburg Solar Park, Swedish district heating business (“Värmevärden”) and the UK water distribution business (“Bristol Water”); a TransCanada Pipelines Limited (“TCPL”) gas transportation rate of $2.24 per gigajoule in 2012; the level of gas mitigation revenue earned by the Corporation’s Cardinal cogeneration facility (“Cardinal”); that there will be no unplanned material changes to the Corporation’s facilities, equipment or contractual arrangements, no unforeseen changes in the legislative and operating framework for the Corporation’s businesses, no delays in obtaining required approvals, no unforeseen changes in rate orders or rate structures for the Corporation’s power business, Värmevärden or Bristol Water, no unfavourable changes in environmental regulation and no significant event occurring outside the ordinary course of business; that there will be a stable regulatory environment and favourable decisions will be received from regulatory bodies concerning outstanding rate and other applications; that the Corporation’s senior credit facility, used to partially fund the Bristol Water acquisition, will be repaid on or prior to its maturity on October 3, 2012; refinancing of the credit facility in place at the Corporation’s Capstone Power Corporation and Cardinal Power of Canada, L.P. subsidiaries and the project financing of the Corporation’s hydro power facilities (that potentially include amortization profiles); the completion of the previously-announced follow-on Värmevärden bond offering; the implementation of the Government of Ontario’s amendments to the application of the Global Adjustment Mechanism which comprises a portion of the revenue escalator in the power purchase agreements for Cardinal and the Corporation’s hydro facilities located in Ontario; the accounting treatment for Bristol Water’s business under International Financial Reporting Standards, particularly with respect to accounting for maintenance capital expenditures; the amount of capital expenditures by Bristol Water; the Swedish krona to Canadian dollar exchange rate; the UK pounds sterling to Canadian dollar exchange rate; and that Bristol Water will operate and perform in a manner consistent with the regulatory assumptions underlying its current asset management plan (“AMP”), including, among others, real and inflationary increases in Bristol Water’s revenue, Bristol Water’s expenses increasing in line with inflation, and capital investment, leakage, customer service standards and asset serviceability targets.

Although the Corporation believes that it has a reasonable basis for the expectations reflected in these forward-looking statements and the financial outlook, actual results may differ from those suggested by the forward-looking statements and financial outlook for various reasons, including risks related to power infrastructure (operational performance; power purchase agreements (in particular, the risk associated with Cardinal's power purchase agreement expiring in the fourth quarter of 2014); fuel costs and supply (including increases in the gas transportation rate charged by TCPL); contract performance; development risk; technology risk; default under credit agreements; land tenure and related rights; regulatory regime and permits; environmental, health and safety requirements; climate change and the environment; and force majeure); to the Corporation's investment in Värmevärden (general business risks inherent in the district heating business; fuel costs and supply; reliance on industrial customers and ability of residential customers to cancel contracts on short notice; geographic concentration; government regulation; environmental health and safety liabilities; reliance on key personnel; labour relations; enforcement of indemnities against the vendors of Värmevärden; minority interest; and foreign exchange); to the Corporation's investment in Bristol Water (revenue is substantially influenced by price determinations made by Ofwat; failure to deliver capital investment programs; failure to deliver water leakage targets; the imposition of penalties under Ofwat's new comparative incentive mechanism; the economic downturn impacting the lending environment, as well as debt and capital markets, resulting in more costly financing and inflation negatively impacting leverage and key financial ratios, which may have a negative impact on credit ratings, as well as increasing the cost of capital expenditures; pension plan obligations may require Bristol Water to make additional contributions; failure to meet existing regulatory requirements and the potentially adverse impact of future legislative and regulatory changes; the ability for a Special Administrator to be appointed by the UK Secretary of State for the Environment, Food and Rural Affairs or Ofwat in certain circumstances (including the breach by Bristol Water of its licence); foreign exchange; operational risks (including significant interruption of the provision of its services and catastrophic damage resulting in loss of life, environmental damage or economic and social disruption); development of competition within the water sector; reliance on key personnel; default under its Artesian loans, bonds, debentures or credit facility; geographic concentration; potential seasonality and climate change; labour relations; and enforcement of indemnities against the vendors of Bristol Water); and to the Corporation (tax-related risks; variability and payment of dividends, which are not guaranteed; geographic concentration and non-diversification; insurance; environmental, health and safety regime; availability of financing; shareholder dilution; and the unpredictability and volatility of the common share price of the Corporation).

For a more comprehensive description of these and other possible risks, please see the risks set out in this document under the heading "Risks and Uncertainties", as updated in subsequently filed interim MD&A, subsequent Annual Information Forms of the Corporation and other filings by the Corporation with Canadian securities regulatory authorities (such documents are available under the Corporation's profile on www.sedar.com). The assumptions, risks and uncertainties described above are not exhaustive and other events and risk factors could cause actual results to differ materially from the results and events discussed in the forward-looking statements and financial outlook. The forward-looking statements within this document reflect current expectations of the Corporation as at the date of this document and speak only as at the date of this document. Except as may be required by applicable law, the Corporation does not undertake any obligation to publicly update or revise any forward-looking statements or financial outlook.

STRATEGIC OVERVIEW

PERFORMANCE OVERVIEW

Capstone's Business

Capstone's mission is to build and responsibly manage a high quality portfolio of infrastructure businesses in Canada and internationally in order to deliver a superior total return to our shareholders by providing reliable income and capital appreciation. Our vision is to be the pre-eminent diversified infrastructure company in Canada.

Infrastructure businesses provide services that meet critical, long-term community needs, such as power generation, electricity transmission, roads and transportation networks, and water systems. These businesses typically benefit from some form of barrier to entry, stable and growing demand, and other competitive advantages that provide stability in cash flow.

Our power infrastructure platform includes gas cogeneration, wind, hydro, biomass and solar power generation facilities in Canada, totalling approximately 370 megawatts of installed capacity. These facilities have power purchase agreements with creditworthy customers. Our objectives for the power platform are to maximize production and to maintain or improve the quality of each facility while efficiently managing costs.

Our utilities platform includes a 70% equity interest in Bristol Water, a regulated business in the United Kingdom that earns a return on its regulated capital value ("RCV"), or asset base. Bristol Water is the sole water supplier in the Bristol region, serving a population of 1.1 million people. Our objectives for Bristol Water are to invest capital to grow its RCV, to provide safe, reliable drinking water that is cost-effective for customers, and to operate efficiently and in compliance with all regulatory and environmental requirements.

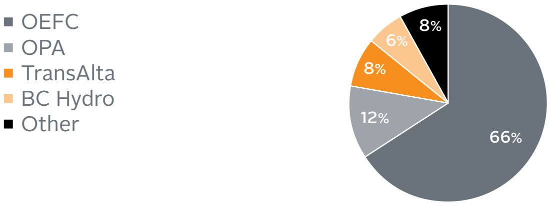
We also hold a 33.3% equity interest in Värmevärden, a district heating business in Sweden that serves residential customers and also has long-term contracts with industrial customers. Our objectives for Värmevärden are to renew or renegotiate contracts with industrial partners, ensure high plant availability and operational efficiency, and manage fuel costs by using more cost-effective fuels.

We expect to continue to build upon these two platforms and to further diversify our portfolio by geographic region and infrastructure category, which could include power distribution and transmission; roads and transportation; and public-private partnerships.

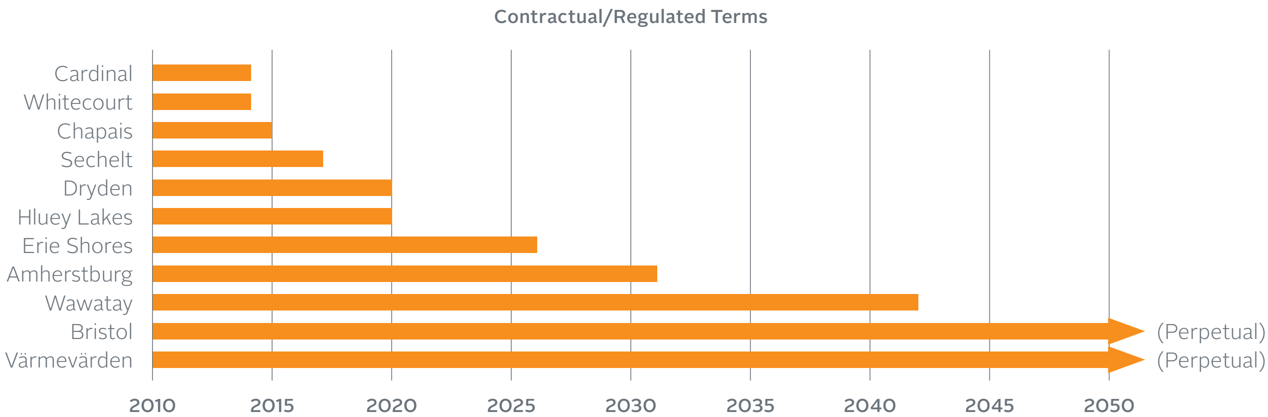
Availability (%)

Facility	2011	Five-Year Average
Cardinal	**97.6**	97.3
Erie Shores	**96.9**	96.2
Hydro Power Facilities	**98.8**	97.9
Whitecourt	**96.6**	90.9

Percentage of 2011 Power Revenue by Counterparty



Duration of Cash Flow



STRATEGY

Accomplishing Our Vision

In support of its long-term vision, Capstone's decision making is guided by the following imperatives:

Maximize and sustain the long-term value of our existing businesses
Each of our assets undergoes an annual strategic planning exercise to assess progress against goals and to determine how we can further improve the efficiency, quality and performance of our operations. We work closely with the management teams at each asset to optimize operating and financial performance, which includes applying strong risk management principles and procedures to safeguard Capstone's performance. In addition, each business follows a comprehensive, planned maintenance program, which contributes significantly to long-term value.

Deliver strong financial performance
Our infrastructure businesses provide essential services for which there is consistent demand throughout the economic cycle. They also operate within contractual frameworks or environments where they benefit from high barriers to entry. Combined, these attributes result in relatively predictable operating cash flow. We also strive to maintain a capital structure that suits the quality and cash flow profile of our businesses. We continue to meet all covenants under our senior loan, CPC-Cardinal, Erie Shores and Amherstburg credit facilities, and are working to address our refinancing requirements in 2012 with the goal of improving our financial strength and flexibility.

Achieve prudent growth.
Capstone's growth strategy includes:

- An international scope encompassing Canada as well as countries that are members of the Organization for Economic Cooperation and Development ("OECD") offering a stable political, regulatory and economic environment;
- A focus on regulated or contractually defined core infrastructure businesses, which typically generate stable cash flow throughout the economic cycle;
- A blend of operating businesses as well as development opportunities that offer an appropriate risk-adjusted rate of return; and
- A preference for wholly owned businesses with the ability to take a minority position where we are protected by a strong governance framework.

Capstone's strategy is reviewed annually by its Board of Directors.

Core Infrastructure Categories

Highly regulated → Less regulated

Strong competitive advantage → More competitive environment

Target Assets for CSE

P3s	REGULATED ASSETS	USER-PAY ASSETS	COMPETITIVE ASSETS
▸ Courts ▸ Schools ▸ Police Stations & Other Government Facilities	▸ Transmission & Distribution Assets ▸ Water & Sewerage ▸ Contracted Power	▸ Road ▸ Rail ▸ Airports ▸ Ports	▸ Merchant Power ▸ Energy Trading
	▸ District heating: favourable utility-like characteristics with user-pay dimension		

Increasing Risk

MARKET FUNDAMENTALS

Effective infrastructure supports economic growth and ensures a high quality of life. Globally, infrastructure investment requirements are significant and growing, driven by underinvestment as well as major factors of change such as global economic growth, technological progress, climate change, urbanization and growing congestion. There is a significant gap between the infrastructure investments required for the future and the capacity of the public sector to meet those requirements from traditional sources.

Significant infrastructure investment is required in Canada and internationally
A 2005 study by the OECD estimates that approximately US$2 trillion per year will need to be invested between 2020 and 2030 to meet global requirements for basic infrastructure such as electricity, transportation, telecommunications and water. A 2008 study by Statistics Canada found that Canada's bridges had passed 57% of their total life span while roads and water treatment plants had passed 53% and 63% of their life spans, respectively. It is estimated that approximately $400 billion will be required

by 2020 to plug Canada's infrastructure deficit: its physical foundation of public buildings, roads, bridges, sewers, electrical grids, water purification plants and other critical infrastructure.

Strong demand for power infrastructure investment
A 2008 study by the International Energy Agency ("IEA") estimated that power infrastructure requirements globally will amount to a total of about US$14 trillion by 2030. The Canadian Electricity Association ("CEA") estimates that the combined public and private cost to meet Canada's electricity supply shortfall and transmission challenges will be approximately $150 billion over the next two decades. At the same time, Canada's renewable energy industry is expected to continue to expand in the coming years.

Growing need for investment in water infrastructure
Aging infrastructure and years of underinvestment, growing demand and a variety of environmental pressures, including scarcity and climate change, are creating a growing need for investment in the modernization and improvement of water infrastructure systems throughout the OECD. The Federation of Canadian Municipalities estimates that Canada's water infrastructure deficit is approximately $31 billion. Water infrastructure investment needs in the United States over the next 20 years are estimated at more than US$500 billion.

Growing public support for private sector investment in infrastructure
There are currently 162 public-private partnership ("P3") projects at various stages underway in Canada, mostly involving hospitals, health care, courthouses, and transportation. The market for P3s is expected to continue to grow in Canada with water and waste water, energy and transit demanding more investment. A study conducted by the Canadian Council for Public-Private Partnerships in late 2011 showed that 70% of Canadians believe the private sector should work with governments to deliver critical infrastructure.

KEY PERFORMANCE DRIVERS

Power

The major factors that drive the results of our power infrastructure segment are:

Consistently high availability
Availability is the number of hours that a generating unit is capable of generating electricity, whether or not it is actually generating electricity, as a percentage of total hours in the period. Our power businesses are characterized by high availability, which reflects the quality of plant operations and underpins the reliability of Capstone's cash flow.

PPAs with creditworthy counterparties
Our power businesses have a sustainable competitive advantage through PPAs that provide price certainty for 98.7% of the power generated by our facilities, contributing to the overall predictability of Capstone's revenue. The weighted average PPA term remaining is approximately eight years. The remaining 1.3% of power, which represents approximately 4 MW of net capacity at Whitecourt, is sold at the Alberta Power Pool spot price.

Counterparty Credit Ratings

Counterparty	Credit Rating
OEFC	AA (low)/Stable – DBRS
OPA	A (high) – DBRS
TransAlta	BBB/Stable – DBRS
BC Hydro	AA (high)/Stable – DBRS
Other	n/a
Total	n/a

Preventive maintenance and continuous operational improvement
Each facility has an established maintenance program with an emphasis on routine and preventive maintenance, which helps to ensure the plants' continuing consistent availability, capacity and long life.

In addition, we seek to improve the capacity and efficiency of each facility through the implementation of technological and operational enhancements.

Utilities

The major factors that drive the results of our utilities segment are:

Water

Stable regulatory regime
The regulatory framework for water utilities in the United Kingdom enables Bristol Water to recover operating costs and earn a reasonable return on the capital it invests, resulting in highly visible and stable cash flows. As an incentive-based regime, the regulatory structure allows for significant outperformance through cost efficiency and capital structuring.

Capital investment program
In the current regulatory period, which runs from April 2010 to March 2015, Bristol Water will complete an approximately $412 million (£261 million) capital investment program. This program will enable Bristol Water to maintain and improve its infrastructure and operations, to continue to meet water quality requirements and to support growth arising from an increasing population and expanded business activity in the region. This significant capital program will drive growth in Bristol Water's regulated capital value, which will increase the overall value of this investment for Capstone's shareholders.

Achievement of regulatory targets
Bristol Water is subject to a number of regulatory performance targets, including targets for serviceability, both above ground and below ground, security of supply, leakage and water efficiency. Failing to meet these targets could result in a fine or reduced revenue allowance at the next price setting review in 2014. Management is focused on achieving the following key regulatory outputs by 2014:

- Water leakage of 49 million litres of water per day ("Ml/day") with a 2012 leakage target of less than 51 Ml/d;
- A base service water efficiency (amount of water saved) target of 2.4 Ml/d;

- A 100% grade on the regulator's security of supply index, which measures the reliability of the company's water supply;
- Stable serviceability;
- Exceptional customer service as measured by the regulator's Service Incentive Mechanism ("SIM"), which is measured through customer satisfaction surveys and quantitative data related to complaints. Bristol Water ranked fifth out of 21 companies during 2010-2011 and has set a goal to achieve top quartile performance in 2012.

District Heating

Managing fuel costs
Fuel costs are the largest expense for Värmevärden, accounting for approximately 40% of revenue. As a result, efficient management of fuel costs is a key driver of financial stability.

Strong customer relationships
Värmevärden's industrial customers provide approximately 30% of EBITDA. In addition, Värmevärden relies on its industrial partners for low-cost waste heat, which is a cost-effective fuel source. Renewing existing customer contracts and securing new customers is important to Värmevärden's overall performance.

Increasing the availability and capacity of baseload production
Ensuring high plant availability and capacity helps to maximize revenue potential while minimizing the use of more expensive peak fuel.

CAPABILITY TO DELIVER RESULTS

Capstone's core competencies give us the capability to deliver on our mission. They include:

Record of operational excellence
We seek to ensure a stable portfolio by owning and managing a mix of relatively low-risk businesses. At each of our businesses, we work with the asset managers or our investment partners to improve productivity, manage costs and enhance long-term operations.

Proven ability to execute on growth opportunities
In 2011, we acquired interests in Värmevärden and Bristol Water, diversifying our portfolio by geography and asset category, and opened the Amherstburg Solar Park, expanding our renewable energy footprint. Collectively, these investments increase Capstone's size, scope and value and extend the sustainability of Capstone's cash flow.

Strong leadership
Capstone's corporate management team comprises executives with a combined 50 years of expertise in managing and financing infrastructure businesses. Our Board of Directors comprises seasoned executives with a broad mix of skills in finance, government and corporate governance. In addition, employees throughout our organization are dedicated to operational excellence and continuous improvement.

The regulatory framework for water utilities in the United Kingdom enables Bristol Water to recover operating costs and earn a reasonable return on the capital it invests.

Efficient management of fuel costs is a key driver of Värmevärden's financial stability.

We expect to further diversify our portfolio by geographic region and infrastructure category, which could include power transmission, roads and transportation, and public-private partnerships.

MANAGEMENT'S DISCUSSION AND ANALYSIS

INTRODUCTION

Management's discussion and analysis ("MD&A") summarizes Capstone Infrastructure Corporation's (the "Corporation" or "Capstone") consolidated results and cash flows for the years ended December 31, 2011 and 2010 and the Corporation's financial position as at their date. This MD&A should be read in conjunction with the accompanying audited annual consolidated financial statements of the Corporation and notes thereto as at December 31, 2011, 2010 and January 1, 2010. Additional information about the Corporation, including its Annual Information Form ("AIF") for the year ended December 31, 2010, quarterly financial reports of Capstone and other public filings of the Corporation will be available on the Canadian Securities Administrators' System for Electronic Document Analysis and Retrieval ("SEDAR") website at www.sedar.com. Prior to January 1, 2011, refer to the public filings available on SEDAR of Macquarie Power & Infrastructure Income Fund ("MPT" or the "Fund"), the previous name of the Corporation. The information contained in this MD&A reflects all material events up to March 7, 2012, the date on which this MD&A was approved by the Corporation's Board of Directors.

All amounts are in Canadian thousands of dollars or thousands of share amounts unless otherwise indicated.

Financial Highlights

	As at and for the year ended, December 31,		
($000s)	**2011**	2010	2009[1]
Revenue	**215,967**	158,512	148,384
Net income (loss)	**(3,263)**	15,901	11,259
Earnings (loss) per share			
Basic and diluted	**(0.108)**	0.339	0.226
Cash dividends per share			
Common	**0.66**	0.66	1.05
Preferred	**0.4212**	n/a	n/a
Total assets	**1,697,744**	804,134	706,597
Total long-term liabilities	**928,797**	414,480	347,139

(1) Information for 2009 is presented in Canadian GAAP and may not be comparable with information provided under IFRS for 2010 and 2011.

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CHANGES IN THE BUSINESS

International Financial Reporting Standards

The 2011 and 2010 financial information contained herein is prepared in accordance with International Financial Reporting Standards ("IFRS"). On January 1, 2011, Capstone adopted IFRS and converted from Canadian generally accepted accounting principles ("GAAP"). The significant impacts of the conversion to IFRS on the consolidated financial statements is discussed on page 25 of this MD&A.

Corporate Conversion

Following changes in Canadian tax rules for specified investment flow-through ("SIFT") entities, during 2010 Macquarie Power & Infrastructure Income Fund completed a Plan of Arrangement (the "Arrangement") under the Business Corporations Act (British Columbia) to convert from a mutual fund trust structure into Macquarie Power and Infrastructure Corporation ("MPIC"), a corporation (the "Conversion"). On completion of the Arrangement, effective January 1, 2011, MPIC became the owner, directly or indirectly, of the businesses owned by the Fund.

Internalization of Management

On April 15, 2011, MPIC terminated all management and administrative agreements with Macquarie Power Management Ltd. ("MPML" or "the Manager"), a subsidiary of Macquarie Group Limited ("MGL"), thereby internalizing its management. On internalization, the Corporation retained its current leadership team, which has deep expertise and broad relationships in the infrastructure sector. Additionally, MPIC was renamed Capstone Infrastructure Corporation ("Capstone" or the "Corporation"). With the new corporate name, Capstone's Toronto Stock Exchange ("TSX") symbols were changed to CSE for the common shares and CSE.DB.A for the convertible debentures.

Capstone and its subsidiaries made payments to a subsidiary of MGL as consideration for terminating all management and administration agreements. MGL's subsidiary immediately used $7,000 of the $14,000 it received to subscribe for Capstone common shares, which MGL will hold for at least one year.

Acquisitions

Värmevärden

On March 31, 2011, the Corporation acquired a 33.3% indirect interest in a Swedish district heating ("DH") business from subsidiaries of Fortum Corporation (collectively, "Fortum"), which now operate under the name Värmevärden AB ("Värmevärden"), for approximately $109,146 (or 710,000 Swedish Kronor ("SEK"). The remaining 66.7% interest in Värmevärden was acquired by Macquarie European Infrastructure Fund II ("MEIF II"), a private unlisted infrastructure fund managed by a subsidiary of MGL.

Bristol Water

On October 5, 2011, Capstone acquired a 70% indirect interest in Bristol Water, a regulated water utility in the United Kingdom, from Suez Environnement through its subsidiary, Agbar (Sociedad General de Aguas de Barcelona), for $213,476. The purchase price was funded through a combination of existing credit facilities, cash on hand and a new $150,000 senior credit facility. The acquisition of Bristol Water supports the Corporation's long-term value proposition..

The total consideration paid by Capstone has been preliminarily allocated to net assets acquired as follows:

($000s)	£	$
Working capital	495	804
Tangible assets	312,179	506,792
Intangible assets – licence	13,300	21,591
Intangible assets – goodwill	85,780	139,255
Incremental deferred income tax asset on acquisition	9,416	15,285
Less: Net financial liabilities (net of cash received £24,324, $39,487)	(231,188)	(375,310)
Other	(31,657)	(51,392)
Incremental deferred income tax liability on acquisition	(7,231)	(11,739)
Non-controlling interest	(19,594)	(31,810)
Total cash consideration	131,500	213,476

The acquisition was accounted for using the purchase method of accounting, which requires Capstone to recognize the identifiable assets acquired and liabilities assumed at their fair values. Goodwill was recognized as the excess of consideration paid over the fair value of net identifiable assets acquired and liabilities assumed. The non-controlling interest was calculated only on the fair value of the net identifiable assets. In accordance with IFRS, the allocation of the purchase price is preliminary and may be updated up to one year after the date of acquisition.

Public Offerings of Securities

On June 30, 2011, the Corporation completed an offering of 3,000,000 cumulative five-year rate reset preferred shares, series A (the "Series A Preferred Shares"), at a price of $25.00 per Series A Preferred Share for gross proceeds of $75,000 (net proceeds of $72,072). The Series A Preferred Shares were sold to a syndicate of underwriters on a bought deal basis and are publicly listed for trading on the TSX under the symbol CSE.PR.A. The net proceeds of the offering were used by the Corporation to fund the final equity payment for the construction of the Amherstburg Solar Park, to fund future potential acquisitions and for general corporate purposes.

On November 10, 2011, Capstone completed a public offering for $75,000 (net proceeds of $70,424) by issuing 12,000 common shares. The proceeds from the offering were used to repay a portion of the new $150,000 senior credit facility.

FUNCTIONAL CURRENCY

Amounts included in the consolidated financial statements of each entity in the Corporation are measured using the currency of the primary economic environment in which the entity operates ("functional currency"). The consolidated financial statements are presented in Canadian dollars ("presentation currency"), which is Capstone's functional currency. The exchange rates used in the translation to the presentation currency are as follows:

As at and for the periods ended	Swedish Kronor (SEK)		Pounds Sterling (£)	
($000s)	Average	Spot	Average	Spot
January 1 – March 31	n/a	0.1537	n/a	n/a
April 1 – June 30	0.1545	0.1525	n/a	n/a
July 1 – September 30	0.1518	0.1528	n/a	1.6234(1)
October 1 – December 31	0.1482	0.1479	1.6076	1.5799

(1) Exchange rate for acquisition was as of October 5, 2011

INTERNATIONAL FINANCIAL REPORTING STANDARDS

On January 1, 2011, Capstone implemented IFRS as its financial reporting framework with a transition date of January 1, 2010. The transition required the Corporation to restate its 2010 financial results, which were previously prepared in accordance with Canadian GAAP. While many of the accounting principles and standards comprising IFRS are similar to Canadian GAAP, certain standards result in financial reporting differences that render financial results under Canadian GAAP and IFRS not comparable.

As previously reported, Capstone converted from a mutual fund trust to a corporation on January 1, 2011. As a result, certain differences between Canadian GAAP and IFRS only impact financial results prior to January 1, 2011, while other IFRS differences impact financial reporting periods before and after January 1, 2011.

IFRS Adjustments Impacting Both Historical and Prospective Financial Reporting

The adoption of IFRS has an impact on Capstone's historical and prospective financial reporting for capital assets and business combination transaction costs.

Under IFRS, major maintenance and inspections that are periodically undertaken at each facility may not be expensed as incurred. Instead, these costs must be capitalized and depreciated until the facility's next major maintenance.

For business combination transaction costs, under IFRS, only those costs related to debt or equity issuance or acquisitions of equity accounted investments are eligible to be capitalized. All other transaction costs arising for a business combination must be expensed as incurred rather than capitalized to the purchase price of the business combination as allowed under Canadian GAAP.

IFRS Adjustments Impacting Only Historical Financial Reporting

Under IFRS, Capstone has additional financial reporting differences relative to Canadian GAAP that are only applicable prior to January 1, 2011, when the Corporation operated as a trust. These differences relate to the Class B exchangeable units, the convertible debentures and deferred income taxes.

IFRS requires that the Class B exchangeable units of MPT LTC Holding LP, a subsidiary of Capstone, be classified as a financial liability and measured at fair value during the period that Capstone operated as a mutual fund trust. The change in the fair value of the units and the distributions paid to the unitholders were charged to net income (loss) as a financing cost, consistent with the classification of the units as debt. Following conversion to a corporation on January 1, 2011, the Class B exchangeable units were reclassified under IFRS to the consolidated equity of the Corporation based on the carrying value of the units at December 31, 2010.

For the convertible debentures, IFRS requires Capstone to reclassify the conversion option from equity under Canadian GAAP to a liability for 2010. This classification is due to the debentures being convertible in 2010 into trust units, which are deemed to have a limited life, and therefore the debentures need to be measured as held for trading and accounted for at fair value with changes reported in the consolidated statements of income. On January 1, 2011, the conversion option was transferred to equity on the basis that the Corporation's shares are permanent in nature. The value of the conversion option on January 1, 2011 was equal to the carrying value on December 31, 2010, which is the same as fair value, which is adjusted for deferred income tax consequences being offset to shareholders' equity. Prospectively, the carrying value of the conversion option will remain unchanged aside from any future conversions.

For deferred income taxes, IFRS requires that a trust use the "undistributed" income tax rate in the determination of income tax amounts for financial reporting. This requires a trust to use the applicable income tax rate assuming that no distributions were made to offset taxable income. As a result, a trust is required to use the highest marginal personal income tax rate of 46% in the calculation of deferred income taxes. For Capstone, the impact is a non-cash increase to deferred income taxes in the January 1, 2010 opening consolidated statement of financial position to reflect the rate differential between the highest marginal personal tax rate of 46% and the SIFT tax rate of 25%.

The adjustments to Capstone's Canadian GAAP figures to IFRS are summarized as follows:

($000s)	Canadian GAAP	Deferred income taxes	Capitalized transaction costs	ARO accretion	Major maintenance	Equity portion of convertible debentures	Class B units	IFRS
Adjustments to Net income and Non-GAAP performance measures for the year ended, Dec 31, 2010:								
Net income (loss)	**11,569**	16,442	2,142	–	(1,792)	(3,459)	(9,001)	**15,901**
Adjusted EBITDA	**55,039**	–	(2,092)	179	2,692	–	–	**55,818**
AFFO	**36,687**	–	(2,092)	179	–	–	–	**34,774**
Adjustments to Retained Earnings as at:								
January 1, 2010	**(214,073)**	(51,033)	(3,075)	–	168	(4,385)	15,647	**(256,753)**
December 31, 2010	**(235,979)**	(34,590)	(933)	–	(1,626)	(7,845)	8,790	**(272,183)**

NON-GAAP AND ADDITIONAL GAAP PERFORMANCE MEASURE DEFINITIONS

While the accompanying consolidated financial statements have been prepared in accordance with IFRS, this MD&A also contains figures that are performance measures not defined by IFRS. These non-GAAP and additional GAAP performance measures do not have any standardized meaning prescribed by IFRS and are, therefore, unlikely to be comparable to similar measures presented by other issuers. The Corporation believes that these indicators are important since they provide additional information about the Corporation's earnings performance and cash generating capabilities and facilitate comparison of results over different periods. The non-GAAP and additional GAAP measures used in this MD&A are defined below.

Earnings Before Interest Expense, Taxes, Depreciation and Amortization ("EBITDA")

EBITDA is net income (loss), including that net income (loss) related to the non-controlling interest and interest income excluding interest expense, income taxes, depreciation and amortization. EBITDA represents Capstone's continuing capacity to generate income from operations before taking into account management's financing decisions and costs of consuming tangible capital assets and intangible assets, which vary according to their vintage, technological currency, and management's estimate of their useful life. EBITDA is presented on the consolidated statement of income.

Adjusted EBITDA

Adjusted EBITDA is calculated as revenue less operating and administrative expenses plus interest income and dividends/distributions received from equity accounted investments. Amounts attributed to any non-controlling interest are deducted. Adjusted EBITDA is reconciled to EBITDA by removing equity accounted income, other gains and losses (net), foreign exchange gains and losses, and adding in dividends/distributions from equity accounted investments.

Adjusted Funds from Operations ("AFFO")

The Corporation uses AFFO as a measure of the cash generating ability of operating activities. The Corporation defines AFFO as Adjusted EBITDA plus principal received from loans receivable on equity accounted investments less interest paid, dividends paid on the Corporation's preferred shares and income taxes paid, maintenance capital expenditures and scheduled repayment of principal on debt, net of changes to the levelization liability. For the Utilities-Water segment, Capstone defines maintenance capital expenditures as the amount, including adjustments for inflation, required by the regulator for the Asset Management Period ("AMP") to maintain the productive capacity of the business. Differences between the regulatory required and actual maintenance capital expenditures are adjusted during the AMP when the difference is determined to be permanent.

Payout Ratio

Payout ratio measures the proportion of cash generated from operations that is paid as dividends. The payout ratio is calculated as dividends declared divided by AFFO. AFFO may not reflect actual cash movements in the form of dividends from Capstone's infrastructure businesses in particular a portion of Bristol Water's AFFO is reinvested in the business.

The following table reconciles Adjusted EBITDA and AFFO to the most applicable GAAP measures:

Reconciliation of Non-GAAP Performance Measures

	For the year ended	
($000s)	**Dec 31, 2011**	Dec 31, 2010
EBITDA	**32,066**	32,652
Equity accounted (income) loss	**5,276**	(3,333)
Other gains and losses (net)	**21,742**	23,939
Foreign exchange (gain) loss	**3,274**	19
Distributions from equity accounted investments	**–**	2,541
Non-controlling interest portion	**(6,685)**	–
Adjusted EBITDA	**55,673**	55,818
Cash flow from operating activities	**50,881**	29,011
Interest expense in excess of interest paid	**3,939**	2,146
Dividends on redeemable preferred shares	**(1,264)**	–
Income tax expense – current portion	**187**	8
Income taxes paid (recovery)	**538**	(8)
Principal from loans receivable	**884**	793
Foreign exchange	**35**	19
Maintenance capital expenditures	**(13,409)**	(4,010)
Scheduled repayment of debt principal	**(4,688)**	(2,025)
Non-controlling interest portion	**(6,685)**	–
Distributions from equity accounted investments	**–**	2,541
Other working capital changes	**(12,812)**	6,299
AFFO	**17,606**	34,774

SUBSEQUENT EVENTS

On February 24, 2012, Värmevärden's parent company, Sefyr Värme AB, in which Capstone holds a 33.3% indirect investment, completed a $138,000 (922,000 SEK) offering of senior secured bonds to select institutional investors. The bonds have a five-year term, are non-amortizing and carry a coupon of 7.0%. Sefyr Värme AB has the option to issue up to an additional $12,000 (78,000 SEK) of senior secured bonds at any time over the next five years, bringing the offering to an aggregate size of up to approximately $150,000 (1,000,000 SEK).

Proceeds from the issuance were distributed to the owners of Sefyr Värme AB, with Capstone receiving one third or $46,000, which was used to repay a portion of the $78,375 outstanding on the senior credit facility as at December 31, 2011.

RESULTS OF OPERATIONS

Overview

During 2011, Capstone's Adjusted EBITDA decreased by $145, or 0.3%, while AFFO decreased by $17,168 or 49.4%. Excluding costs to internalize management, Adjusted EBITDA increased by $18,644, or 32.9%, while AFFO increased by $1,621, or 4.5%. The year-over-year increase in these two measures was attributable to earnings from Bristol Water and Värmevärden, which were acquired in 2011. Amherstburg Solar Park, which commenced operations on June 30, 2011, also contributed favourably to both Adjusted EBITDA and AFFO.

	For the year ended	
($000s)	**Dec 31, 2011**	Dec 31, 2010
Revenue	**215,967**	158,512
Expenses	**(160,052)**	(106,183)
Interest income	**6,443**	948
Distributions from equity accounted investments	**–**	2,541
Less: non-controlling interest	**(6,685)**	–
Adjusted EBITDA	**55,673**	55,818
Principal from loans receivable	**884**	793
Interest paid	**(20,128)**	(15,794)
Dividends paid on Capstone's preferred shares	**(1,264)**	–
Income taxes paid	**538**	(8)
Maintenance capital expenditures	**(13,409)**	(4,010)
Scheduled repayment of debt principal	**(4,688)**	(2,025)
AFFO	**17,606**	34,774
Internalization costs	**19,675**	886
AFFO before internalization costs	**37,281**	35,660
After internalization costs		
AFFO per share(1)	**0.273**	0.693
Payout ratio	**238.7%**	96.3%
Before internalization costs		
AFFO per share(1)	**0.578**	0.711
Payout ratio	**112.7%**	93.9%
Dividends declared per share	**0.66**	0.66

(1) For comparability, the calculation of AFFO in 2010 treats Class B exchangeable units as equity. As a result, interest paid in 2010 has been reduced and the weighted average number of shares has been increased.

Consolidated revenue increased by $57,455, or 36.2%, primarily due to Bristol Water, which contributed $43,560 between October 5, 2011 and year end. Revenue from Capstone's power assets increased by $13,895, with Amherstburg contributing $7,289 and Cardinal increasing by $3,697.

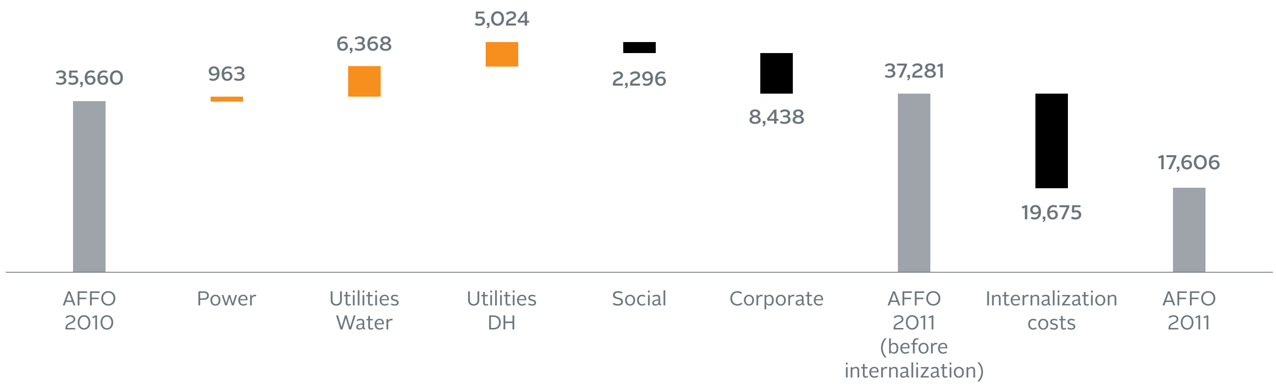
Expenses increased by $53,869, or 50.7%, including internalization costs. Excluding internalization costs, expenses increased by $35,080, or 33.3%. Expenses at Capstone's operating businesses increased by $27,781, or 29.5%, while corporate administrative expenses increased $7,299, or 66.4%. The operating expenses increase was attributable to $21,569 of Bristol Water costs and a $6,457, or 6.9%, increase at the power assets. The increase in corporate administrative expenses was primarily attributable to a $5,683 increase in business development costs mostly related to the Bristol Water acquisition.

Interest income increased by $5,495, or 580%, which was attributable to the Värmevärden shareholder loans that form part of the acquisition structure. Dividends from equity investments decreased by $2,541, or 100%, as the 2010 amount was attributable to Leisureworld, which was sold in March 2010.

Interest paid increased by $4,334, or 27.4%, and was primarily attributable to a $3,933 increase at the power segment where the Amherstburg debt converted from a construction facility to a term facility following the start of commercial operations.

Maintenance capital expenditures increased by $9,399, or 234%, and was primarily attributable to Bristol Water, which represents $9,280 of the total.

The following chart shows the change in AFFO from 2010 to each of Capstone's business segments:



Results by Segment

Capstone's segmented results comprise income from power facilities across Canada, utilities in Europe and corporate activities.

The power segment includes gas cogeneration, hydro, wind, biomass and solar power. In 2011, Capstone made strategic investments in the utilities segment through the acquisition of a 70% interest in Bristol Water, a regulated water utility in the United Kingdom, and a 33.3% interest in Värmevärden, a district heating business in Sweden. The full results of Bristol Water are consolidated with Capstone's other businesses before deducting the portion attributable to non-controlling interests. Värmevärden contributes interest income and dividends as part of Capstone's non-controlling interest in the business.

For the year ended, Dec 31, 2011		Utilities			
($000s)	Power	Water	DH	Corporate	Total
Revenue	172,407	43,560	–	–	215,967
Expenses	(100,517)	(21,569)	–	(37,966)	(160,052)
Interest income	787	291	5,024	341	6,443
Dividends from equity accounted investments	–	–	–	–	–
Less: non-controlling interest	–	(6,685)	–	–	(6,685)
Adjusted EBITDA	72,677	15,597	5,024	(37,625)	55,673
Principal from loans receivable	884	–	–	–	884
Interest paid	(14,696)	(487)	–	(4,945)	(20,128)
Dividends paid on preferred shares	–	–	–	(1,264)	(1,264)
Income taxes (paid) recovery	–	538	–	–	538
Maintenance capital expenditures	(4,129)	(9,280)	–	–	(13,409)
Scheduled repayment of debt principal	(4,688)	–	–	–	(4,688)
AFFO	50,048	6,368	5,024	(43,834)	17,606
Internalization costs	–	–	–	19,675	19,675
AFFO before internalization costs	50,048	6,368	5,024	(24,159)	37,281

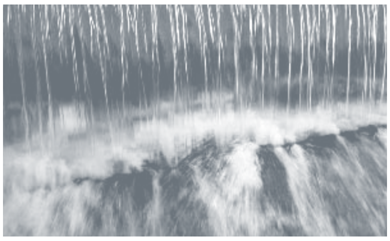
For the year ended, Dec 31, 2010 ($000s)	Power	Social	Corporate	Total
Revenue	158,512	–	–	158,512
Expenses	(94,060)	(245)	(11,878)	(106,183)
Interest income	639	–	309	948
Distributions from equity accounted investments	–	2,541	–	2,541
Adjusted EBITDA	65,091	2,296	(11,569)	55,818
Principal from loans receivable	793	–	–	793
Interest paid	(10,763)	–	(5,031)	(15,794)
Income taxes paid	(1)	–	(7)	(8)
Maintenance capital expenditures	(4,010)	–	–	(4,010)
Scheduled repayment of debt principal	(2,025)	–	–	(2,025)
AFFO	49,085	2,296	(16,607)	34,774
Internalization costs	–	–	886	886
AFFO before internalization costs	49,085	2,296	(15,721)	35,660

Infrastructure – Power

Capstone's power facilities produce electricity from gas cogeneration, wind, biomass, hydro and solar and are located in Ontario, Alberta, British Columbia and Quebec. Results from these facilities were:

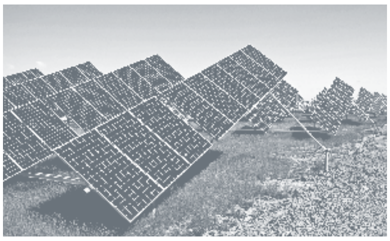
99MW

Erie Shores currently represents approximately 5% of total installed wind capacity in Ontario.



1.5%

Increase in 2011 production by the hydro power facilities over their annual average long-term production.



4,000

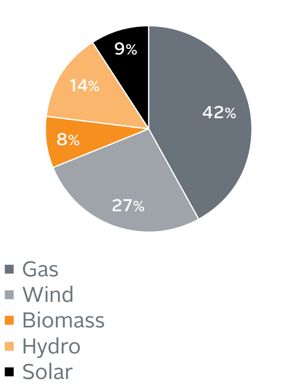
Approximate number of households capable of being powered by Amherstburg's green electricity each year.

For the year ended, Dec 31, 2011 ($000s)	Gas	Wind	Biomass[1]	Hydro	Solar	Total
Power generated (GWh)	**1,256.1**	**236.7**	**202.4**	**161.6**	**17.6**	**1,874.4**
Capacity factors	**95.0%**	**27.2%**	**95.9%**	**51.4%**	**19.9%**	**n.m.f**
Availability	**97.6%**	**96.9%**	**96.6%**	**98.8%**	**95.6%**	**n.m.f**
Revenue	114,311	23,093	14,217	13,497	7,289	172,407
Operating expenses	(84,185)	(3,409)	(8,559)	(3,326)	(1,038)	(100,517)
Interest income	87	7	547	–	146	787
Adjusted EBITDA	30,213	19,691	6,205	10,171	6,397	72,677
Principal from loans receivable	–	–	884	–	–	884
Interest paid	(1,027)	(6,315)	(14)	(3,966)	(3,374)	(14,696)
Income taxes paid	–	–	–	–	–	–
Maintenance capital expenditures	(1,749)	(347)	(969)	(1,064)	–	(4,129)
Scheduled repayment of debt principal	–	(4,129)	–	974	(1,533)	(4,688)
AFFO	27,437	8,900	6,106	6,115	1,490	50,048

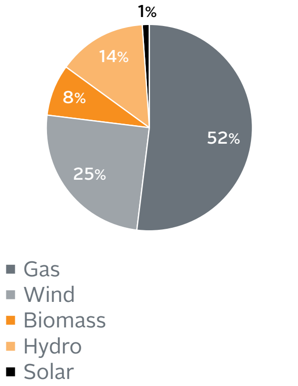
For the year ended, Dec 31, 2010 ($000s)	Gas	Wind	Biomass[1]	Hydro	Solar	Total
Power generated (GWh)	**1,258.5**	**227.8**	**199.5**	**151.7**	**–**	**1,837.5**
Capacity factors	**95.4%**	**26.3%**	**93.4%**	**48.4%**	**–**	**n.m.f**
Availability	**97.9%**	**97.7%**	**93.9%**	**98%**	**–**	**n.m.f**
Revenue	110,614	22,144	13,125	12,629	–	158,512
Operating expenses	(76,015)	(5,537)	(8,426)	(3,572)	(510)	(94,060)
Interest income	–	–	639	–	–	639
Adjusted EBITDA	34,599	16,607	5,338	9,057	(510)	65,091
Principal from loans receivable	–	–	793	–	–	793
Interest paid	(1,014)	(6,053)	(21)	(3,675)	–	(10,763)
Income taxes paid	–	–	(1)	–	–	(1)
Maintenance capital expenditures	(1,381)	(506)	(1,508)	(615)	–	(4,010)
Scheduled repayment of debt principal	–	(3,110)	–	1,085	–	(2,025)
AFFO	32,204	6,938	4,601	5,852	(510)	49,085

(1) Includes interest and loan receivable receipts from Capstone's 33% equity interest in the Chapais facility. Statistics for power generated, capacity factors and availability do not include the Chapais facility.

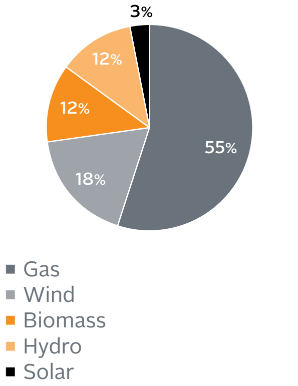
Adjusted EBITDA – 2011



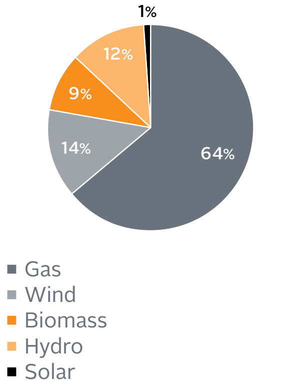
Adjusted EBITDA – 2010



AFFO – 2011



AFFO – 2010



Revenue

Revenue increased by $13,895, or 8.8%, while total power production increased by 36.9 gigawatt hours ("GWhs"), or 2.0%. Higher revenue was primarily attributable to Amherstburg, which produced $7,289 of revenue during the second half of 2011 following completion of the facility at the end of June. All other facilities contributed higher revenue in 2011 with Cardinal contributing an additional $3,697 based on higher electricity prices in 2011.

Operating Expenses

Operating expenses increased by $6,457, or 6.9%, with Cardinal contributing $8,170 to the increase. During 2011, Cardinal incurred both higher gas prices and higher gas transportation toll from TransCanada Pipelines Limited ("TCPL"). Effective March 1, 2011, the TCPL transportation toll increased to $2.24 dollars per gigajoule ("GJ") from a rate of $1.64 dollars per GJ in 2010.

Interest Paid and Scheduled Repayment of Debt Principal

Interest paid increased by $3,933, or 36.5%, primarily due to the completion of Amherstburg, which accounted for $3,374 of the increase. Debt principal repayments increased by $2,663, or 132%, primarily due to Amherstburg, which repaid $1,533 since the debt began amortizing following completion of the facility. Principal repayments at Erie Shores increased by $1,019 following the refinancing of the Tranche C debt to an amortizing loan on April 1, 2011.

Seasonality

The Power segment's operating results fluctuate mainly due to seasonal factors that affect quarterly production of the individual facilities. The factors contributing to these results include scheduled major maintenance, seasonal electricity demands and environmental factors such as water flows, wind speeds, temperature and humidity, which affect the production of electricity. Historically, these factors resulted in the highest average long-term electricity production during the first and fourth quarter as shown in the following table:

			Actual	Average long-term production (GWh)(1)				
Type	Facility	PPA Expiry	2011	Q1	Q2	Q3	Q4	Annual
Gas	Cardinal	2014	**1,256.1**	343.0	282.0	304.0	332.6	1,261.6
Wind	Erie Shores(2)	2026	**236.7**	74.7	53.5	34.2	78.1	240.5
Biomass	Whitecourt	2014	**202.4**	49.9	45.0	50.3	49.5	194.7
Hydro	Various(3)	2017–2042	**161.6**	32.2	56.1	29.7	41.2	159.2
Solar	Amherstburg(4)	2031	**17.6**	–	–	11.5	6.1	17.6
Total			**1,874.4**	499.8	436.6	429.7	507.5	1,873.6

(1) Average long-term production is from March 2005 to December 2011, except for Erie Shores, which is from June 2006, and Amherstburg, which is from July 2011.

(2) One 1.5 MW turbine is owned by a landowner.

(3) The hydro power facilities include Sechelt, Wawatay, Hluey Lakes and Dryden.

(4) The third quarter of 2011 was the first quarter of electricity production at the Amherstburg facility.

Outlook

In 2012, Capstone's power infrastructure businesses are expected to perform in line with long-term average production, subject to variations in wind, water flows and sunlight.

Overall steady production from the facilities, including a full year contribution from Amherstburg, is expected to be partially offset by lower revenue and higher costs at Cardinal in 2012 due to:

- Lower gas mitigation revenues, primarily reflecting a lower spot gas price.
- The implementation of Government of Ontario amendments to the application of the Global Adjustment Mechanism ("GAM"). The GAM previously represented a significant portion of the Direct Customer Rate ("DCR"), which is the revenue escalator contained in Cardinal's PPA. The amended GAM will result in lower growth in revenue at Cardinal in 2012.
- An interim gas transportation rate of $2.24 dollars per GJ, which is currently expected to remain in effect for the duration of the year.

Total maintenance capital expenditures across the power businesses, including Cardinal's planned maintenance outage, which is expected to span 12 days, are expected to be approximately $5,500 in 2012.

Management is continuing to seek incremental growth opportunities to enhance the contribution of its power businesses, including the sale of renewable energy credits ("RECs"). In 2012, we expect to derive approximately $450 in revenue from the sale of RECs at Whitecourt.

Infrastructure – Utilities

Water

Capstone's Utilities-Water segment represents a 70% investment in Bristol Water, which was acquired on October 5, 2011 and is located in the United Kingdom. As the business was acquired in 2011, no results were reported in Capstone's comparative figures.

($000s)	Results for period of ownership from Oct 5 – Dec 31, 2011
Water supplied (megalitres)	19,700
Revenue	43,560
Operating expenses	(21,569)
Interest income	291
Less: Non-controlling interest	(6,685)
Adjusted EBITDA	**15,597**
Interest paid(1)	(487)
Income taxes (paid) recovery(1)	538
Maintenance capital expenditures(1)	(9,280)
Scheduled repayment of debt principal(1)	–
AFFO	**6,368**

(1) Amount included at 70%, the attributable amount to Capstone based on ownership interest.

(2) Bristol Water paid $3,908 of inter-company dividends to Capstone during the period.

Revenue

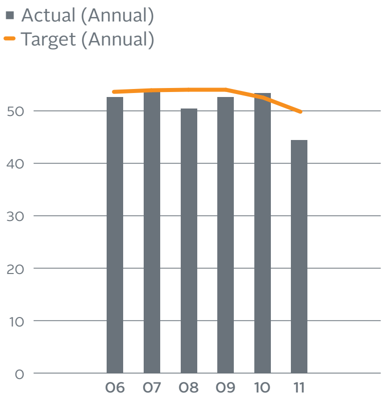
Bristol Water is a regulated business subject to supervision by the Water Services Regulation Authority ("Ofwat"). Bristol Water is currently in the second year of its five-year Ofwat approved asset management plan ("AMP5"). Revenue in 2011 was over 97% derived from water sales and grew in proportion to regulatory inflation and prescribed rate increases.

Operating expenses

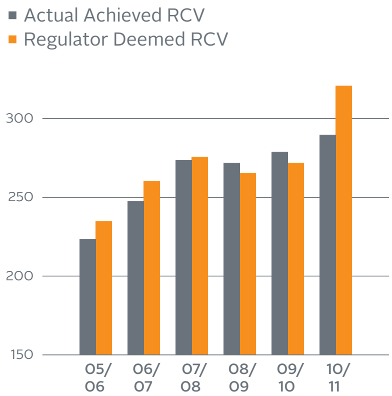
Operating expenses primarily comprised raw materials, consumables, bad debts and other charges less recoveries ($15,021) and labour costs ($3,384) to maintain the network and deliver water services to retail and commercial customers. During the fourth quarter, operating expenses were below expectations, as a result of lower repairs and maintenance expenditures of the water infrastructure assets with some savings being achieved due to milder than expected weather, which resulted in fewer pipe bursts.

Key Performance Indicators for Bristol Water

Water Leakage Versus Target



Growth in Regulated Capital Value



[Periods from April 1 to March 31]

$110 – $120M

Expected capital expenditures in 2012 in line with regulatory requirements. The capital program is aimed at improving and expanding Bristol Water's network of reservoirs, treatment facilities, water mains and pipes.

Non-controlling interest

The non-controlling interest represents 30% of Bristol Water's Adjusted EBITDA to bring the measure in line with Capstone's 70% interest in Bristol Water. The 30% non-controlling interest is held by Agbar.

Capital expenditures

Bristol Water is in the second year of its five-year asset management plan. The total capital expenditure planned for AMP5 is approximately $412,000, or £261,000. As at December 31, 2011, cumulative capital expenditure in AMP5 was $79,000, which was $58,500 less than planned. The shortfall was primarily the result of delays at the start of AMP5 as planned expenditures were dependent on a competition commission ruling. Bristol Water expects its expenditures over the remainder of AMP5 to achieve the cumulative approved capital expenditure.

Maintenance capital expenditures for the purposes of our AFFO definition represent the portion of capital expenditures required for Bristol Water to maintain its productive capacity as measured by regulated capital value, adjusted for inflation. During the fourth quarter of 2011, actual capital expenditures were $23,999.

Seasonality

Bristol Water experiences little seasonal variation in demand, resulting in stable revenues throughout the year. Operating expenses vary during the year depending on the availability of water from Bristol Water's various sources, the quantity of water requiring treatment as a result of dry weather, and pipe bursts in periods where freezing and thawing occur. As well, the level of capital expenditure activity fluctuates with weather, which impacts the infrastructure renewals expenditure.

Outlook

In 2012, Bristol Water will contribute a full year of results to Capstone. The business is expected to deliver over $8 million in dividends to Capstone in 2012, reflecting Bristol Water's continuing stable performance. For 2012/2013, Bristol Water will benefit from an approximately 3.9% real increase and a 5.2% inflationary increase in its regulated revenue.

In 2012, Bristol Water expects to complete capital expenditures of approximately $110,000 to $120,000, or £68,750 to £75,000, in line with regulatory requirements. Bristol Water's capital program is aimed at improving and expanding Bristol Water's network of reservoirs, treatment facilities, water mains and pipes in order to continue providing high quality water to customers, reducing the amount of water lost to leakage, and positioning Bristol Water to effectively serve a growing population.

Management is also focused on achieving key regulatory output targets, including leakage of less than 51 million litres of water per day ("Ml/d") in 2012/2013, and is striving for a top quartile ranking in Ofwat's SIM customer service measure. Strong performance on the SIM, which is measured through customer satisfaction surveys and quantitative data related to complaints, can result in an increased revenue allowance for Bristol Water in the next regulatory period.

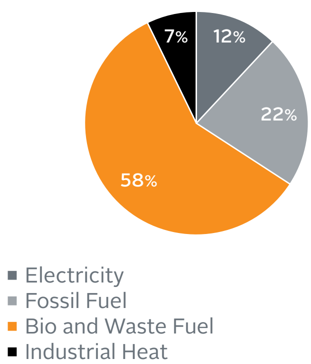
District Heating

Capstone's Utilities – District Heating segment represents a 33.3% interest in Värmevärden, a district heating business located in Sweden, which was acquired on March 31, 2011. As the business was acquired in 2011, no results were reported in Capstone's comparative figures.

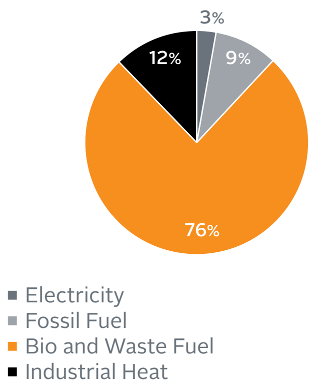
($000s)	Results for period of ownership from Mar 31 – Dec 31, 2011
Heat production (GWh)	733
Equity accounted income (loss)	(5,270)
Interest income	5,024
Dividends	–
Adjusted EBITDA	5,024
Principal from loans receivable	–
AFFO	5,024

Key Performance Indicators for Värmevärden

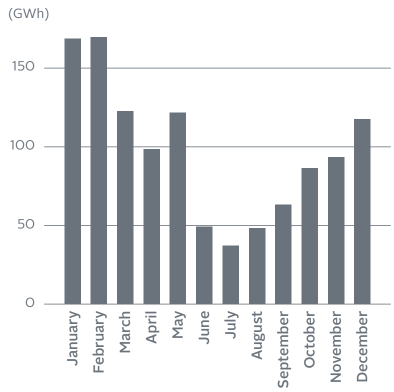
Fuel Mix Breakdown by Cost ($)



Fuel Mix Breakdown by MWh



Heat and Steam Production in 2011



Interest income

Interest is earned on the shareholder loan receivable from Värmevärden. Interest is earned at the rate of 7.965% per annum and was earned for nine months in 2011.

Equity accounted income

During 2011, Värmevärden contributed a $5,270 equity accounted loss to Capstone's net income. The loss is attributed in part to $2,414 of transaction costs from acquisition, which is reflected in Värmevärden's net income. In addition, since Värmevärden was acquired on March 31, 2011, no results for the first quarter of 2011 were recognized, which is when typically 35% of annual revenue is achieved.

Seasonality

Revenue from the sale of heat is higher during the colder months of the year. In Sweden, this is highest in the first quarter followed by the fourth quarter, which when combined, historically accounted for 65% of Värmevärden's annual revenue.

Outlook

In 2012, Värmevärden will continue to seek to enhance its operational efficiency, including exploring options to improve the cost effectiveness of its fuel mix. Another area of focus for the company will be the continuing development of retail and industrial pricing strategies and building or enhancing relationships with customers.

Värmevärden completed a debt financing in February 2012 to recapitalize the business, thereby allowing its shareholders to repatriate a portion of the shareholder loans.

Värmevärden's performance in 2012 is expected to continue to support interest payments on Capstone's loan receivable and dividends on Capstone's equity investment.

Social

Capstone's 45% investment in Leisureworld, a senior care facility located in Canada, was sold in 2010. Capstone continues to use equity accounting for its residual interest in Macquarie Long Term Care L.P. ("MLTCLP") until such time as the windup of the remaining activities is completed. During 2011, MLTCLP distributed $54,666 to settle outstanding loans payable. This simultaneously reduced Capstone's equity accounted investment in MLTCLP.

During 2011, Capstone recognized $6 of income from its 45% interest in the residual activities of MLTCLP. Capstone expects to complete the windup of MLTCLP in 2012.

Corporate

Corporate activities primarily comprise business development activities, capital structure expenses not specifically attributed to the businesses, and costs to manage and report on Capstone's infrastructure businesses.

	For the year ended	
($000s)	**Dec 31,2011**	Dec 31, 2010
Administrative expenses	**(37,966)**	(11,878)
Interest income	**341**	309
Adjusted EBITDA	**(37,625)**	(11,569)
Interest paid	**(4,945)**	(5,031)
Dividends paid on Capstone's preferred shares	**(1,264)**	–
Income taxes paid	**–**	(7)
Scheduled repayment of debt principal	**–**	–
AFFO	**(43,834)**	(16,607)
Internalization costs	**19,675**	886
AFFO before internalization costs	**(24,159)**	(15,721)

Administrative Expenses

	For the year ended	
($000s)	**Dec 31, 2011**	Dec 31, 2010
Internalization expenses	**19,675**	886
Business development	**8,289**	2,606
Salaries and benefits	**4,126**	–
Manager fees	**1,825**	5,193
Other administrative expenses	**4,051**	3,193
	37,966	11,878

Internalization expenses represent amounts paid to MGL to terminate the management arrangements ($14,000) as well as one-time payments to staff ($4,000). The remainder was paid for professional fees and other administrative costs. Business development expenses were $5,683, or 218%, higher in 2011. The year-over-year increases were primarily attributable to $5,997 of transaction costs for the Bristol Water acquisition. Salaries and benefits reflect amounts paid to corporate employees beginning April 15, 2011 following internalization of management.

Manager fees were $3,368, or 64.9%, lower in 2011, which reflected the termination of management contracts with MGL effective April 15, 2011, following which Capstone no longer incurred new management and administrative fees, cost reimbursement or incentive fees to MGL.

Other administrative expenses were $958, or 26.9%, higher in 2011. Other administrative expenses include audit fees, investor relations costs, office administration costs and professional fees other than for business development. Also included are project costs for the SIFT conversion ($361 in 2011; $2,630 in 2010) and IFRS conversion ($40 in 2011; $261 in 2010).

Interest Income

Interest income of $341 was earned on surplus cash balances during 2011. The decline from 2010 primarily reflects lower average daily balances in 2011 following Capstone's redeployment of surplus cash from the Leisureworld sale.

Interest Paid

Interest paid was comparable with the prior year. Interest paid increased due to a higher balance on the CPC-Cardinal facility and a new bridge loan to fund the acquisition of Bristol Water. This was offset by a lower average balance on the convertible debentures in 2011 due to conversions primarily during the fourth quarter of 2010 and the first quarter of 2011.

FINANCIAL POSITION REVIEW

Overview

As at December 31, 2011, Capstone had a consolidated working capital deficit of $86,694 due primarily to long-term debt maturing in 2012. Working capital for the power and the water utilities segments was $64,566 in deficit and $91,864 in surplus, respectively. Unrestricted cash and equivalents was $57,587 on a consolidated basis with the power segment and water utilities segments contributing $13,972 and $35,434, respectively.

During 2011, Capstone's debt to capitalization ratio (as defined on page 36) increased from 37.9% to 71.0% on a fair value basis and 48.9% to 65.7% on a book value basis. On a fair value basis, the increase was primarily attributable to a 53.6% decline in the share price since December 31, 2010, $504,479 of consolidated long-term Bristol Water debt, $112,375 of additional corporate debt to finance the Bristol Water acquisition, and a $63,267 increase in the Amherstburg long-term debt as the facility was completed. This was partially offset by a $18,562 reduction in the fair value of convertible debentures and a $98,220 increase in shareholders' equity as a result of issuing preferred and common shares.

As at December 31, 2011, Capstone and its subsidiaries complied with all debt covenants. Management is in advanced discussions to refinance all long-term debt amounts maturing in 2012 and expects to complete negotiations prior to each balance maturing. Once completed, refinanced terms are expected to result in a well-capitalized structure that supports Capstone's existing businesses and allows Capstone to return to pursuing new growth opportunities.

Liquidity

Working Capital

($000s)	Dec 31, 2011	Dec 31, 2010
Power	(64,566)	(8,931)
Utilities – Water	91,864	–
Social	–	(45,260)
Corporate	(113,992)	95,697
Working capital	**(86,694)**	41,506

The working capital deficit of $86,694 included $230,899 of long-term debt maturing in 2012. The CPC-Cardinal facility matures in June 29, 2012 and has $119,000 outstanding, of which $85,000 is included in the Power segment and $34,000 in Corporate. The senior debt facility, which has $78,375 outstanding, matures on October 5, 2012. Management is evaluating and pursuing refinancing and repayment alternatives for these loans.

Capstone is currently evaluating several alternatives to repay, refinance or extend the long-term debt maturing in 2012. These alternatives include, but are not limited to, issuing new debt, extending the maturity of existing debt or portfolio optimization initiatives. Capstone is in discussion with various lenders to ensure sufficient liquidity and maximize long- term value for shareholders.

Although several options are available to Capstone, the timing, amount and terms of any refinancing, extension or other efforts is not determinable with certainty at the present time.

Cash and Cash Equivalents

($000s)	Dec 31, 2011	Dec 31, 2010
Power	13,972	29,412
Utilities – Water	35,434	–
Social	–	108
Corporate	8,181	98,893
Unrestricted cash and cash equivalents	**57,587**	128,413

Unrestricted cash represent funds available for operating activities, capital expenditures and future acquisitions. The $70,826 reduction in cash from December 31, 2010 was primarily attributable to redeployment of surplus funds generated from the sale of Leisureworld to acquire interests in Värmevärden and Bristol Water. The consolidation of Bristol Water resulted in $39,503 of additional unrestricted cash and $82,274 of short-term deposits. Cash at Bristol Water is primarily earmarked for capital expenditure projects in the company's five-year asset management plan approved by the regulator.

As at December 31, 2011, restricted cash totalled $14,875 compared with $10,602 a year earlier. The 2011 balance included $8,689 of restricted cash at Bristol Water for the debt service reserve. During 2011, restricted cash at the Power segment increased by $3,344 due to debt service account requirements for the Amherstburg facility construction upon completion and for the Erie Shores project debt following refinancing. This increase was offset by a $4,011 decrease in restricted cash following the completion of the one-year post sale period for Leisureworld.

Cash Flow

Capstone's cash and cash equivalents balance decreased by $70,826 in 2011 compared with an increase of $75,292 in 2010. The details of the decrease are described in the consolidated statement of cash flows and are summarized as follows:

($000s)	For the year ended Dec 31, 2011	Dec 31, 2010
Operating activities	50,881	29,011
Investing activities	(401,344)	(32,555)
Financing activities (excluding dividends to shareholders)	322,782	110,167
Dividends paid to shareholders	(42,051)	(31,331)
Effect of exchange rate changes on cash and cash equivalents	(1,094)	–
Change in cash and cash equivalents	(70,826)	75,292

During 2011, Capstone's operating activities generated $21,870 higher cash from operating activities primarily because of the Bristol Water acquisition, which contributed $22,192 to operating activities. Capstone's power segment generated $17,691 higher cash flow in 2011, primarily due to the commencement of commercial operations at the Amherstburg facility. Corporate activities were $32,660 lower, due primarily to administrative expenses for internalization and business development.

Investing activities were $368,789 higher in 2011, primarily to support growth through business acquisitions and construction of the Amherstburg facility. During 2011, Capstone invested $173,989 ($213,476 purchase price less $39,487 of cash at Bristol Water on acquisition) to acquire a 70% interest in Bristol Water. Capstone also invested $109,146 ($24,318 in the form of common shares and $84,828 in the form of loans) to acquire a one-third interest in Värmevärden. Lastly, Capstone invested $94,635 in capital assets for the construction of the Amherstburg facility.

Financing activities were a net source of cash primarily due to a $249,200 increase in long-term debt, to finance the Bristol Water investment and to fund Amherstburg's construction. In addition, Capstone raised $150,175 through common and preferred share offerings. These financing sources were offset by $76,872 in debt repayments, and $71,625 from the common share offering to reduce the senior debt facility.

Capstone's dividends increased by $10,720, or 34.2%, during 2011 based on an increase in the number of shares outstanding following common share offerings in December 2010 and November 2011, as well as debenture conversions and increasing participation in Capstone's dividend reinvestment plan, which issues shares from treasury.

Capital Structure

Capstone considers shareholders' equity and long-term debt, both the current and non-current portion to be the basis of capital structure. Capstone measures capital structure strength through the capitalization ratio using the fair values of long-term debt and shareholders' equity. The following table shows Capstone's capitalization ratio using fair values compared to the ratio calculated using the carrying values reported in Capstone's consolidated financial statements:

	Dec 31, 2011		Dec 31, 2010	
($000s)	Fair Value	Carrying Value	Fair Value	Carrying Value
Long-term debt				
Power	314,196	308,513	245,911	246,777
Utilities – Water[(1)]	353,135	336,237	–	–
Corporate[(2)]	155,124	152,421	61,311	48,875
Deferred financing fees	–	(6,229)	–	(5,556)
	822,455	790,942	307,222	290,096
Equity				
Shareholders' equity[(3)(4)]	335,228	413,520	463,217	264,095
Class B exchangeable unit liability[(5)]	–	–	26,710	26,710
Convertible debentures – conversion option[(5)]	–	–	12,640	12,640
	335,228	413,520	502,567	303,445
Total capitalization	1,157,683	1,204,462	809,789	593,541
Debt to capitalization	71.0%	65.7%	37.9%	48.9%

(1) 70% of the long-term debt at Bristol Water has been included in the calculation to reflect the impact of the non-controlling interest and for consistency between periods (fair value = $504,479 x 70% = $353,135, carrying value = $480,339 x 70% = $336,237). The carrying value of shareholders' equity does not include the amount attributed to the non-controlling interest of $34,450.

(2) The fair value of Capstone's convertible debentures as at December 31, 2011 was based on a market price of $100 (December 31, 2010 – $115.2) and debentures outstanding of $42,749 (December 31, 2010 – $53,221) aggregate principal amount. The carrying value of the equity portion as at December 31, 2011 of Capstone's convertible debentures of $9,283 (December 31, 2010 – $12,640) was excluded from total debt and included as part of shareholders' equity.

(3) The fair value of shareholders' equity reflected the Corporation's market capitalization as at December 31, 2011 based on a share price of $3.81 (December 31, 2010 – $8.22) and common shares outstanding of 74,207 (December 31, 2010 – 56,352 common shares). Common shares outstanding include Class B exchangeable units of MPT LTC Holding LP, a subsidiary of Capstone, of which there were 3,249 outstanding at December 31, 2010, which were classified as a liability on the consolidated statements of financial position.

(4) Fair value of the preferred shares issued on December 31, 2011 was based on a share price of $17.50 and total shares outstanding of 3,000.

(5) The Class B exchangeable unit liability is treated as part of equity in the comparative figures based on its characteristics and for consistency between periods.

Power

The composition of the Power segment's long-term debt was as follows:

			Dec 31, 2011		Dec 31, 2010	
($000s)	Maturity	Interest Rate	**Fair Value**	**Carrying Value**	Fair Value	Carrying Value
CPC-Cardinal credit facility	2012	4.38%	**85,000**	**85,000**	85,000	85,000
Erie Shores project debt	2016, 2026	5.28 – 6.15%	**108,616**	**102,933**	106,197	107,063
Amherstburg Solar Park project debt	2016	7.32%	**94,267**	**94,267**	31,000	31,000
Levelization liability	2032	6.87%	**26,313**	**26,313**	23,714	23,714
			314,196	**308,513**	245,911	246,777

During 2011, long-term debt for the Power segment increased by $61,736 primarily due to a $63,267 increase in the Amherstburg project debt to finance capital expenditures to complete construction of the facility. Reduction of the Erie Shores facility was attributable to regular debt payments. The levelization liability increased by $2,599 primarily due to accrued interest because no payments were required in 2011 in accordance with the terms of the obligation.

With the exception of the CPC-Cardinal facility, which matures on June 29, 2012, each facility has over four years until maturity. Management is currently evaluating alternatives for refinancing the CPC-Cardinal obligation and expects to complete a refinancing prior to maturity.

Covenant compliance

With the exception of the levelization liability, each facility has financial covenant requirement obligations. The Erie Shores and Amherstburg facilities require the Corporation to maintain minimum debt service coverage ratios to allow for distributions. The CPC-Cardinal facility requires minimum interest coverage and maximum debt to EBITDA ratios to remain in compliance and determine the interest rate on the obligation. During 2011, Capstone operated in compliance with all covenants and expects to continue to do so in 2012.

Utilities – Water

The composition of the Utilities segment's long-term debt was as follows:

			Dec 31, 2011		Dec 31, 2010	
($000s)	Maturity	Interest Rate	**Fair Value**	**Carrying Value**	Fair Value	Carrying Value
Bank loans	2012 and 2017	1.43 – 1.52%	**39,662**	**38,956**	–	–
Term loans	2017 – 2041	5.73 – 8.64%(1)	**436,205**	**413,702**	–	–
Debentures	Irredeemable	3.50 – 4.25%	**2,125**	**2,008**	–	–
Cumulative preferred shares	Irredeemable	8.75%	**26,487**	**25,673**	–	–
			504,479	**480,339**	–	–

(1) The interest rate on certain term loans includes an index-linked component to RPI, which was 5% from acquisition to December 31, 2011.

The interest rate on certain term loans includes an index-linked component to RPI, which was 5% from acquisition to December 31, 2011.

Long-term debt for the Utilities-Water segment was used to fund current and ongoing capital expenditures to grow the water network. Each long-term debt balance matures beyond one year with the exception of a $23,699 of bank loan debt that matures in 2012. Existing undrawn credit facilities are sufficient to repay the mature bank loan. The preferred shares are included in long-term debt on the basis that they are irredeemable. All Bristol Water debt is non-recourse to Capstone.

Covenant compliance

As at December 31, 2011, all covenants for the Utilities-Water segment were in compliance.

Corporate

The composition of Capstone's corporate long-term debt was as follows:

			Dec 31, 2011		Dec 31, 2010	
($000s)	Maturity	Interest Rate	**Fair Value**	**Carrying Value**	Fair Value	Carrying Value
Senior debt facility	2012	4.70%	**78,375**	**78,375**	–	–
CPC–Cardinal credit facility	2012	3.78%	**34,000**	**34,000**	–	–
Convertible debentures	2016	6.50%	**42,749**	**40,046**	61,311	48,875
			155,124	**152,421**	61,311	48,875

During 2011, corporate long-term debt increased by $103,546 due to the new senior debt facility and the draw on the CPC-Cardinal credit facility. Both of these facilities increased to fund a portion of the Bristol Water acquisition. The reduction in the convertible debenture balance was attributable to conversions of 9,876 debentures with a carrying value of $10,472.

Of the $152,421 carrying value, 51.4% represents the senior debt facility that matures on October 3, 2012. Management is actively pursuing refinancing options and expects to complete a refinancing prior to maturity of the obligation.

Covenant compliance

The CPC-Cardinal facility covenants were discussed above under the Power segment. The senior debt facility restricts Capstone from funding Power segment operations from non-Power segment activities. During 2011, Capstone has operated in compliance with all covenants and expects to continue to do so in 2012.

Shareholders' Equity

Shareholders' equity is the core of Capstone's capital structure and is composed of the following:

($000s)	Dec 31, 2011	Dec 31, 2010
Common shares	626,861	536,278
Preferred shares	72,020	–
Class B exchangeable units	26,710	–
Equity portion of convertible debentures	9,284	–
Accumulated other comprehensive income	6,729	–
Retained earnings (deficit)	(314,626)	(272,183)
Equity to Capstone shareholders	413,520	264,095
Non–controlling interests	34,450	–
Total shareholders' equity	**447,970**	264,095

Capstone is authorized to issue an unlimited number of common shares as well as a number of preferred shares equal to 50% of the outstanding common shares. The change in common shares was as follows:

	2011		2010	
($000s and 000s of shares)	Shares	Amount	Units	Amount
Opening balance	56,362	536,278	46,665	466,662
Shares issued (1)(2)(3)	12,856	77,526	9,079	65,249
Conversion of convertible debentures (4)	1,496	11,819	611	4,390
Units redeemed	–	–	(3)	(23)
Dividend reinvestment plan (DRIP)(5)	253	1,238	–	–
Ending balance	**70,967**	**626,861**	56,352	536,278

(1) On December 22, 2010, Capstone completed a private placement of 9,079 shares at a price of $7.60 per share for gross proceeds of approximately $69,000 before issue costs of $3,751. The net proceeds were used by Capstone for acquisitions and for general purposes. During 2011, $102 of the private placement transaction costs were included in share capital.

(2) On April 15, 2011 the Corporation issued 856 common shares subscribed to by MGL as part of the management internalization at $8.18 per share for gross proceeds of approximately $7,000.

(3) On November 10, 2011, the Corporation issued 12,000 of common shares for net proceeds of $70,474 ($75,000 of gross proceeds less issue costs of $4,526.

(4) $11,819 (2010 – $4,390) of the convertible debentures were converted into shares of Capstone, which is net of transaction costs incurred to issue the convertible debentures.

(5) During 2011, 253 common shares at an aggregate value of $1,238 were issued by the Corporation under the Dividend Reinvestment Plan (DRIP).

On June 30, 2011, Capstone issued 3,000 cumulative 5-year rate reset preferred shares at a price of 25 dollars per share for gross proceeds of $75,000 before issue costs of $2,928.

As discussed on page 25 of this MD&A, the Class B exchangeable units were classified as debt prior to the corporate conversion in accordance with IFRS. Capstone has 3,249 Class B exchangeable units outstanding that were issued by a subsidiary entity at the time Leisureworld was acquired. The Class B exchangeable units are eligible to receive distributions under the same terms and conditions as shares of Capstone. Each Class B exchangeable unit may be converted at the option of the unitholders into one share of Capstone any time up to October 18, 2020.

Retained earnings (deficit) reflects the aggregation of Capstone's net income (loss) since formation of the Corporation less aggregate dividends paid to shareholders and aggregate distributions paid to Class B exchangeable unitholders.

Contractual Obligations

As at December 31, 2011, Capstone's outstanding contractual obligations are due in the following periods:

($000s)	Within one year	One year to five years	Beyond five years	Total
Long-term debt	230,899	166,394	546,683	943,976
Finance lease obligations	5,256	4,779	1,948	11,983
Operating leases	932	3,741	8,952	13,625
Asset retirement obligations	–	–	5,657	5,657
Purchase obligations	80,639	206,059	8,618	295,316
Total contractual obligations	317,726	380,973	571,858	1,270,557

Long-term Debt

Long-term debt is discussed as a part of the Capital Structure section on page 36 of this MD&A.

Leases

Cardinal leases the site on which the facility is located from Canada Starch Operating Company Inc. ("Casco"). Under the lease, Cardinal pays nominal rent. The lease extends to 2016 and expires concurrently with the energy savings agreement between Casco and Cardinal.

A subsidiary of Capstone has lease agreements with the Provinces of Ontario and British Columbia with respect to certain lands, lands under water and water rights necessary for the operation of its hydro power facilities. The payments with respect to these agreements vary based on actual power production. The terms of the lease agreements extend between 2023 and 2042.

Amherstburg leases the land on which its operating facilities are located. The terms of the lease agreements extend to 2032.

Erie Shores has lease and easement agreements with local landowners, municipalities and other parties with respect to certain lands for the operation of the wind farm. The terms of the lease agreements extend to 2025, with a 20-year renewal option.

During 2011, the Corporation entered into an operating lease for premise, which has a term to 2018 with an option to extend to 2023. Capstone also has finance leases for certain equipment and vehicles.

Asset Retirement Obligations

Commitments associated with our asset retirement obligations are expected to occur over the next 30 years for our power infrastructure facilities.

Purchase Obligations

Capstone enters into contractual commitments in the normal course of business. These contracts include electricity supply contracts, energy savings agreements, wood waste supply agreements, natural gas purchase contracts, operations and maintenance agreements, capital commitments and guarantees.

Energy Savings Agreement

Under the terms of an energy savings agreement between Cardinal and Casco, Cardinal is required to sell up to 723 million pounds of steam per year to Casco for its manufacturing operations. The energy savings agreement matures on December 31, 2014 but may be extended by up to two years at Cardinal's option.

Wood Waste Supply Agreement

Whitecourt has a long-term agreement with Millar Western to ensure an adequate supply of wood waste. The agreement expires in June 2016.

Gas Purchase Contract

Cardinal has a long-term purchase agreement for natural gas that expires on May 1, 2015. The minimum purchase commitment for natural gas under the agreement is 9,289,104 MMBtu per year through to expiration in 2015, which is equivalent to 80% of the contract maximum.

Operations and Management Agreements

Capstone has an O&M agreement with Regional Power OPCO Inc. ("Regional") to operate and maintain the hydro power facilities, expiring on November 15, 2016 with an automatic renewal term. Regional is paid a monthly management fee and is eligible for an annual incentive fee.

Capstone has an O&M agreement with SunPower Energy Systems Canada Corporation to operate and maintain the Amherstburg Solar Park, expiring on June 30, 2031. Capstone has the ability to terminate the agreement during the term of the contract.

Capstone has an O&M agreement with Agbar to provide management support to Bristol Water, with an initial five-year term, which automatically extends indefinitely. Capstone has the ability to terminate the contract.

Capital Commitments

Bristol Water has commitments for capital expenditures at December 31, 2011 contracted for but not provided of $29,396.

Guarantees

Capstone also provides three guarantees relating to Clean Power Income Fund's legacy obligations. As at December 31, 2011, no claims had been made on these guarantees.

There have been no other significant changes to the specified contractual obligations that are outside the ordinary course of business. Capstone is not engaged in any off-balance sheet financing transactions.

Equity Accounted Investments

See discussion in the results of operations on page 34 of this MD&A for detailed discussion on Capstone's equity accounted investments in Värmevärden and MLTCLP.

For Capstone's equity interest in Chapais Électrique Limitée ("CHEL"), the general partner in the Chapais investment, no income has been recorded on the investment since its acquisition in 2007. Capstone does not expect to earn any future equity accounted income from this investment.

Capital Expenditure Program

Capstone invested $111,051 in capital expenditures during the year. Below is the breakdown of the investment by operating segment:

($000s)	2011	2010
Power	87,451	37,410
Utilities – Water	22,962	–
Corporate	638	–
	111,051	37,410

Capital expenditures for the Power segment in both 2011 and 2010 related primarily to the construction of the Amherstburg facility. For the Utilities – Water segment, expenditures include both growth and maintenance initiatives as outlined in Bristol Water's regulatory capital expenditures program. In aggregate, Bristol Water's capital expenditure program spans the five-year Asset Management Plan ("AMP") period. Overall, Bristol Water's program is behind the schedule of the five-year plan, but is expected to catch up to the target.

Retirement Benefit Surplus

($000s)	
Fair value of assets	267,114
Present value of defined benefit obligation	(207,010)
	60,104

Capstone's 70% owned subsidiary, Bristol Water, has a defined benefit retirement plan for the current and former employees of Bristol Water. The defined benefit retirement plan is closed to new employees of Bristol Water. New employees are allowed to join the defined contribution plan.

Bristol Water expects to make employer contributions of $3,729 during 2012 to the defined benefit retirement plan.

As at December 31, 2011, the defined benefit retirement plan is in a surplus position in accordance with IFRS. The surplus is subject to a number of critical accounting estimates, which can materially impact the balances; refer to page 52 of this MD&A for further details. The fair values included in the surplus are calculated with the assistance of an actuary and assumptions used are considered to be reasonable by management.

Loans Payable

In March 2010, Capstone divested its interest in Leisureworld, held by MLTCLP, in which Capstone held an approximate 45% interest. Capstone received its proportionate share of the initial net cash proceeds from MLTCLP in the form of a loan payable for $49,200, which increased by $5,466 on March 23, 2011 when the final holdback conditions were satisfied. In September 2011, the loans were settled by way of a non-cash distribution from MLTCLP.

Deferred Income Taxes

Deferred income tax assets and liabilities are recognized on Capstone's consolidated statement of financial position based on temporary differences between the accounting and tax bases of existing assets and liabilities. Capstone had the following deferred income tax balances:

($000s)	Dec 31, 2011	Dec 31, 2010	Jan 1, 2010
Deferred income tax assets	32,897	24,211	18,443
Deferred income tax liabilities	(178,201)	(105,251)	(135,323)
	(145,304)	(81,040)	(116,880)

The reduction in the deferred income tax asset and liability balances was primarily attributable to using the general corporate income tax rate of 25% as at December 31, 2011 and the undistributed income tax rate of 46% as at December 31, 2010 when Capstone operated as a mutual fund trust.

The following table summarizes Capstone's tax loss carry-forwards recognized and unrecognized as part of the deferred income tax assets:

($000s)	Recognized	Unrecognized	Total
Canadian – capital losses	–	70,557	70,557
Canadian – non-capital losses	6,092	31,960	38,052
US – non-capital losses	–	17,942	17,942
UK – capital losses	–	4,681	4,681
UK – advanced corporation tax	–	6,196	6,196
	6,092	131,336	137,428

During 2011, Capstone used $19,366 of net capital loss carry-forwards to offset capital gains arising from the MLTCLP non-cash distribution.

During 2011, Capstone reported a net income tax recovery of $35,758, consisting of $35,945 of deferred income taxes and $187 of current income tax expense. The current tax expense is primarily from Bristol Water.

The recovery included a $34,808 reduction in the deferred income tax liability following conversion to a corporation on January 1, 2011. Included in deferred income taxes was $2,514 for Bristol Water's future tax effects. The primary impacts relate to timing differences between depreciation and tax amortization of tangible and intangible assets and pension deductions.

In 2010, the income tax recovery included a $10,722 reduction in the deferred income tax liability attributable to the sale of Capstone's investment in Leisureworld. The remaining deferred income tax recovery was attributable to fluctuations in the fair value adjustments in financial instruments and differences between depreciation and capital cost allowance.

DERIVATIVE FINANCIAL INSTRUMENTS

Capstone has exposure to market risk, credit risk and liquidity risk from its use of financial instruments. Refer to Note 11 (Financial Instruments) and 12 (Financial Risk Management) in the consolidated financial statements for the year ended December 31, 2011. These notes contain further detail on the risks implicit and valuation methodology employed, related to Capstone's financial instruments.

To manage the risks inherent to the business, Capstone enters into derivative contracts to mitigate the economic impact of the fluctuations in interest rates, the price of natural gas and foreign exchange rates.

Financial instruments are required to be measured at fair value on initial recognition. Changes in the fair values of derivative financial instruments are reported in the consolidated statement of income for the year ended December 31, 2011, except for cash flow hedges that meet the conditions for hedge accounting. The portion of the gain or loss on the hedging instruments that is determined to be an effective hedge is recognized directly in other comprehensive income, and the ineffective portion in the income statement. The gains or losses deferred in other comprehensive income in this way are subsequently recognized in the statement of income in the same period in which the hedged underlying transaction or firm commitment is recognized in the statement of income.

The fair value of these contracts, as reported on Capstone's consolidated statements of financial position was:

($000s)	**Dec 31, 2011**	Dec 31, 2010	Jan 1, 2010
Derivative contract assets	**3,144**	8,497	16,502
Derivative contract liabilities	**(34,143)**	(17,306)	(7,453)
Net derivative contract assets (liabilities)	**(30,999)**	(8,809)	9,049

The change in the net derivative contract assets (liabilities) is directly related to the change in fair value during the year. The composition of derivative contracts in 2011 is consistent with 2010 except for entering two foreign currency contracts. These contracts are to mitigate the effect of currency movements on interest payments from Värmevärden and dividends from Bristol Water. Additionally the gas swap contract expired in 2011.

The unrealized gain (loss) on derivatives on the consolidated statements of income and comprehensive income was:

	For the year ended	
($000s)	**Dec 31, 2011**	Dec 31, 2010
Interest rate swap contracts	**(8,128)**	(4,794)
Gas swap contracts	**(1,918)**	(213)
Foreign currency option contracts	**(644)**	–
Embedded derivative contracts	**(11,052)**	(12,851)
Unrealized loss on derivatives in net loss	**(21,742)**	(17,858)
Interest rate swap contracts – classified as cash flow hedges	**(60)**	–
Unrealized loss on derivatives in total comprehensive income loss	**(21,802)**	(17,858)

The unrealized losses on derivatives in 2011 were primarily attributable to the interest rate swaps, embedded derivatives and gas swaps. On June 23, 2010, Capstone entered into an interest rate swap contract for the Amherstburg debt. This contributed $7,256 to the loss during 2011. The decrease in the fair value of the interest rate swaps was primarily due to a decrease in the long-term interest rates.

Falling natural gas spot and forward prices, as determined at a regional gas interconnection, storage and trading hub in southwest Ontario (the Union Gas Dawn facility), are the primary source of the embedded derivative loss.

The gas swap contracts value is lower as the contract expired in October 2011.

RISKS AND UNCERTAINTIES

Capstone is subject to a variety of risks and uncertainties that could have an adverse impact on our businesses, operating results and financial condition, which could adversely affect our ability to pay dividends to shareholders.

This section addresses some, but not all, risk factors that could affect our future results. For a more comprehensive description of these and other possible risks, please refer to the "Risk Factor" section of the Corporation's most recently-filed annual information form, as supplemented by risk factors contained in any annual information forms, material change reports (except confidential material change reports), business acquisition reports, interim financial statements, interim management's discussion and analysis and information circulars filed by the Corporation with securities commissions or similar authorities in Canada after the date of this annual MD&A, which is available on the SEDAR website at www.sedar.com.

Capstone periodically updates these risks through Quarterly Financial Reports, the Annual Information Form and other filings with the Canadian securities regulatory authorities. These filings are available on SEDAR at www.sedar.com.

Risk Management Processes

Management and the Board of Directors responsibly manage the risks that Capstone is subject to by:

- Identifying internal and external risk exposures;
- Evaluating risks to determine frequency and potential financial, regulatory or reputational impact;
- Developing a risk management strategy;
- Implementing policies and procedures for managing risk;
- Monitoring and testing compliance;
- Reporting exceptions as necessary, remedying them and taking steps to prevent the risk of re-occurrence;
- Maintaining systems and records to ensure the ongoing integrity of the process; and
- Reviewing annually controls for completeness and effectiveness.

We seek to reduce the likelihood of material risk events from impacting Capstone and to reduce the significance of the consequence if an event occurs. Our risk controls include governance policies and procedures that apply equally to the individual businesses within the portfolio, which ensures consistency and reliability in risk management and reporting. Employees are trained in respect of the policies and procedures to be followed and compliance with applicable regulations, policies and procedures is regularly reviewed. Our Code of Ethics defines ethical business conduct and must be followed by all directors, officers, employees, contractors and agents of Capstone.

In addition, each of our businesses completes an annual operational risk self-assessment, which applies a formal process to identifying, ranking, mitigating and monitoring risks. Over time, such processes lead to continuous improvement of controls, which results in lower residual risk.

Capstone initiated an enterprise risk management initiative, which will align our planning, risk management and newly established internal audit processes to reflect risk management principles outlined in the International Standards Organization ("ISO") 31000 risk management standard.

Risk Factors

Capstone groups risk exposures into four categories: strategic, financial, operational and regulatory and legal. Each category has risk subcategories which contain risk factors specific to Capstone's business. Capstone's risk management process includes periodically reviewing and updating risks subcategories and risk factors to determine the appropriate emphasis for risk management and mitigation.

There are other risks and uncertainties that may affect Capstone's performance and ability to achieve its objectives that are not currently known to Capstone, or which may be immaterial.

For each risk category, Capstone tracks and manages various specific risk factors. The following risk statements are based on a variety of factors and assumptions. Risk assessment and mitigation assumptions are based on information currently available to Capstone including information provided by third-party sources. Actual risk mitigation results may vary depending on changing circumstances and other contributing factors which may influence overall risk exposure.

Strategic Risk

Power Purchase Agreements (PPAs) – Power businesses

Capstone sells most of the power generated by its facilities to large utilities or creditworthy customers under PPAs that provide a specified rate for a defined period of time. Additionally, excess power may be sold by some of the facilities in the open market, where prices can vary. As the facilities' PPAs expire, Capstone may not be able to renegotiate or enter into new PPAs, or to do so on commercially reasonable terms. If we sell the power produced by the facilities on the open market, the market price may not always exceed the marginal cost of operations. Capstone mitigates these risks by maintaining its facilities in excellent operating condition, thereby sustaining or extending useful lives, and by maintaining strong relationships with counterparties and other stakeholders.

Geographic concentration and non-diversification – Power businesses

The Power segment derives 81% (82% in 2010) of its Adjusted EBITDA from facilities (Cardinal, Erie Shores and Amherstburg along with the Wawatay and Dryden hydro power facilities) that are located in Ontario. This concentration means that Capstone could be exposed to local or regional economic conditions or an adverse change in the regulatory environment in Ontario. This risk is partially mitigated by Capstone's power facilities in Alberta and British Columbia, along with the Swedish district heating business and Bristol Water.

Geographic concentration – Water business

Bristol Water's operations only service the Bristol area of the UK. If the Bristol market was to generally experience a severe decline in financial performance as a result of changes in local or regional economic conditions or an adverse change to the regulatory environment, the market value of Bristol Water, the income generated from its operations and the overall financial performance of the Corporation could be negatively affected.

Seasonality and climate change – Water business

Although there is little seasonal variation in demand, the proportion of water used from each type of Bristol Water's sources of water varies on a daily and seasonal basis according to the availability of water, the relative costs and other operational constraints. Additionally, the quantity of treated water supplies fluctuates owing to a variety of seasonal factors, such as dry weather and burst pipes due to freeze/thaw cycles affecting the ground during winter months. In addition, climate or weather pattern changes may adversely affect the availability of water resources or demand by customers.

Assumption of liabilities – Water business

In connection with the acquisition of Bristol Water, there may be liabilities that the Corporation failed to discover or did not appropriately quantify during the due diligence process that occurred prior to the closing of the transaction. As a result, the Corporation may not be fully indemnified for some or all of these liabilities. Any such liabilities could materially and adversely affect Bristol Water's financial performance and future prospects.

Geographic concentration – District heating business

All of Värmevärden's heat production facilities and distribution networks are located in Sweden. This concentration means that Värmevärden could be exposed to local or regional economic conditions or an adverse change in the regulatory environment in Sweden. Additionally, since many of the district heating facilities primarily service specific municipalities, a decline in the populations of such municipalities could materially and adversely affect Värmevärden's business, operating results, financial condition and cash flow.

Financial Risk

Fuel costs and supply – Power businesses

Cardinal's natural gas supply is contracted under a long-term gas purchase agreement. When this agreement expires on May 1, 2015, it will either be renegotiated or a new gas supply agreement will be arranged. This may not be possible to do on comparable terms, resulting in gas purchases at the market price.

Cardinal's ability to produce power could also be affected if the transportation of gas to the facility is disrupted. In addition, further increases in the gas transportation rate, which is regulated by the National Energy Board, could result in higher operating costs and a significant reduction in Capstone's cash flow.

From time to time, Cardinal sells excess natural gas it does not need for its operations. Gas price fluctuations are managed through gas swap agreements that could expose us to losses in certain circumstances, such as the counterparty defaulting on its obligations under the agreements.

Whitecourt and Chapais have long-term contracts with substantial forest products companies to provide a majority of the facilities' wood waste fuel. As these fuel supply agreements expire, Capstone must either renegotiate them, enter into new fuel supply agreements, although this may not be possible on similar terms, or buy wood waste at the market price. The performance of Whitecourt and Chapais could be affected if the fuel supply is interrupted or if there is an increase in costs to transport the fuel to the facilities. There can be no assurance as to the supply or price of wood waste available on the open market when our agreements expire.

The wind and hydro power facilities have no fuel costs but rely on the availability of wind and water resources, which could vary with weather conditions. For Amherstburg, performance relies on the availability and intensity of solar radiation.

Capstone manages fuel costs and supply risks by ensuring that a majority of fuel is secured under long-term contract and by diversifying the portfolio by asset type, geography and location to limit exposure to any one type or source of fuel.

Credit agreements – Power businesses

Capstone's credit agreements contain a number of standard financial and other covenants. A failure by CPC, Cardinal, Erie Shores or Amherstburg to comply with these obligations could result in a default, which, if not cured or waived, could result in the termination of dividends and permit acceleration of the relevant indebtedness. There can be no assurance that the assets of Cardinal, CPC, Erie Shores or Amherstburg would be sufficient to repay that indebtedness, or that sufficient cash flow will be generated to pay outstanding indebtedness or to fund other liquidity needs. In addition, there can be no assurance Capstone could refinance credit agreements or obtain additional financing on commercially reasonable terms. Borrowing under Capstone's credit agreement may be at variable rates of interest, which exposes us to the risk of increased interest rates. Capstone mitigates these risks by monitoring and managing potential liquidity requirements, preparing and monitoring long-term financing plans to reflect changes in business plans and market conditions, and maintaining a capital structure that matches the long-term cash flow profile of our businesses.

Foreign exchange risk – Water Business
Through its investment in Bristol Water, the Corporation is exposed to foreign exchange risk through exchange rate movements attributable to future cash flows (transaction exposure) and in the revaluation of net assets in foreign subsidiaries (translation or balance sheet exposure) as the revenue generated by Bristol Water and its assets is denominated in pounds sterling. As a result, fluctuations in the Canadian dollar and pounds sterling could materially affect the performance of the Corporation's investment in Bristol Water. The Corporation's foreign exchange hedging policy seeks to reduce foreign exchange risk by selecting an appropriate hedging strategy that accounts for hedging costs and tax implications. However, an imperfect hedging arrangement could expose the Corporation to losses under various circumstances.

Default under Bristol Water's artesian loans, bonds, debentures and credit facility – Water business
A portion of Bristol Water's cash flow is devoted to servicing its debt. There can be no assurance that Bristol Water will continue to generate sufficient cash flow from operations to meet the required interest and principal payments on its Artesian loans, bonds, debentures or drawings under its credit facility. If Bristol Water were unable to meet such interest or principal payments, it could be required to seek renegotiation of such payments or obtain additional equity, debt or other financing. If this were to occur, it could have an impact upon the business, operating results and financial condition of Bristol Water, which could adversely affect the Corporation's results and its ability to pay dividends on its common shares. In addition, the Artesian loans, bonds, debentures and Bristol Water's credit facility contain a number of customary financial and other covenants. A failure by Bristol Water to comply with its obligations under these instruments could result in a default, which, if not cured or waived, could result in the termination of dividends by Bristol Water and permit acceleration of the relevant indebtedness and a possible sale of Bristol Water by its lenders pursuant to their security rights in relation to the Artesian loans and/or bonds. Such a default could have an impact upon the business, operating results and financial condition of Bristol Water, which could adversely affect the Corporation's results and its ability to pay dividends on its common shares.

Economic environment, inflation and capital market conditions – Water business
In recent years, the global financial crisis and economic downturn have impacted the bank lending environment as well as the debt and equity capital markets. As a result, the financing arrangements available to Bristol Water are potentially more expensive and difficult to secure. Another challenge arises from the relationship between the RCV of Bristol Water and the retail price index ("RPI"). The RCV is adjusted annually for inflation so, if RPI decreases, the RCV would be adjusted downward to reflect this. This may lead to pressure on leverage and other key financial ratios, which may have an adverse impact on the credit ratings of Bristol Water, and increase the cost or limit the availability of credit. In the extreme, Bristol Water may be required to increase its equity base by either reducing its dividend payments or raising new equity capital. The global economic environment continues to present difficult trading and financing conditions for customers, contractors and suppliers of materials and/or services to Bristol Water. The movement of the Construction Price Index ("COPI") relative to RPI will influence the calculation of RCV at the next price review. If the COPI decreases relative to RPI, then the initial RCV at the start of the next regulatory period will be lower, potentially adversely impacting financial leverage. Given the significant investments Bristol Water is set to undertake over the remainder of AMP5, it will have to be mindful of any such movement relative to RPI in the determination of dividends.

Pension plan obligations – Water business
Bristol Water operates both defined benefit and defined contribution pension arrangements. Pension arrangements for Bristol Water's employees are partly provided through Bristol Water's membership in the Water Companies' Pension Scheme ("WCPS"), which provides defined benefits based on final pensionable pay. Bristol Water's pension assets and liabilities are managed within a separate section of WCPS. Bristol Water's section was closed to new employees in 2002. Since that closure, all new employees are offered membership in a stakeholder pension plan outside of the WCPS. Estimates of the amount and timing of future funding for Bristol Water's defined benefits plan are based on various actuarial assumptions and other factors including, among other things, the actual and projected market performance of the plan assets, future long-term bond yields, average life expectancies and relevant legal requirements. The impact of these assumptions and other factors may require Bristol Water to make additional contributions to its pension plan, which, to the extent they are not recoverable under the regulatory price determination process, could materially adversely affect Bristol Water's results of operations and financial condition.

Foreign exchange risk – District heating business
Through its investment in Värmevärden, the Corporation is exposed to foreign exchange risk through exchange rate movements attributable to future cash flows (interest payments and dividends) and in the revaluation of loans receivable denominated in Swedish Kronor. As a result, fluctuations in the Canadian dollar and the Swedish Krona could materially affect the performance of the Corporation's investment in Värmevärden. The Corporation has implemented a foreign exchange hedge to reduce foreign exchange risk taking hedging costs and tax implications into consideration. However, an imperfect hedging arrangement could expose the Corporation to losses under various circumstances.

Fuel costs and availability – District heating business
Värmevärden purchases most of its fuel on a rolling basis and is therefore exposed to market price fluctuations. Although Värmevärden has the ability to pass on fuel price increases on an annual basis to its customers, this ability is limited in the short term. Additionally, price increases may make alternative heating technologies, such as pellet boilers and geothermal pumps, more competitive with the district heating service provided by Värmevärden. In addition, Värmevärden could be materially and negatively affected if the supply of fuel, particularly biomass, which comprises a majority of its fuel mixture, is interrupted or if there is an increase in the costs to transport the fuel to the district heating facilities. There can be no assurance as to the supply or price of fuel (or alternative fuel sources) available on the open market.

Industrial and residential contracts – District heating business
Värmevärden has entered into a number of contracts with large industrial consumers for the supply of heat and/or steam that account for a material amount of Värmevärden's total revenue. Certain of the contracts also include termination and/or buyback options. Värmevärden enjoys a relatively stable base of residential customers as a result of the large majority of the Swedish population residing in multi-unit residential buildings, the majority of which derive their heat from district heating operations. However, residential customers are able to cancel their contracts with Värmevärden at any time upon short notice. As its industrial and residential contracts expire, there is a risk that Värmevärden may not be able to renegotiate or enter into new contracts or do so on commercially reasonable terms.

Default under Värmevärden bonds – District heating business
A portion of Värmevärden's cash flow is devoted to servicing its debt and there can be no assurance that Värmevärden will continue to generate sufficient cash flow from operations to meet the required interest and principal payments the Värmevärden Bonds. If Värmevärden were unable to meet such interest or principal payments, it could be required to seek renegotiation of such payments or obtain additional equity, debt or other financing. If this were to occur, it could have an impact upon the business, operating results and financial condition of Värmevärden which could adversely affect the Corporation's results and its ability to pay dividends on its shares. As well, the Värmevärden Bonds contain a number of customary financial and other covenants and a failure by Värmevärden to comply with its obligations under these instruments could result in a default, which, if not cured or waived, could result in the termination of dividends by Värmevärden and permit acceleration of the relevant indebtedness and a possible sale of Värmevärden by its lenders pursuant to their security rights. Such a default could have an impact upon the business, operating results and financial condition of Värmevärden, which could adversely affect the Corporation's results and its ability to pay dividends to its securityholders.

Operational Risk

Reliance on key personnel – The Corporation
The success of Capstone and its businesses depends heavily on its ability to attract, retain and motivate key employees, including senior management. If a business loses the services of some or all of its key executives and cannot replace them in a timely manner, the business's ability to develop and pursue its business strategy may be adversely affected, which could materially and negatively affect the business, operating results, financial condition and cash flow.

Operational performance – Power businesses
Revenue from the power facilities depends on the amount of electricity each facility generates. The ability of each facility to generate electricity could be affected by premature wear or failure, defects in design, material or workmanship, or longer than anticipated downtime for maintenance and repair.

Capstone manages these risks by:

- Operating the facilities within defined and proven operating standards;
- Performing regular and comprehensive routine and preventive maintenance; and
- Employing technologies that are proven.

Additionally, the operational performance of Erie Shores, the hydro power facilities and Amherstburg is dependent upon wind speeds and density, water flows, and solar insolation, respectively.

Technology risk – Power businesses
The performance of Amherstburg could be affected if the solar modules fail to perform as expected, or by premature wear or failure due to defects in design, material or workmanship. It is possible that Amherstburg may not operate as planned and that design or manufacturing flaws could occur that are not covered by warranty. In addition, mechanical breakdown could occur in equipment after the period of warranty has expired, resulting in loss of production as well as the cost of repair.

This technology risk is mitigated by a fixed-price EPC contract, under which SunPower will provide a two-year warranty for Amherstburg following the start of commercial operations. There are also manufacturers' warranties on specific components, including a 25-year warranty on the photovoltaic panels and 10 years on the inverters. In addition, for the first two years of commercial operations, SunPower will provide a weather-adjusted performance guarantee.

Capital investment programs – Water business
Bristol Water's regulated business requires significant capital expenditures, including investment in new or replacement water distribution networks and treatment facilities. Historically, Bristol Water has financed these capital expenditures using operating cash flows, external debt, an issue of irredeemable preference shares and retained profits. If operating cash flows decline or external debt financing and other sources of capital are not available or at a similar

cost to that assumed by Ofwat, Bristol Water may not be able to meet future capital expenditure requirements. The delivery of capital investment programs could also be affected by a number of other factors, including adverse legacy effects of earlier capital investments, such as increased maintenance or enhancement costs, and the failure to adequately deliver specified outputs or amounts funded in regulatory capital investment programs proving insufficient to meet the actual amount required. This may affect Bristol Water's ability to meet regulatory and other environmental performance standards, which may result in Bristol Water's regulators imposing sanctions, including fines of an amount of up to 10% of its revenue for each infringement.

Operational risks – Water business

Bristol Water controls and operates a water network and maintains the associated assets with the objective of providing a continuous service. Bristol Water faces a number of risks in its operations that could have an adverse impact on its business, operating costs and results, future profitability, and financial condition. These risks include:

- A significant interruption of service or catastrophic damage, which could result in significant loss of life, environmental damage, or economic and social disruption. These circumstances could arise in a variety of ways, including: energy shortages; the failure of an asset or an element of a network or supporting plant and equipment; human error; unavailability of access to critical sites or key staff; malicious intervention; failure by a supplier; labour disputes; pollution or contamination; or naturally occurring events. In these circumstances, Bristol Water could be fined for breaches of statutory obligations or held liable to third parties, or be required to provide an alternative water supply of equivalent quality. Insurance coverage may be inadequate or unobtainable;
- Dependence upon access to and use of remote communication via electronic software applications mounted upon corporate information technology hardware and communicating through internal and external networks. The ownership, maintenance and recovery of such applications, hardware and networks are not wholly under Bristol Water's control;
- Limited control over future energy or chemical costs, abstraction charges, levels of customer bad debt or taxes;
- Debt collection costs and bad debt write-offs, as domestic customers cannot be disconnected from their supply for failure to pay their bill. An allowance for bad debts is included when Ofwat sets price limits; and
- Dependence upon suitable weather conditions supplying raw water as inflow for its abstraction points. Bristol Water has a drought contingency plan in place should there be a lack of such rainfall.

Labour relations – Water business

Approximately 33% of Bristol Water's employees are represented by unions. While Bristol Water has traditionally maintained positive labour relations, there can be no assurance that it will not, either in connection with a renegotiation process or otherwise, experience strikes, labour stoppages or any other type of conflict with unions or employees in the future.

Labour relations – District heating business

A portion of Värmevärden's employees are represented by unions. While Värmevärden has traditionally maintained positive labour relations, there can be no assurance that it will not in the future, whether in connection with a renegotiation process or otherwise, experience strikes, labour stoppages or any other type of conflict with unions or employees which could materially and adversely affect Värmevärden's business, operating results, financial condition and cash flow. Such risks may be mitigated by Swedish legislation that prohibits labour disruptions in the provision of essential services such as district heating.

Operational risks – District heating business

The financial performance of Värmevärden depends in part on its ability to successfully operate its district heating facilities. The cost of operations and maintenance and the operating performance of a district heating facility may be adversely affected by a number of factors that could significantly increase expenses or reduce overall generating capacity and reduce or eliminate revenues generated by a district heating facility. These factors include but not limited to:

- regular and unexpected maintenance and replacement expenditures;
- shutdowns due to the breakdown or failure of the facility's equipment or the equipment of the distribution system;
- operator error;
- labour disputes;
- catastrophic events such as fires, explosions, earthquakes, landslides, floods, releases of hazardous materials, severe storms, or similar occurrence affecting a district heating facility, the heating distribution system, any district heating customers or third parties providing services or waste heating to a district heating facility; and
- the aging of district heating facilities, which may reduce their operating performance and increase their cost of maintenance.

Legal and Regulatory Risk

Contract performance – Power businesses

Capstone's ability to pay dividends to shareholders depends in part on our customers, suppliers and other parties fulfilling their contractual obligations, including the OEFC and OPA under various PPAs, Husky Marketing under Cardinal's gas purchase agreement and Millar Western under its wood waste supply agreement for Whitecourt. The ability of Amherstburg to generate cash flow depends on the ability of the OPA and SunPower to fulfill their contractual obligations.

Land tenure and related rights – Power businesses
Our facilities' operations depend on various land tenure and resource access rights. If any of these rights are successfully challenged, or if they cannot be renewed or renegotiated on acceptable and commercially reasonable terms upon expiry, the affected facility will likely be unable to continue to operate. In these circumstances, there can be no assurance that we will have or be able to obtain the necessary financial resources to pay for required restoration and remediation works.

Regulatory regime and permits – Power businesses
The power facilities are highly regulated and must abide by the relevant market rules as administered by the system operators in each local jurisdiction. The performance of our facilities depends in part on a favourable regulatory climate and on our ability to obtain, maintain, or renew all necessary licences, permits or government approvals. While Capstone is currently compliant with all regulatory requirements, significant expense could be incurred to achieve or maintain compliance with any new laws or regulations that are introduced. If Capstone is unable to comply with applicable regulations and standards, the Corporation could become subject to claims, costs or enforcement actions.

The following summarizes key regulatory considerations for each of our facilities:

Facility	Regulatory Consideration
Cardinal	▸ Subject to environmental regulations, including greenhouse gas emissions ("GHG") emission standards and/or approvals related to operations
Erie Shores	▸ Subject to regulations and/or approvals related to birds, mammals and other animals, and to sound
Hydro Power Facilities	▸ Water rights are generally owned by governments and government agencies reserve the right to control water levels and to change or impose new dam safety regulations
Whitecourt	▸ Subject to environmental regulations, including GHG emission standards and/or approvals related to operations, including biomass supply and wood ash disposal
Amherstburg	▸ Subject to regulations and approvals related to land use, wildlife and wildlife habitat, and to sound

Capstone mitigates these risks by developing and adhering to compliance plans and by participating in industry groups to remain abreast of evolving issues or requirements. In addition, each facility completes an annual operational risk self-assessment, which applies a formal process to identifying, ranking, mitigating and monitoring risks.

Environmental, health and safety – Power businesses
The power facilities are subject to a complex and increasingly stringent environmental, health and safety regulatory regime, which includes environmental, health and safety laws. The operation of the facilities carries an inherent risk of environmental, health and safety liabilities (including potential civil actions, compliance or remediation orders, fines and other penalties). To Capstone's knowledge, none of our businesses have been notified of any such civil or regulatory action in regard to their operations.

The following presents the primary potential environmental risks to our businesses:

Facility	Primary Environmental Risks
Cardinal	▸ Air quality and emissions issues ▸ Soil contamination resulting from oil spills ▸ Issues related to the storage and handling of chemicals used in normal operations
Erie Shores	▸ Potential harm to the local migratory bird population ▸ Harm to the local bat population ▸ Sound levels from wind turbines ▸ Impact on scenic environment around the facility
Hydro Power Facilities	▸ Dam failure, which results in flooding ▸ Equipment failure that results in oil or other lubricants being spilled into the waterway ▸ Water flow issues that impact fish population, water quality and potential increases in soil erosion around a dam facility
Whitecourt and Chapais	▸ Air quality and emissions issues ▸ Soil contamination resulting from oil spills ▸ Issues related to the storage and handling of chemicals used in normal operations ▸ Issues related to the storage of wood waste fuel on-site ▸ Issues related to the disposal of fly ash
Amherstburg	▸ Sound levels of the facility's electrical equipment ▸ Impacts to local plants, wildlife and wildlife habitat

Changes in environmental, health and safety laws, or more aggressive enforcement of existing laws, could lead to material increases in unanticipated liabilities or expenditures for investigation, assessment, remediation or prevention, capital expenditures, restrictions or disruptions in operations.

These risks are mitigated by:

- Following generally accepted industry practices to prevent and minimize any potential negative impact on the environment and health and safety;
- Completing regular facility inspections to monitor and mitigate the above risks, and ensuring that each facility is in compliance with its regulatory requirements;
- Working continuously with all employees to foster a progressive safety culture within all operations; and
- Establishing safety committees at each facility and appointing dedicated staff to ensure existing safety programs are continuously improved.

Influence of Ofwat's price determinations on revenue – Water business

Bristol Water operates in an industry that is substantially influenced by the service levels, regulatory targets and periodic price determinations set by its economic regulator Ofwat, as well as Ofwat's assessment of its delivery against these targets. Under the terms of Bristol Water's Instrument of Appointment, Ofwat is required to review Bristol Water's price limits periodically (currently every five years). Ofwat's price determinations, which limit the prices Bristol Water can charge its customers, may be appealed to the Competition Commission ("CC"). The price limits were last reviewed and reset by Ofwat in 2009 for the five-year period from April 2010 ("AMP5") and, following the rejection by Bristol Water, were subsequently amended by the CC. The conditions of Bristol Water's Instrument of Appointment can be modified by Ofwat either with Bristol Water's agreement, or following reference to the CC, on public interest grounds. Implicit within the most recent price limits set by Ofwat (as amended by the CC) are assumptions concerning Bristol Water's future operating expenditures and the achievement of operating cost savings. The failure to achieve these efficiencies may be reflected in less favourable outcomes in future profitability and cash flows or in Ofwat's future price determinations.

Water leakage – Water businesses

Bristol Water is required to meet an annual target for water leakage. If Bristol Water does not achieve this target by a significant margin in any one year or by a small margin over a number of years, Ofwat may impose a fine or a reduced revenue allowance at the next price-setting review. In addition, if performance were to decline, Bristol Water may incur additional operating or capital expenditure to restore performance.

Introduction of a Service Incentive Mechanism and the serviceability assessment – Water business

For the 2010-2015 period, Ofwat introduced the SIM, a new comparative incentive mechanism to reward or penalize water companies' service performance. The SIM, which replaced the Overall Performance Assessment, compares companies' quality of customer service. The SIM comprises both a quantitative measure of complaints and unwanted contacts, and a qualitative measure, based on survey evidence, that looks at how satisfied customers are with the quality of service that they receive. The SIM will be measured over the period 2011/12 to 2013/14. Depending upon Bristol Water's relative performance under the SIM, it could receive a reduced or increased revenue allowance when price limits are next reset in November 2014. Bristol Water is required to maintain the serviceability of its water assets, ensuring they continue to deliver a level of service and performance at least as good as in the past. Where serviceability falls below required reference levels of performance, Ofwat may impose a reduced revenue allowance at the next price-setting review. In addition, if performance were to decline, Bristol Water may incur additional operating or capital expenditure to restore performance.

Legal and regulatory risks – Water business

Bristol Water is subject to various laws and regulations of the UK and the EU. Regulatory authorities may, from time to time, make enquiries of companies within their jurisdiction regarding compliance with regulations. In addition to regulatory compliance proceedings, Bristol Water could become involved in a range of third-party proceedings related to, for example, land use, environmental protection, and water quality. These proceedings may include civil actions by third parties for infringement of rights, nuisance claims or other matters or criminal liability. Furthermore, it is difficult to predict the impact of future changes in laws or regulations or the introduction of new laws or regulations that affect the business. In addition, the interpretation of existing laws or regulations may also change over time, or the approach to their enforcement may become more rigorous. The UK Government released a White Paper in 2011, that may result in new legislation, including in relation to water charging, Ofwat and increased competition. If Bristol Water fails to comply with applicable law or regulations, in particular in relation to its Instrument of Appointment, or has not successfully undertaken corrective action, regulatory action could be taken. This regulatory action could include a financial penalty (of up to 10% of relevant revenue for each infringement) or an enforcement order requiring Bristol Water to incur additional capital or operating expenditure to remedy its non-compliance. In extreme cases, non-compliance may lead to revocation of Bristol Water's Instrument of Appointment or the appointment of an administrator to manage the affairs, business and property of Bristol Water.

Special administration – Water business

The UK Water Industry Act ("WIA") contains provisions enabling the Secretary of State for Ofwat (with the permission of the Secretary of State) to secure the general continuity of water supply by petitioning the UK High Court for the appointment of a Special Administrator in certain circumstances. Examples of such circumstances include a situation where Bristol Water is in breach of its principal duties under its Instrument of Appointment, or in breach of the provisions of a final or confirmed provisional enforcement order (and in either case, the breach is serious enough to make it inappropriate for Bristol Water to continue to hold its Instrument of Appointment or is a serious breach of the provisions of a final or confirmed provisional enforcement order) or Bristol Water is unable, or is unlikely to be able, to pay its debts.

In addition, a petition by a creditor of Bristol Water to the UK High Court for the winding up of Bristol Water would be appropriate to make such a winding-up order if Bristol Water were not a company holding an appointment under the WIA. The duties and functions of a Special Administrator differ in certain important respects to those of an administrator of a non-regulated company. During the period of the Special Administration Order, Bristol Water would be managed by the Special Administrator for the purposes of the order and in a manner protecting the interest of shareholders and creditors. As noted on the previous page, while an order is in force, no steps may be taken to enforce any security over the property of Bristol Water except with the consent of the Special Administrator or the leave of the court. A Special Administrator would be able to dispose of assets free of any floating charge existing in relation to them. On such a disposal, however, the proceeds would be treated as if subject to a floating charge, which has the same priority as that afforded to the original security. A Special Administrator may not dispose of property that is the subject of fixed charge without the agreement of the relevant creditor except under an order of the court. On such a disposal, the Special Administrator must account for the proceeds to the chargee, although the disposal proceeds to which the chargee is entitled are determined by reference to "the best price which is reasonably available on a sale, which is consistent with the purposes of the Special Administration Order" as opposed to an amount not less than "open market value", which would apply in a conventional administration for a company that is not a regulated company under English insolvency legislation.

Due to the statutory purposes of a Special Administration Order, it is not open to a Special Administrator to accept an offer to purchase the assets on a break-up basis in circumstances where the purchaser would be unable properly to carry out the relevant functions of a regulated company. Where the Special Administrator determines that the business of the regulated company should be transferred to one or more different companies as a going concern, the transfer is effected by a transfer scheme, which the Special Administrator puts in place, subject to the approval of the Secretary of State of Ofwat on behalf of the existing regulated company. The transfer scheme may provide for the transfer of the property, rights and liabilities of the existing regulated company to the new regulated company(ies) and may also provide for the transfer of the existing regulated company's Instrument of Appointment (with modifications as set out in the transfer scheme) to the new regulated company(ies).

Risk of increased competition – Water business

In December 2011, the Government published its White Paper "Water for Life". The Paper set out a package of reforms to make the existing competition regime work more effectively. The proposed reforms include: expanding the market to all non-household customers; extending the regime to sewerage services; reforming the wholesale pricing regime; reform of the upstream market; and guidance on social tariffs. In addition, the White Paper sets out a process to examine reforms to the regulation of water abstraction licences for possible implementation in a subsequent Parliament. Ofwat has consulted on how to change the way it regulates prices in order to meet these aims of Government. A key potential development is the introduction of separate price caps for the retail element of the business. Ofwat has continued to support the inset appointment regime, which allows new entrants to supply green field sites, often with a bulk supply from the existing undertaker. At present no insets have been sought within the Bristol Water supply area. The development of competition, or granting of new insets within the Bristol Water supply area, may potentially result in adverse consequences to the financial position of Bristol Water.

Regulatory environment – District heating business

Värmevärden is subject to regulation under Sweden's DH Act as well as under consumer protection and other legislation and regulations of general application. Värmevärden's business is presently not subject to price regulation or third-party access ("TPA"). However, in April 2011, a committee established by the Swedish parliament released a report that included recommendations regarding the establishment of a regulatory framework containing price regulation and TPA. The imposition of one of both of price regulation and TPA could materially and adversely affect Värmevärden's business, operating results, financial condition and cash flow.

Värmevärden's operations, including its heat production and distribution activities, require numerous licences and permits from various governmental authorities and such operations are subject to laws and regulations governing production, taxes, labour standards, occupation health, waste disposal, toxic substances, land use, environmental protection, project safety and other matters. Värmevärden may experience increased costs and delays in the production and distribution of district heating as a result of complying with applicable laws, regulations, licences and permits. While Värmevärden is currently compliant in all material respects with all applicable regulations and standards, Värmevärden could incur significant expenses to achieve or maintain compliance with any new laws or regulations that are introduced.

Environmental, health and safety – District heating business

Värmevärden is subject to a complex and stringent environmental, health and safety regulatory regime. As such, its operations carry an inherent risk of environmental, health and safety liabilities (including potential civil actions, compliance or remediation orders, fines and other penalties) that may result in its facilities being involved from time to time in administrative and judicial proceedings related to such matters, which could materially and adversely affect Värmevärden's business, financial condition and results of operations. Värmevärden has not been notified of any such civil or regulatory action in regards to its operations. However, it is not possible to predict with certainty what position a regulatory authority may take regarding matters of non-compliance with environmental, health and safety laws. Changes in such laws, or more aggressive enforcement of existing laws, could lead to material increases in unanticipated liabilities or expenditures for investigation, assessment, remediation or prevention, capital expenditures, restrictions or delays in the facilities' activities, the extent of which cannot be predicted. The primary environmental risks associated with Värmevärden operations include potential air quality and emissions issues, soil contamination resulting from oil spills, issues around the storage and handling of chemicals used in normal operations and the storage of fuel on site. Värmevärden's procedures, in place to prevent and minimize any impact of the foregoing, meet generally acceptable industry practices. As such, the Corporation does not believe that Värmevärden engages in the improper discharge of emissions, untreated water, chemicals or oil at these facilities.

ENVIRONMENTAL, HEALTH AND SAFETY REGULATION

Overview

The Corporation's power infrastructure facilities and various facilities operated by Bristol Water and Värmevärden hold all necessary permits and approvals required for their respective operations. These facilities and their respective operations are subject to a complex and stringent environmental, health and safety regulatory regime, including: (a) European Union, national, federal, provincial, municipal and local laws, as applicable; (b) regulations, by-laws, common law, licences, permits and other approvals; (c) government directions and orders; and (d) government guidelines and policies and other requirements governing or relating to, among other things: (i) air emissions; (ii) taking of water and discharges into water; (iii) the storage, handling, use, transportation and distribution of dangerous goods and hazardous and residual material (such as chemicals); (iv) the prevention of releases of hazardous materials into the environment; (v) the prevention, presence and remediation of hazardous materials in soil and ground water, both on and off site; (vi) workers' health and safety issues; and (vii) noise regulation (collectively, "Environmental, Health and Safety Laws"). The facilities are managed in a manner designed to maintain compliance with Environmental, Health and Safety Laws. The Corporation believes that all of these facilities and their respective operations are in compliance in all material respects with Environmental, Health and Safety Laws. Due to the nature of their operations, none of the Corporation's facilities are subject to any material contingent environmental liabilities or environmental remediation costs upon the retirement of assets.

Greenhouse gases and other air pollutants

The Corporation's power infrastructure businesses and various facilities operated by Bristol Water and Värmevärden have an impact on the environment, particularly the Cardinal facility, the Whitecourt facility and Värmevärden, which emit greenhouse gases and/or other air pollutants (collectively, GHGs, such as nitrous oxides, sulphur oxides, volatile organic compounds and particulate matter. The Corporation complies, in all material respects, with current European Union, national, federal, provincial and local, as applicable, environmental legislation and guidelines on GHGs and other emissions. Additional European Union, national, federal and provincial legislation and guidelines to govern and regulate GHG emissions, air pollution and carbon trading systems are in various stages of development, making the final form and scope of proposed legislation and guidelines, and how they may apply to the Corporation's businesses, difficult to predict. The Corporation mitigates the potential impact of future European Union, national, federal and provincial environmental legislation and guidelines by remaining diligent in the operation of its facilities, including stringent policies and procedures to prevent the improper discharge of emissions or other pollutants from its facilities. The Corporation's environmental footprint is also mitigated by the renewable profile of its wind, hydro, biomass and solar power facilities, which could create viable GHG offset credits provided that these businesses meet any applicable eligibility requirements and that they have the ownership of these credits under their respective power purchase agreements.

Cardinal facility

There is currently no legislated limit to the amount of CO_2 that the Cardinal facility may emit, although the facility is required to report its CO_2 emissions to Environment Canada and Statistics Canada. In 2011, the Cardinal facility emitted 566,973 tonnes of CO_2. Ontario legislation that came into effect in 2004 introduced a cap-and-trade system with respect to NOx emissions. Under this system, facilities subject to the legislation receive a maximum yearly emission compliance limit, which may be achieved by source emission control or reduction, or by trading NOx allowances. For 2011, the Cardinal facility received 1,207 tonnes of NOx allowances based on actual generation in 2009. The Cardinal facility expects to retire 356 tonnes of NOx allowances for 2011, leaving a cumulative allowance balance of 6,526 tonnes. NOx emissions from the Cardinal facility's existing generating equipment fall below the levels mandated by legislation.

Whitecourt facility

Average annual emission levels at the Whitecourt facility are approximately 50% below the levels of permitted emissions as set out under its environmental permit. The Whitecourt facility is also subject to certain reporting requirements. However, as emissions from biomass combustion are considered CO2 neutral under the Alberta regulatory regime, the Whitecourt facility is not required to submit compliance reports due to the facility's low level of GHG emissions once CO2 emissions from biomass are excluded. However, the Whitecourt facility is required to report total GHG emissions. In addition, the wood ash produced by the Whitecourt facility must comply with standards and guidelines for the use of wood ash as a liming material for agricultural soils.

Hydro power facilities, Erie Shores Wind Farm and Amherstburg Solar Park

The Corporation's hydro power facilities, Erie Shores Wind Farm and the Amherstburg Solar Park do not produce GHGs. However, the hydro power facilities' operations are governed by water management plans, which specify the hydrological conditions during which production may proceed. Erie Shores Wind Farm is subject to regulations and/or approvals related to birds, mammals and other animals, and to sound. The primary environmental regulation of the Amherstburg Solar Park relates to potential sound emission issues. The operation of these facilities involves little disruption to the land and does not add pollutants to the soil or ground water, thereby minimizing their environmental impact.

Värmevärden

In 2007, the European Union adopted a long-term climate change target, which is commonly referred to as 20-20-20. The goal of the target is for member states (including Sweden) to increase the proportion of renewable energy utilized by 20%, reduce carbon dioxide emissions by 20% (from 1990 levels) and reduce energy use by 20%, all by 2020. The government of Sweden has subscribed to the 20-20-20 targets and it has made biomass-fired and waste-fired district heating facilities an important component in its overall plan to meet its carbon dioxide reduction commitments. Based on the nature of its operations and its reliance on biomass fuel, Värmevärden believes that it has achieved a carbon-neutral profile.

Bristol Water

Energy use in water treatment and other activities carried out by Bristol Water results in indirect emissions of GHGs. Bristol Water is subject to the UK Climate Change Levy (which is estimated will result in an annual cost to Bristol Water of approximately £20,000 in 2011/2012) and the UK CRC Energy Efficiency Scheme, a mandatory UK emissions trading scheme for significant consumers of energy (which is estimated will result in an annual cost to Bristol Water of approximately £500,000 in 2011/2012).

RELATED PARTY TRANSACTIONS

The Corporation has various related party transactions, which range from being common routine transactions in the ordinary course of business to non-routine as described below.

On April 15, 2011, Capstone and MGL terminated the management and administration agreements that established the related party relationship between Capstone and MGL.

Transactions with MGL

From January 1 to April 15, 2011, Capstone had related party transactions with respect to services provided by MPML, including fees for certain administration and support functions carried out by the Manager under certain management and administrative agreements that totalled $16,755 during 2011 ($5,845 – 2010). Costs of $13,101 related to the internalization have been included in these figures, which is further disclosed on page 24 of this MD&A.

Transactions with the Manager

Capstone's related party transactions during 2011 were with MPML, including fees for certain administration and support functions carried out by the Manager under an administrative agreement.

In March 2011, due diligence and legal fees of $1,313 (8,334 SEK) were paid to a subsidiary of MGL with respect to the acquisition of Värmevärden in Sweden. This cost was expensed in the consolidated statement of income for the year ended December 31, 2011 as part of equity accounted income as it was incurred by Värmevärden.

In March 2011, $646 became payable to Macquarie European Infrastructure Fund II for the reimbursement of due diligence costs with respect to the acquisition of Värmevärden in Sweden. These costs were accrued in the consolidated statement of financial position in accounts payable and other liabilities and capitalized to equity accounted investments as at December 31, 2011.

In March 2011, a financial advisory fee of $500 was payable to a subsidiary of MGL with respect to the refinancing of Tranche C of the Erie Shores project debt. These costs were paid and capitalized to long-term debt as at December 31, 2011.

Compensation of Key Management

Aside from amounts paid as part of the management internalization the disclosure of compensation of key management can be found in note 28 (b) to the consolidated financial statements for the period ended December 31, 2011.

Prior to April 15, 2011, the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") of Capstone and other employees were employed by the Manager. Accordingly, employee compensation disclosure only includes executive compensation since the internalization of management.

SUMMARY OF QUARTERLY RESULTS

The following table provides a historical summary for the previous eight quarters of Capstone's financial performance, which illustrates the effect of seasonality on Capstone's performance.

($000s, except for per share amounts)	2011 Q4	2011 Q3	2011 Q2	2011 Q1	2010 Q4	2010 Q3	2010 Q2	2010 Q1
Revenue	91,663	40,361	37,028	46,915	44,265	34,598	35,497	44,152
Net income (loss)(3)	(4,891)	(11,783)	(30,370)(6)	41,332	(2,648)	(6,845)	(2,239)	27,633
Adjusted EBITDA	31,120	13,253	(6,569)	17,869	16,531	10,166	9,220	19,901
AFFO	12,597	5,460	(13,596)	13,145	9,795	6,223	3,353	15,403
Common dividends(4)	11,569	10,225	10,217	10,015	8,232	7,700	7,699	7,700
Preferred dividends	1,264	–	–	–	–	–	–	–
Earnings Per Share – Basic	(0.086)	(0.190)	(0.492)(6)	0.685	(0.055)(1)	(0.147)(1)	(0.048)(1)	0.592(1)
Earnings Per Share – Diluted	(0.086)	(0.190)	(0.492)(6)	0.625(2)	(0.055)	(0.163)(2)	(0.048)	0.547(2)
AFFO per share(5)	0.177	0.088	(0.220)	0.218	0.192	0.125	0.067	0.309
Dividends declared per common share	0.165	0.165	0.165	0.165	0.165	0.165	0.165	0.165

(1) Class B exchangeable units were not included in the weighted average shares outstanding, as they were classified as debt during this period under IFRS.

(2) Convertible debentures were dilutive during the period.

(3) Net income (loss) attributable to the shareholders of Capstone.

(4) Common dividends include amounts declared during the periods for both the common shares of the Corporation and the Class B exchangeable units.

(5) Included in the AFFO per share are the Class B exchangeable units to allow the non-GAAP measures to be comparative.

(6) Net loss has been adjusted by $2,409 for acquisition costs on Capstone's investment in Värmevärden.

FOURTH QUARTER 2011 HIGHLIGHTS

($000s)	Three months ended Dec 31, 2011	Three months ended Dec 31, 2010
Revenue	91,663	44,265
Operating expenses	(50,037)	(25,708)
Administrative expenses	(5,944)	(2,641)
Equity accounted income (loss)	320	(440)
Interest income	2,123	285
Other gains and (losses), net	(7,918)	(3,918)
Foreign exchange loss	(2,735)	(15)
Earnings before, interest, taxes, depreciation and amortization	27,472	11,828
Interest expense	(15,377)	(5,834)
Depreciation of capital assets	(11,912)	(7,077)
Amortization of intangible assets	(2,478)	(1,959)
Income (loss) before income taxes	(2,295)	(3,042)
Income tax recovery (expense)		
Current	(179)	–
Deferred	(32)	394
Total income tax recovery (expense)	(147)	394
Net income	(2,442)	(2,648)
Net income attributable to:		
Shareholders of Capstone	(4,891)	(2,648)
Non-controlling interest	2,449	–
	(2,442)	(2,648)

During the fourth quarter of 2011, Capstone's operations changed with the acquisition of Bristol Water on October 5, 2011. Specifically, Bristol Water contributed $19,136 of EBITDA, $7,669 of income before income taxes and $5,003 of net income.

Capstone's revenues were $47,398, or 107.1%, higher than in 2010, with Bristol Water contributing $43,560 since acquisition. The Power segment contributed the remaining $3,838 based on higher power rates than in the fourth quarter of 2010.

Expenses were $27,632, or 97.5%, higher in the fourth quarter of 2011 with Bristol Water making up $24,715 of the increase. In addition, administrative expenses for corporate activities were $3,303 higher primarily due to business development expenses, which were $3,868 higher in the 2011.

Other gains and losses were $4,000, or 102.1%, higher in 2011. The increase in the loss was attributable to fair value adjustments for the embedded derivative and other derivative swap contracts.

Foreign exchange loss was $2,720 higher than in 2010 and was attributable to translation of the loan receivable with Värmevärden in Sweden. Since the loan was advanced, the Swedish Krona depreciated against the Canadian dollar. Capstone hedges the interest payments, but not the outstanding loan receivable.

Interest expense was $9,543, or 163.6%, higher in 2011 with Bristol Water contributing $6,417 of the difference. The remainder of the difference was attributable to interest on new long-term debt from Amherstburg, the senior debt facility and the increase in the CPC-Cardinal credit facility.

In addition to the above performance highlights, during the fourth quarter, Capstone's total assets increased by $860,592 with Bristol Water comprising $913,811 of total assets as at December 31, 2011. The reduction in assets from Capstone's other segments was primarily attributable to a $31,000 reduction in cash to partly fund the Bristol Water acquisition.

The increase in total assets was accompanied by a $87,569 increase in shareholders' equity and a $773,023 increase in liabilities. The increase in liabilities was primarily due to a $591,744 increase in long-term debt comprising $480,339 of Bristol Water long-term debt, $78,375 for the senior debt facility and $34,000 on the CPC-Cardinal credit facility. The increase in shareholders' equity was primarily attributable to a $70,474 increase in share capital following the common share issue in November 2011. In addition, as a result of the Bristol Water acquisition, Capstone has recognized $34,450 for non-controlling interest with fourth quarter of dividends of $11,569 on common shares and $1,264 on Series A preferred shares and the net loss of $2,442 representing the remainder of the change.

ACCOUNTING POLICIES AND INTERNAL CONTROL

Significant Changes in Accounting Standards

On January 1, 2011, Capstone transitioned to IFRS. The notes to the consolidated financial statements as at and for the year ended December 31, 2011 contain a summary of the new significant accounting policies used in preparation of the consolidated financial statements.

Future Accounting Changes

In 2011, the IASB issued or amended the following standards, which have not yet been adopted by the Corporation:

IFRS revisions expected to impact Capstone

Title of the new IFRS (1)		Effective date (2)
IFRS 9	Financial Instruments	January 1, 2015
IFRS 12	Disclosure of Interests in Other Entities	January 1, 2013
IFRS 13	Fair Value Measurement	January 1, 2013
IAS 1	Presentation of Financial Statements	July 1, 2012
IAS 19	Employee Benefits	January 1, 2013
IAS 27	Separate Financial Statements	January 1, 2013
IAS 28	Investments in Associates and Joint Ventures	January 1, 2013

(1) Annual periods beginning on or after.

(2) See note 3 to the consolidated financial statement for the year ended December 31, 2011 for further details about the nature of these future accounting changes.

The Corporation has not yet begun the process of assessing the impact that the new and amended standards will have on its financial statements or whether to early adopt any of the new requirements.

Accounting Estimates

The consolidated financial statements are prepared in accordance with IFRS, which require the use of estimates and judgment in reporting assets, liabilities, revenues, expenses and contingencies.

The following accounting estimates included in the preparation of the consolidated financial statements are based on significant estimates and judgments, which are summarized as follows:

Area of significant estimate	Assumptions and judgments
▸ Purchase price allocations	▸ Initial fair value of net assets
▸ Depreciation on capital assets	▸ Estimated useful lives and residual value
▸ Amortization on intangible assets	▸ Estimated useful lives
▸ Asset retirement obligations	▸ Expected settlement date and amount and discount rate

Area of significant estimate	Assumptions and judgments
▸ Impairment assessments of capital, assets, intangibles and goodwill	▸ Future cash flows and discount rate
▸ Impairment of trade receivables	▸ Probability of a failure to recover amounts when they fall into arrears
▸ Derivative financial instruments	▸ Interest rate, natural gas price, and direct consumer rate
▸ Retirement benefits	▸ Future cash flows and discount rate
▸ Income taxes	▸ Timing of reversal of temporary differences

Management's estimates are based on historical experience, current trends and various other assumptions that are believed to be reasonable under the circumstances. Actual results could materially differ from those estimates.

Internal Controls

Capstone's CEO and CFO, on behalf of Capstone's Board of Directors, are required by the various provincial securities regulators to certify annually that they have designed, or caused to be designed, Capstone's disclosure controls and procedures, as defined in the Canadian Securities Administrators' Multilateral Instrument 52-109 ("MI 52-109"), and that they have evaluated the effectiveness of these controls and procedures in the applicable period. Disclosure controls are those controls and other procedures that are designed to provide reasonable assurance that the relevant information that Capstone is required to disclose is recorded, processed and reported within the timeframes specified by such securities regulators.

Capstone's management, under the supervision of and with the participation of the CEO and CFO, has designed internal controls over financial reporting, as defined in MI 52-109. The purpose of internal controls over financial reporting is to provide reasonable assurance regarding the reliability of Capstone's financial reporting, in accordance with IFRS, focusing in particular on controls over information contained in the audited annual and unaudited interim consolidated financial statements. The internal controls are not expected to prevent and detect all misstatements due to error or fraud.

Capstone updated its internal controls and testing for changes in its operations during the year ended December 31, 2011, including the construction of Amherstburg and acquisition of Värmevärden and Bristol Water, as well as its internal controls over financial reporting specifically with respect to the transition to IFRS.

The CEO and CFO have concluded that Capstone's disclosure controls and procedures were effective as at December 31, 2011 to ensure that information required to be disclosed in reports that Capstone files or submits under Canadian securities legislation is recorded, processed, summarized and reported within applicable time periods.

As at December 31, 2011, Capstone's management had assessed the effectiveness of Capstone's internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission in Internal Control – Integrated Framework. Based on this assessment, management has determined that Capstone's internal control over financial reporting was effective as at December 31, 2011.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The consolidated financial statements are the responsibility of Capstone Infrastructure Corporation and have been approved by the Corporation's Board of Directors. These consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards and include amounts that are based on estimates and judgments. Financial information contained elsewhere in this annual report is consistent with the consolidated financial statements. Capstone Infrastructure Corporation maintains a system of internal controls that are designed to provide reasonable assurance that the financial records are reliable and accurate and form a proper basis for the preparation of consolidated financial statements.

The Board of Directors of Capstone Infrastructure Corporation appointed an Audit Committee, which is composed entirely of independent Directors. The Audit Committee reviews the consolidated financial statements with management and the external auditor before the consolidated financial statements are submitted to the Board of Directors for approval. The independent auditor, PricewaterhouseCoopers LLP, has examined the consolidated financial statements in accordance with Canadian generally accepted auditing standards. The independent auditor's responsibility is to express an opinion on the consolidated financial statements. The following report of PricewaterhouseCoopers LLP outlines the scope of its examination and its opinion on the consolidated financial statements.

MICHAEL BERNSTEIN
President and Chief Executive Officer

MICHAEL SMERDON
Executive Vice President and Chief Financial Officer

Toronto, Canada
March 7, 2012

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Capstone Infrastructure Corporation

We have audited the accompanying consolidated financial statements of Capstone Infrastructure Corporation and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2011, 2010 and January 1, 2010 and the consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years ended December 31, 2011 and December 31, 2010, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Capstone Infrastructure Corporation and its subsidiaries as at December 31, 2011, 2010 and January 1, 2010 and their financial performance and their cash flows for the years ended December 31, 2011 and 2010 in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Accountants, Licenced Public Accountants

Toronto, Canada
March 7, 2012

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Statements of Financial Position

($000s)	Notes	Dec 31, 2011	Dec 31, 2010	Jan 1, 2010
Current assets				
Cash and cash equivalents	6	**57,587**	128,413	53,121
Restricted cash	6	**14,875**	10,602	5,490
Short-term deposits	7	**82,274**	–	–
Accounts receivable	8	**73,583**	21,696	16,128
Other assets	9	**4,719**	3,552	3,771
Current portion of loans receivable	10	**984**	884	794
Current portion of derivative contract assets	11	**261**	1,918	1,026
		234,283	167,065	80,330
Non-current assets				
Loans receivable	10	**85,824**	5,221	6,105
Derivative contract assets	11	**2,883**	6,579	15,476
Equity accounted investments	13	**15,993**	54,789	54,186
Capital assets	14	**977,456**	408,623	396,338
Intangible assets	15	**288,304**	137,646	140,866
Retirement benefit surplus	16	**60,104**	–	–
Deferred income tax assets	17a	**32,897**	24,211	18,443
Total assets		**1,697,744**	804,134	711,744
Current liabilities				
Accounts payable and other liabilities	18a	**81,734**	28,896	22,977
Current portion of derivative contract liabilities	11	**3,088**	2,505	1,310
Loans payable	13	**–**	49,200	–
Current portion of finance lease obligations	19	**5,256**	120	119
Current portion of long-term debt	20	**230,899**	44,838	42,035
		320,977	125,559	66,441
Long-term liabilities				
Derivative contract liabilities	11	**31,055**	14,801	6,143
Electricity supply and gas purchase contracts	15	**4,894**	6,524	8,154
Deferred income tax liabilities	17b	**178,201**	105,251	135,323
Deferred revenue	18b	**1,363**	–	–
Finance lease obligations	19	**6,727**	129	248
Long-term debt	20	**704,145**	284,608	282,165
Liability for asset retirement obligation	21	**2,412**	3,167	3,171
Total liabilities		**1,249,774**	540,039	501,645
Equity attributable to shareholders of Capstone (1)	22	**413,520**	264,095	210,099
Non-controlling interest		**34,450**	–	–
Total liabilities and shareholders' equity (1)		**1,697,744**	804,134	711,744
Commitments and contingencies	17			
Subsequent events	31			

(1) 2010 is unitholders' equity.

See accompanying notes to these consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity

		Equity attributable to shareholders of Capstone					
($000s)	Notes	Share Capital[1]	Convertible debentures	AOCI[2]	Retained Earnings	NCI[3]	Total Equity
Balance, January 1, 2010		466,662	–	190	(256,753)	–	210,099
Units redeemed	22a	(23)	–	–	–	–	(23)
Equity share of other comprehensive loss of equity accounted investments	13a	–	–	(190)	–	–	(190)
Units issued	22a	65,249	–	–	–	–	65,249
Conversions of debentures, net of costs	22a	4,390	–	–	–	–	4,390
Net loss during the period		–	–	–	15,901	–	15,901
Distributions declared	22d	–	–	–	(31,331)	–	(31,331)
Balance, December 31, 2010		536,278	–	–	(272,183)	–	264,095
Common shares issued	22a	77,526	–	–	–	–	77,526
Preferred shares issued	22c	72,020	–	–	–	–	72,020
Reclassification of class B exchangeable units	4b(iii)	26,710	–	–	–	–	26,710
Reclassification of convertible debentures – conversion option		–	11,554	–	–	–	11,554
Debenture conversions, net of costs	22a	11,819	(2,270)	–	–	–	9,549
Equity share of other comprehensive loss of equity accounted investments	13a	–	–	(724)	–	–	(724)
Non-controlling interest in net assets acquired of Bristol Water	5	–	–	–	–	31,810	31,810
Cumulative translation difference on translation of foreign operations		–	–	(5,963)	–	(927)	(6,890)
Losses on financial instruments designated as cash flow hedges (net of tax – $19)		–	–	(42)		(18)	(60)
Actuarial gains recognized in respect of retirement benefit obligations (net of tax – $3,123)	16	–	–	–	6,559	2,811	9,370
Net income (loss) for the period		–	–	–	(5,712)	2,449	(3,263)
Dividends declared to common shareholders of Capstone	22a,d	1,238	–	–	(42,026)	–	(40,788)
Dividends declared to preferred shareholders of Capstone	22d	–	–	–	(1,264)	–	(1,264)
Dividends declared by Bristol Water		–	–	–	–	(1,675)	(1,675)
Balance, December 31, 2011		725,591	9,284	(6,729)	(314,626)	34,450	447,970

(1) 2010 is units, Share Capital includes Preferred Shares and Class B Exchangeable Units.
(2) Accumulated other comprehensive income ("AOCI").
(3) Non-controlling interest ("NCI").

See accompanying notes to these consolidated financial statements.

Consolidated Statements of Income

($000s, except per share amounts)	Notes	Dec 31, 2011	Dec 31, 2010
Revenue		215,967	158,512
Operating expenses	25	(122,086)	(94,305)
Administrative expenses	25	(37,966)	(11,878)
Equity accounted income (loss)	13a	(5,276)	3,333
Interest income	11b	6,443	948
Other gains and (losses), net	26	(21,742)	(23,939)
Foreign exchange gain (loss)		(3,274)	(19)
Earnings before, interest expense, taxes, depreciation and amortization	3	32,066	32,652
Interest expense	11b	(31,668)	(21,533)
Depreciation of capital assets	14	(31,006)	(25,125)
Amortization of intangible assets	15	(8,413)	(7,834)
Loss before income taxes		(39,021)	(21,840)
Income tax recovery (expense)	17d		
Current		(187)	(8)
Deferred		35,945	37,749
Total income tax recovery		35,758	37,741
Net income (loss)		(3,263)	15,901
Net income (loss) attributable to:			
Shareholders of Capstone		(5,712)	15,901
Non-controlling interest		2,449	–
		(3,263)	15,901
Earnings per share (1)	23		
Basic		(0.108)	0.339
Diluted		(0.108)	0.339

(1) 2010 is earnings per unit.

See accompanying notes to these consolidated financial statements.

Consolidated Statements of Comprehensive Income

($000s, except per share amounts)	Notes	Dec 31, 2011	Dec 31, 2010
Net income (loss)		(3,263)	15,901
Equity share of other comprehensive loss of equity accounted investments	13a	(724)	(190)
Cumulative translation difference on translation of foreign operations		(6,890)	–
Losses on financial instruments designated as cash flow hedges (net of tax – $19)		(60)	–
Actuarial gains recognized in respect of retirement benefit obligations (net of tax – $3,123)	16	9,370	–
Total comprehensive income (loss)		(1,567)	15,711
Comprehensive income (loss) attributable to:			
Shareholders of Capstone		(5,882)	15,711
Non-controlling interest		4,315	–
		(1,567)	15,711

See accompanying notes to these consolidated financial statements.

Consolidated Statements of Cash Flows

($000s)	Notes	For the year ended Dec 31, 2011	Dec 31, 2010
Operating activities:			
Net income (loss)		(3,263)	15,901
Deferred income tax recovery		(35,945)	(37,749)
Depreciation and amortization		39,419	32,959
Other gains and losses (net)	26	21,742	23,939
Amortization of deferred financing costs and non-cash financing costs		7,599	3,593
Equity accounted (income) loss	13a	5,276	(3,333)
Unrealized foreign exchange (gain) loss on loan receivable	10	3,241	–
Change in non-cash working capital	30	12,812	(6,299)
Total cash flows from operating activities		50,881	29,011
Investing activities:			
Business acquisitions (net of cash acquired of $39,487)	5	(173,989)	–
Investment in capital assets	14	(122,385)	(28,116)
Loan to equity accounted investments	10	(84,828)	–
Investment in equity accounted investments (net return of capital of $3,694)	13a	(20,624)	–
Purchase of foreign exchange contracts		(2,468)	–
Capitalized transaction costs on equity accounted investments	13a	(1,258)	(237)
Change in restricted cash and short-term investments	10	3,324	(7,536)
Receipt of loans receivable		884	793
Distributions received from equity accounted investments	13a	–	2,541
Total cash flows used in investing activities		(401,344)	(32,555)
Financing activities:			
Proceeds from long-term debt		249,200	39,585
Proceeds from issuance of common and preferred shares, net of costs		150,175	65,249
Proceeds from loans payable		5,466	49,200
Repayment of long-term debt and finance lease obligations		(76,872)	(42,139)
Dividends paid to common and preferred shareholders(1)		(42,051)	(31,331)
Financing fees paid on debt issuance		(3,512)	(1,705)
Dividends paid to non-controlling interest		(1,675)	–
Redemption of units		–	(23)
Total cash flows from financing activities		280,731	78,836
Effect of exchange rate changes on cash and cash equivalents		(1,094)	–
Increase (decrease) in cash and cash equivalents		(70,826)	75,292
Cash and cash equivalents, beginning of year		128,413	53,121
Cash and cash equivalents, end of year		57,587	128,413
Supplemental information:			
Interest paid		20,128	15,794
Taxes paid (recovery)		(538)	8

(1) 2010 is distributions paid.

See accompanying notes to these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. CORPORATE INFORMATION

Capstone is incorporated and domiciled in Canada and principally located at 155 Wellington Street West, Suite 2930, Toronto, Ontario, M5V 3H1. The mission of Capstone Infrastructure Corporation (formerly Macquarie Power and Infrastructure Corporation and Macquarie Power & Infrastructure Income Fund (the "Fund")) and its subsidiaries (together the "Corporation" or "Capstone") is to build and responsibly manage a high quality portfolio of infrastructure businesses in Canada and internationally in order to deliver a superior total return to our shareholders by providing reliable income and capital appreciation. Capstone's portfolio includes investments in gas cogeneration, wind, hydro, biomass and solar power generating facilities, representing approximately 370 MW of installed capacity, a 33.3% interest in a district heating business in Sweden that was acquired on March 31, 2011 and a 70% interest in a regulated water utility in the United Kingdom that was acquired on October 5, 2011.

Macquarie Power Management Ltd. ("MPML" or the "Manager") is an indirect wholly owned subsidiary of Macquarie Group Limited ("MGL"), an Australian public company listed on the Australian Securities Exchange. MPML provided administrative services to the Corporation in accordance with an administration agreement, and management services to Cardinal, Helios and Capstone Power Corp. ("CPC") (formerly Macquarie Power Corp.) in accordance with management agreements. On April 15, 2011, management of the Corporation was internalized upon terminating the management agreements with MPML.

On January 1, 2011, Capstone converted into a corporation following a plan of arrangement whereby each unit of the Fund was automatically exchanged for one common share of the Corporation.

All amounts are in Canadian thousands of dollars or thousands of share amounts unless otherwise indicated.

NOTE 2. BASIS OF PREPARATION AND ADOPTION OF IFRS

The Corporation prepares its financial statements in accordance with Canadian generally accepted accounting principles ("GAAP") as defined in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS") and to require publicly accountable enterprises to apply these standards effective for years beginning

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on or after January 1, 2011. Accordingly, these are the Corporation's first annual consolidated financial statements prepared in accordance with IFRS as issued by the IASB. In these financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

These financial statements were approved by the board of directors for issue on March 7, 2012.

The consolidated financial statements have been prepared in compliance with IFRS. Subject to certain transition elections and exceptions disclosed in note 4, the Corporation has consistently applied the accounting policies used in preparation of its opening IFRS statement of financial position at January 1, 2010 throughout all periods presented, as if these policies had always been in effect. Note 4 discloses the impact of the transition to IFRS on the Corporation's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Corporation's consolidated financial statements for the year ended December 31, 2010 prepared under Canadian GAAP.

NOTE 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following significant accounting policies are used in the preparation of these consolidated financial statements.

Basis of Measurement

The consolidated financial statements have been prepared under the historical cost basis, except for the revaluation of certain financial instruments, which are measured at fair value as explained in the accounting policies set out below and a going concern basis of accounting (see note 12). Historical cost is generally based on the fair value of the consideration given in exchange for assets.

Consolidation

These audited consolidated financial statements include the assets and liabilities and results of operations of CPC, Cardinal Power Inc., Cardinal Power of Canada, L.P. ("Cardinal"), MPT LTC Holdings Ltd., MPT LTC Holding LP ("LTC Holding LP"), Helios Solar A-1 Partnership ("Helios"), MPT Utilities Corp., MPT Utilities Europe Ltd., CSE Water UK Limited and MPT District Heating Luxembourg SARL, all of which are 100% owned subsidiaries controlled by the Corporation, and a 70% controlling interest in Bristol Water plc ("Bristol Water") and group companies. The Corporation accounts for these investments using the consolidation method of accounting from the date control is obtained and deconsolidates from the date that control ceases. All intercompany balances and transactions have been eliminated on consolidation.

Non-controlling interests represent equity interests in subsidiaries owned by outside parties. The share of net assets of subsidiaries attributable to non-controlling interests is presented as a component of equity. Their share of net income and comprehensive income is recognized directly in equity. Changes in the Corporation's interest in subsidiaries that do not result in a loss of control are accounted for as equity transactions.

The Corporation, through its wholly owned subsidiaries, uses the equity method to account for its interests in Macquarie Long Term Care L.P. ("MLTCLP"), Chapais Électrique Limitée ("Chapais") for all periods reported and Sefyr Heat Luxembourg SARL ("Sefyr"), which holds Capstone's 33.3% investment in Värmevärden AB ("Värmevärden"), acquired on March 31, 2011.

Business Combinations

The acquisitions of businesses are accounted for using the purchase method. The consideration for each acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets transferred, liabilities incurred or assumed, and equity instruments issued by the Corporation in exchange for control of the acquired business. The acquired business identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3R, Business Combinations ("IFRS 3R") are recognized at their fair value at the acquisition date.

To the extent the fair value of consideration paid exceeds the fair value of the net identifiable tangible and intangible assets, goodwill is recognized.

The Corporation recognizes any non-controlling interest in the acquiree at the non-controlling interest's proportionate share of the recognized amounts of acquiree's identifiable net assets.

Acquisition-related costs are expensed as incurred.

Foreign Currency Translation

Functional and Presentation Currency

Amounts included in the financial statements of each consolidated entity in the Corporation are measured using the currency of the primary economic environment in which the entity operates ("functional currency"). The consolidated financial statements are presented in Canadian dollars ("presentation currency"), which is Capstone's functional currency. The exchange rates used in the translation to the presentation currency are as follows:

As at and for the periods ended	Swedish Kronor (SEK)		Pounds Sterling (£)	
($000s)	Average	Spot	Average	Spot
January 1 – March 31	n/a	0.1537	n/a	n/a
April 1 – June 30	0.1545	0.1525	n/a	n/a
July 1 – September 30	0.1518	0.1528	n/a	1.6234(1)
October 1 – December 31	0.1482	0.1479	1.6076	1.5799

(1) Exchange rate for acquisition was as of October 5, 2011.

The financial statements of entities that have a functional currency different from that of the Capstone are translated into Canadian dollars as follows: assets and liabilities – at closing rate at the date of the statement of financial position, and income and expenses – at the average rate of the period (as this is considered a reasonable approximation of the actual rates prevailing at the transaction dates). All resulting changes are recognized in other comprehensive income as cumulative translation adjustments.

Transactions and Balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of transactions. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at exchange rates of monetary assets and liabilities denominated in currencies other than an entity's functional currency are recognized in the consolidated statement of income in "foreign exchange gain (loss)".

Cash and Cash Equivalents and Short-term Deposits

Cash and cash equivalents are composed of highly liquid investments with original maturities of 90 days or less at the date of acquisition and are recorded at fair value.

Deposits with original maturities of greater than 90 days are classified as short-term deposits on the consolidated statement of financial position.

Inventories

Inventories are valued at the lower of purchase cost (calculated on a first-in first-out basis) and net realizable value.

Loans Receivable

The Corporation has interest-bearing financial assets that consist of a series of loans receivable from Chapais and Värmevärden. These financial assets are carried at amortized cost.

Equity Accounted Investments

The Corporation has significant influence, but not control over its investments in MLTCLP, Chapais and Värmevärden from March 31, 2011. The equity method is used to account for these investments. Under the equity method, the cost of the investment is adjusted by the Corporation's share of net income (loss) and other comprehensive income (loss) and reduced by any dividends paid to the Corporation. The Corporation assesses at each year-end whether there is any objective evidence that its interests in associates are impaired. If impaired, the carrying value of the Corporation's share of the underlying assets of associates is written down to its estimated recoverable amount (being the higher of fair value less cost to sell and value in use) and charged to the consolidated statement of income (loss).

Capitalized Costs

Capitalized costs related to an asset under development include all eligible expenditures incurred in connection with the development and construction of the asset until it is available for its intended use. The expenditures consist of directly attributable costs related to the asset. The Corporation capitalizes interest and borrowing costs when activities that are necessary to prepare the asset for its intended use are in progress and expenditures for the asset have been used or borrowed to fund the construction or development. Capitalization of interest and borrowing costs ceases when the asset is ready for its intended use.

Grants and Contributions

Grants are recognized at their fair value when there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. Grants and contributions in respect of expenditures charged to the income statement are netted against such expenditures as received.

Capital Assets

Capital assets are stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, only when it is probable that future economic benefits associated with the item will flow to the Corporation and the cost can be measured reliably. The carrying value of an asset is derecognized when replaced.

Major maintenance costs are capitalized in the carrying value of the assets as incurred, and depreciated over the period to the next scheduled major maintenance. Other repair and maintenance costs are charged to the statement of income during the period incurred.

The Corporation allocates the amount initially recognized in respect of an item of capital assets to its significant parts and depreciates separately each such part. Residual values, method of amortization and useful lives of the assets are reviewed annually and adjusted if appropriate. The major categories of capital assets are depreciated using the straight-line method as follows:

Power	
Equipment and vehicles	3 to 15 years
Property and plant	20 to 40 years
Utilities – Water	
Infrastructure assets	70 to 213 years
Equipment and vehicles:	
Computer hardware, software, communications, meters and telemetry equipment	3 to 15 years
Vehicles and mobile plant	5 to 7 years
Property and plant:	
Operational properties and structures	15 to 100 years
Treatment, pumping and general plant	20 to 24 years

Infrastructure assets comprise the integrated network of impounding and pumped raw water storage reservoirs and water mains and associated underground pipework. For accounting purposes, the water system is segmented into components representing categories of asset classes with similar characteristics and asset lives. Expenditure on such assets relating to increases in capacity, enhancements or planned maintenance of the network is treated as an addition to fixed assets and is included at cost. The cost of infrastructure assets is their purchase cost together with incidental expenses of acquisition and directly attributable labour costs, which are incremental to the Corporation.

Gains or losses on disposals are determined by comparing the proceeds of sale with the carrying amount and are recognized within the income statement.

Leased Assets

Assets financed by leasing agreements that transfer substantially all the risks and rewards of ownership of an asset to the lessee are capitalized and depreciated over the shorter of their estimated useful lives and the lease term. The corresponding liability is recorded as borrowings. The capital element of the lease rental is deducted from the obligation to the lessor as paid. The interest element of lease rentals and the depreciation of the relevant assets are charged to the income statement.

Operating lease rental payments are charged to the income statement on a straight-line basis as incurred over the term of the lease.

Transfers of Assets from Customers

Where an item of property, plant and equipment that must be used to connect customers to the network is received from a customer, or where cash is received from a customer for the acquisition or construction of such an item, that asset is recorded and measured on initial recognition at its fair value in accordance with IFRIC 18. The period over which the credit is recognized depends upon the nature of the service provided by the Corporation as determined by the agreement with the customer. If the agreement does not specify a period, the revenue is treated as deferred income and recognized over a period no longer than the useful life of the transferred asset used to provide the ongoing service.

Intangible Assets

Identifiable Intangible Assets

The Corporation separately identifies acquired intangible assets including computer software and system developments, electricity supply contracts, gas purchase contracts, water rights and licences and records each at their fair value at the date of acquisition. The initial fair value is amortized over their estimated useful lives using the straight-line method as follows:

Computer software	3 to 7 years
Electricity supply and gas purchase contracts	8 to 20 years
Water rights	10 to 35 years
Licences	Indefinite life

The expected useful lives of intangible assets are reviewed on an annual basis and adjusted prospectively.

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Corporation's share of the identifiable net assets of the acquired subsidiary at the date of acquisition. Goodwill is carried at cost less accumulated impairment losses. Impairment losses are recognized in "other gains and (losses), net". Goodwill is allocated to each cash-generating unit ("CGU") or group of CGUs that are expected to benefit from the related business combination. Gains and losses on disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Impairment of Non-financial Assets

The capital assets and intangible assets with finite lives are tested for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash inflows. The recoverable amount is the higher of an asset's fair value less costs to sell the assets and the value in use (being the present value of the expected future cash flows of the relevant assets or CGU). An impairment loss is recognized for the amount by which the asset's carrying value exceeds its recoverable amount. The Corporation evaluates impairment losses, other than goodwill impairment, for potential reversals when events or circumstances warrant such consideration.

Goodwill and intangible assets with indefinite lives are reviewed for impairment annually or at any time when an indicator of impairment exists. Management monitors goodwill and intangible assets with indefinite lives for internal purposes based on its CGUs, which are its operating segments.

Provisions

Provisions are recognized when the Corporation has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are measured using management's best estimate of the expenditure required to settle the obligation at the end of the reporting period, and are discounted to present value where the effect is material. The Corporation performs evaluations to identify onerous contracts and, where applicable, records provisions for such contracts.

Pension Costs

The Corporation operates both defined benefit and defined contribution pension arrangements for the employees of Bristol Water. Defined benefit pension arrangements are provided through Bristol Water's membership in the Water Companies' Pension Scheme ("WCPS") via a separate section.

Costs of defined contribution pension schemes are charged to the income statement in the period in which they fall due. Administration costs of defined contribution schemes are borne by Bristol Water.

Defined benefit scheme liabilities are measured by an independent actuary using the projected unit credit method and discounted at the current rate of return on high quality corporate bonds of equivalent term and currency to the liability. The increase in the present value of the liabilities of Bristol Water's defined benefit pension scheme expected to arise from employee service in the period is charged to operating profit. The expected return on the scheme's assets and the increase during the period in the present value of the scheme's liabilities, arising from the passage of time, is included in other finance income or cost.

The net asset or liability recognized in the balance sheet represents the present value of the defined benefit obligation less the fair value of the plan's assets. Actuarial gains and losses arising from experience adjustments, changes in actuarial assumptions and amendments to pension plans are recognized in full in the period in which they occur in the consolidated statement of comprehensive income.

Past service costs are recognized in the income statement on a straight-line basis over the vesting period or immediately if the benefits have vested. When a settlement or a curtailment occurs, the change in the present value of the scheme liabilities and the fair value of the plan assets reflects the gain or loss, which is recognized in the income statement. Losses are measured at the date that Bristol Water becomes demonstrably committed to the transaction and gains when all parties whose consent is required are irrevocably committed to the transaction.

Asset Retirement Obligations

The Corporation recognizes a provision for the future retirement obligations associated with its operating plants. These obligations are initially measured at fair value, which is the discounted future cost of the liability. A reassessment of the expected costs associated with these liabilities is performed annually with changes in the estimates of timing or amount of cash flows added or deducted from the cost of the related asset. The liability accretes until the date of expected settlement of the retirement obligations.

Share Capital

Common shares are classified as equity. Incremental costs directly attributable to the issuance of shares are recognized as a deduction from equity.

Fund Units

Prior to conversion into a corporation, the Corporation's equity was represented by fund units.

Under IAS 32, the fund units were considered a puttable financial instrument due to the holders' ability to redeem fund units, generally at any time, subject to certain restrictions. In accordance with IAS 32 paragraph 16, the Corporation has classified fund units as equity.

Exchangeable Securities

The Class B exchangeable units issued by LTC Holding LP meet the criteria set out in IAS 32 and have been presented as equity following execution of the plan of arrangement to convert Capstone to a corporation on January 1, 2011. Previously under IFRS, the Class B exchangeable units were classified as debt as they were settled in Fund units. Prior to the Fund's conversion to a corporation, these securities were re-measured each period at fair value with changes in fair value recorded in the consolidated statement of income. Distributions paid on these securities were recorded as interest expense.

Preferred Shares

The Corporation classifies its series A preferred shares as equity for reporting purposes given that the preferred shares may be convertible into a fixed number of the Corporation's own equity instruments and there is no settlement required at a future date. Incremental costs directly attributable to the issuance of shares are recognized as a deduction from equity.

The irredeemable preferred shares of Bristol Water have been classified as debt in accordance with IAS 39.

Dividends

Dividends on common and series A preferred shares are recognized in the Corporation's consolidated financial statements in the period in which the dividends are approved by the Board of Directors of the Corporation.

Revenue and Expense Recognition

Power revenue derived from the sale of electricity, power and steam is recognized when delivered to the customer and priced in accordance with the provisions of the applicable power and steam sales agreements. Certain power purchase arrangements ("PPAs") provide for an electricity rate adjustment, which is updated periodically both for the current and prior periods. The Corporation accounts for such adjustments when a reliable estimate of the adjustment can be determined. Revenue derived from power sales of Whitecourt Power LP ("Whitecourt") to the Power Pool of Alberta in excess of the volume as stipulated in the PPA is recorded at the hourly power pool rate. Cardinal has a profit-sharing arrangement with Husky Energy Marketing Inc. ("Husky Marketing") to sell excess gas not used in its operations in the market. Net proceeds from gas mitigation are recognized as revenue when delivery has taken place.

Capstone follows Accounting for Government Grants and disclosure of Government Assistance (IAS 20) with respect to certain power contracts with provincial jurisdictions.

Water revenue is recognized upon delivery of water and comprises the fair value of charges to and accrued income from customers for water services, exclusive of value added tax ("VAT"). Revenue from metered supplies is based upon actual volumes of water invoiced plus estimated volumes of un-invoiced water delivered to customers during the year.

Costs related to the purchases of fuel are recorded upon delivery. All other costs are recorded as incurred.

Deferred Share Unit Plan

The Corporation has a Deferred Share Unit ("DSU") plan for eligible directors of Capstone as described in note 24(a) to these consolidated financial statements. The Corporation accounts for DSUs as an expense over the vesting period of the DSUs using the fair value of the underlying common shares, as determined by the closing price of the Corporation's publicly traded common shares on the reporting date.

Long-term Incentive Plan

The Corporation has a long-term incentive plan ("LTIP") as described in note 24(b). The Corporation accounts for its grants under this plan in accordance with IFRS 2 Share-Based Payments. Compensation expense is measured at the grant date at fair value and recognized over the service period, based on the vesting period applicable and is adjusted for any changes in market value of the Corporation's share price.

Income Taxes

Current and deferred income taxes are recognized in the consolidated statement of income except to the extent that they relate to items recognized directly in equity, in which case the income tax is also recognized directly in equity.

Current income tax is the expected amount payable on the taxable income for the year, using tax rates enacted, or substantively enacted, at the reporting period, and any adjustments to income tax payable or recoveries in respect of previous years.

The Corporation follows the liability method of accounting for deferred income tax whereby deferred income tax is recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying values in the consolidated financial statements. Deferred income tax is determined on a non-discounted basis using income tax rates and laws that have been enacted or substantively enacted as at the date of the consolidated statement of financial position and are expected to apply when the deferred income tax asset or liability is settled. Deferred income tax assets are recognized to the extent that it is probable that the asset can be recovered. Deferred income tax assets and liabilities are presented as non-current.

Basic and Diluted Earnings per Share

Basic earnings per share is established by dividing the net income attributable to the shareholders' of Capstone, less dividends declared to preferred shareholders by the weighted average number of common shares and Class B exchangeable units of LTC Holding LP for 2011. For 2010, the Class B exchangeable units of LTC Holding LP were excluded as the units were classified as debt of the Corporation.

Diluted earnings per share is computed in a similar manner as the basic earnings per share but reflects the dilutive effect of convertible debenture shares and Class B exchangeable units of LTC Holding LP for 2010. Potential shares are excluded from the computation of diluted net income per share if their effect is anti-dilutive.

Comprehensive Income

Other comprehensive income ("OCI") represents changes in shareholders' equity during a period arising from transactions and other events with non-owner sources and includes unrealized gains and losses on translation of net assets of foreign operations, the equity share of OCI of equity accounted investments and actuarial gains recognized in respect of retirement benefit obligations. OCI also includes the effective portion of the change in fair value of designated cash flow hedges of Bristol Water less any amounts reclassified to interest and other expenses, net, in the period the underlying hedged item is also recorded in interest and other expenses, net. Accumulated other comprehensive income ("AOCI") is included as a component in the consolidated statement of shareholders' equity.

Financial Instruments

Financial assets and financial liabilities are recognized on the consolidated statements of financial position when the Corporation becomes a party to the contractual provisions of the financial instrument. Financial instruments are required to be measured at fair value on initial recognition. Measurement in subsequent periods depends on the classification of the financial instrument. The Corporation has classified the financial instruments based on the purpose for which the financial instruments were acquired or issued, their characteristics and the designation of such instruments. The Corporation has designated each of its significant categories of financial instruments outstanding as follows:

Classification	Significant Categories	Measurement
Financial assets and liabilities at fair value through profit and loss	▸ Cash and cash equivalents ▸ Restricted cash ▸ Short-term deposits ▸ Derivative contract assets ▸ Derivative contract liabilities ▸ Class B exchangeable units (pre-January 1, 2011, see note 4(b)(iii)) ▸ Convertible debentures – Conversion option (pre-January 1, 2011, see note 4(b)(iv))	▸ At fair value with changes in fair value recognized in the consolidated statement of income.
Loans and receivables	▸ Accounts receivable ▸ Loans receivable	▸ At amortized cost using the effective interest method
Other liabilities	▸ Accounts payable and other liabilities ▸ Loans payable ▸ Finance lease obligations ▸ Long-term debt	▸ At amortized cost using the effective interest method

Transaction costs relating to financial instruments classified as loans and receivables and other liabilities are deferred and amortized over the expected life of the instrument using the effective interest method. Transaction costs that are directly attributable to the acquisition or issue of financial instruments classified as held-for-trading are expensed as incurred.

The Corporation determines the fair value of its financial instruments based on the following hierarchy:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
- Level 3 – Inputs that are not based on observable market data.

Derivative Financial Instruments

The Corporation's derivatives are carried at fair value and are reported as assets when they have a positive fair value and as liabilities when they have a negative fair value.

For the year ended December 31, 2011, the Corporation's derivatives include gas and interest rate swap contracts along with foreign currency contracts.

Changes in the fair values of derivative financial instruments are reported in the consolidated statement of income for the year ended December 31, 2011, except for cash flow hedges that meet the conditions for hedge accounting. The portion of the gain or loss on the hedging instruments that are determined to be an effective hedge are recognized directly in other comprehensive income, and the ineffective portion in the income statement. The gains or losses deferred in other comprehensive income in this way are subsequently recognized in the statement of income in the same period in which the hedged underlying transaction or firm commitment is recognized in the statement of income.

In order to qualify for hedge accounting, the Corporation is required to document in advance the relationship between the item being hedged and the hedging instrument. The Corporation is also required to document and demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is re-performed at the end of each reporting period to ensure that the hedge remains highly effective.

Derivatives embedded in other financial instruments or contracts are separated from their host contracts and accounted for at fair value when their economic characteristics and risks are not closely related to those of the host contract. The Corporation has determined that Cardinal's gas purchase contract contains embedded derivatives requiring separation and measurement at fair value. The features requiring separation include mitigation options and indexing features (see note 11).

Impairment of Financial Assets

At each reporting date, the Corporation assesses whether there is objective evidence that a financial asset is impaired. If such evidence exists, the Corporation recognizes an impairment loss on financial assets carried at amortized cost. The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted by using the instrument's original effective interest rate. The carrying value of the asset is reduced by the loss either directly or indirectly through the use of an allowance account. Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized.

Segment Reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker is responsible for allocating resources and assessing performance of the operating segments and has been identified as the chief executive officer of Capstone.

Earnings Before Interest Expenses, Taxes, Depreciation and Amortization ("EBITDA")

EBITDA is calculated from the Corporation's earnings excluding interest expense, income taxes, depreciation and amortization. EBITDA includes the Corporations interest income which is derived from shareholder loans with equity accounted investments, cash and cash equivalents, restricted cash and short term deposits. EBITDA represents Capstone's continuing capacity to generate income from operations before taking into account management's financing decisions and costs of consuming tangible capital assets and intangible assets, which vary according to their vintage, technological currency, and management's estimate of their useful life.

EBITDA is presented on the consolidated statement of income.

Future Accounting Changes

In 2011, the IASB issued the following standards, which have not yet been adopted by the Corporation:

Title of the new IFRS	Nature of the impending change	Effective date(1)
IFRS 9, Financial Instruments	Replaces IAS 39, which addresses the classification and measurement of financial assets, as well as the measurement methodology for debt and equity instruments. Capstone has financial instruments that may be impacted by this new standard.	January 1, 2015
IFRS 12, Disclosure of Interests in Other Entities	Establishes disclosure requirements for interests in other entities. Capstone may be impacted by this new standard.	January 1, 2013
IFRS 13, Fair Value Measurement	A comprehensive standard for fair value measurement and disclosure across all IFRS. Capstone may be impacted by this new standard.	January 1, 2013
IAS 1, Presentation of Financial Statements	Amended to require entities to separate items presented in OCI into two groups, based on whether or not items may be recycled in the future. Capstone may be impacted by this new standard.	July 1, 2012
IAS 19, Employee Benefits	Has been amended to make significant changes to the recognition and measurement of defined benefit pension expense and termination benefits and to enhance the disclosure of all employee benefits. The amended standard requires immediate recognition of actuarial gains and losses in other comprehensive income as they arise, without subsequent recycling to net income. This is consistent with Capstone's current accounting policy. A number of other amendments have been made to recognition, measurement, classification and expanded disclosures. Capstone may be impacted by this new standard.	January 1, 2013
IAS 27, Separate Financial Statements	Amended to address changes in IFRS 10-13	January 1, 2013
IAS 28, Investments in Associates and Joint Ventures	Amended to address changes in IFRS 10-13	January 1, 2013

(1) Annual periods beginning on or after

The Corporation has not yet begun the process of assessing the impact that the new and amended standards will have on its financial statements or whether to early adopt any of the new requirements.

Critical Accounting Estimates and Judgments

The Corporation makes estimates and assumptions concerning the future that will, by definition, seldom equal actual results. The following are the estimates and judgments applied by management that most significantly affect the Corporation's financial statements. These estimates and judgments have a risk of causing a material adjustment to the carrying values of financial assets and financial liabilities within the next financial year.

Area of Significance	Critical Estimate	Critical Judgment
Financial instrument fair value measurements When observable prices are not available, fair values are determined by using valuation techniques that refer to observable market data. This is specifically related to Capstone's financial instruments.	▸ Management's valuation techniques include comparisons with similar instruments where market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. ▸ For embedded derivatives, fair values are determined from valuation techniques using non-observable market data or transaction processes. A number of factors such as bid-offer spread, credit profile and model uncertainty are taken into account, as appropriate.	▸ Interest rate ▸ Natural gas rate ▸ Direct customer rate
Accounts receivable The allowance for doubtful accounts for Bristol Water is calculated based on an assessment of cash flows that are expected. Collective impairment losses on receivables with similar credit risk are calculated using a statistical model.	▸ The probability of failing to recover accounts receivable is determined by considering past experience, adjusted for changes in external factors. The accuracy of the impairment calculation would therefore be affected by unexpected changes to the economic situation, and to changes in customer behavior. To the extent that the failure to recover debts in arrears alters by 5%, the provision for impairment would increase or decrease by $1,072.	▸ Probability of a failure to recover accounts receivable when they fall into arrears
Capital and intangible assets – Carrying values Fair value estimates are required in the determination of the net assets acquired in a business combination and in the impairment assessment process for our capital assets and the assignment of amounts to the asset retirement obligations.	▸ These estimates are based on assumptions that are sensitive to change, which may have a significant impact on the valuations performed. ▸ Impairment reviews of the carrying value of capital and other long-lived assets along with the asset retirement obligations require management to make estimates of fair value, future cash flows and business performance.	▸ Initial fair value of net assets ▸ Estimated useful lives and residual value ▸ Estimated future cash flows ▸ Expected settlement date and amount ▸ Discount rate
Retirement benefits The present value of the pension obligations is dependent on actuarial calculations, which include a number of assumptions.	▸ These assumptions include the discount rate, which is used to calculate the present value of the estimated future cash outflows that will be required to meet the pension obligations. In determining the discount rate to use, the Corporation considers market yields of high quality corporate bonds, denominated in British pounds sterling, that have times to maturity approximating the terms of the pension liability.	▸ Future cash flows and discount rate.
Deferred income taxes Estimates in the valuation of the deferred income taxes can affect the assets and liability balances.	▸ The determination of the deferred income tax balances of the Corporation requires management to make estimates of the reversal of existing temporary differences between the accounting and tax bases of assets and liabilities in future periods.	▸ Timing of reversal of temporary differences

NOTE 4. TRANSITION TO IFRS

The effect of the Corporation's transition to IFRS, described in note 2, is summarized in this note as follows.

(A) Transition Accounting Changes

In preparing these consolidated financial statements, the Corporation has applied the mandatory exceptions in IFRS 1 and optional exemptions from full retrospective application in its opening consolidated statement of financial position dated January 1, 2010:

Mandatory Exceptions

Estimates

In accordance with IFRS 1, an entity's estimates under IFRS at the date of transition to IFRS must be consistent with estimates made for the same date under Canadian GAAP, unless there is objective evidence that those estimates were in error. The Corporation's IFRS estimates as of January 1, 2010 are consistent with its Canadian GAAP estimates for the same date.

Optional Exemptions

Business combinations

IFRS 1 indicates that a first-time adopter may elect not to apply IFRS 3R retrospectively to business combinations that occurred prior to the date of transition to IFRS (January 1, 2010). The Corporation has elected to apply IFRS for business combinations prospectively from January 1, 2010. Assets and liabilities acquired in past business combinations have been carried forward without adjustment at the transition date. Future business combinations will be accounted for in accordance with IFRS 3R.

(B) Reconciliation of Shareholders' Equity and Comprehensive Income as Previously Reported Under Canadian GAAP to IFRS

Shareholders' Equity ($000s)	Notes	Dec 31, 2010	Jan 1, 2010
As reported under Canadian GAAP		340,594	293,015
IFRS adjustments			
Major maintenance and componentization	i	(1,626)	168
Capitalized transaction costs	ii	(933)	(3,075)
Class B exchangeable units	iii	(26,710)	(19,854)
Equity portion of convertible debentures	iv	(12,640)	(9,122)
Deferred income tax – rate adjustment	v	(34,809)	(51,401)
Deferred income tax – other adjustments	vi	219	368
As reported under IFRS		264,095	210,099

Comprehensive Income ($000s)	Notes	Dec 31, 2010
Net income – as reported under Canadian GAAP		11,569
IFRS adjustments		
Major maintenance and componentization	i	(1,792)
Capitalized transaction costs	ii	2,142
Class B exchangeable units	iii	(9,001)
Equity portion of convertible debentures	iv	(3,459)
Deferred income tax – rate adjustment	v	16,591
Deferred income tax – other adjustment	vi	(149)
Net income as reported under IFRS		15,901
Other comprehensive loss – under Canadian GAAP and IFRS		(190)
Comprehensive income as reported under IFRS		15,711

Explanatory Notes

i. Major maintenance and componentization

IFRS requires an entity to separately track components of capital assets that have shorter useful lives than the whole category of assets. Under Canadian GAAP, Capstone historically expensed major maintenance and inspection costs as they were incurred. Under IFRS, these costs must be capitalized and amortized separately over the period until the next major maintenance. For Capstone, this required a review of the historical major maintenance expenditures in order to capitalize these costs as of the date incurred and calculate the appropriate amount of depreciation. Calculations were also required for costs of previous major maintenance to appropriately amortize and derecognize the costs prior to the next major maintenance cycle.

The effect of this change is a $1,626 decrease in shareholders' equity as at December 31, 2010 (January 1, 2010 – $168 increase) and a $1,792 decrease in net income before tax for the year ended December 31, 2010.

ii. Capitalized transaction costs

Under IFRS, transaction costs for a business combination must be expensed as incurred. Only certain transaction costs directly related to the issuance of debt or equity are eligible to be capitalized. While business combinations before 2010 are exempt from restatement under the IFRS 1 elections, the June 2010 acquisition of the Amherstburg Solar Park, along with other deferred business development costs have been restated to exclude the transaction costs from the purchase price.

All current and future transaction costs relating to acquisitions will be expensed as incurred. The exception to this treatment is the investment in a business where the acquirer does not obtain control. In this circumstance, IFRS (IAS 28) requires that the directly attributable business acquisition costs be capitalized as part of the amount invested.

Additionally in accordance with IFRS 3R, the acquisition of Helios from SunPower has been capitalized, resulting in a gain at the time of acquisition in June 2010. The effect of this change was a $6,144 increase in intangibles ($4,234, net of the increase related to the deferred tax liability), $1,910 increase in the deferred tax liability and a $4,234 increase in net income. The Corporation released $831 of deferred tax liability during the year ended December 31, 2011, to reflect the use of the general corporate rate as described further in note 4(b)(v).

The effect of these changes is a $933 decrease in shareholders' equity as at December 31, 2010 (January 1, 2010 – $3,075 decrease) and an increase in net income before tax for the year ended December 31, 2010 of $2,142.

iii. Class B exchangeable units

Until the end of 2010, the Corporation was organized as a mutual fund trust. Under this structure, IFRS requires that the Class B exchangeable units be treated as a liability and recorded at fair value with distributions to unitholders treated as interest expense and movements in the fair value reported on the consolidated statement of income. Under Canadian GAAP, the Class B exchangeable units were treated as equity, recorded at historical cost, with the distributions being recorded in equity.

On January 1, 2011, the Trust completed its plan of arrangement and became a corporation. Under IFRS, this change required reclassification of the Class B exchangeable units as equity. This requirement is based on the Class B exchangeable units feature to convert into the share capital and their terms allow them to participate on an equal basis with the corporate shareholders in all financial respects in the earnings of the corporation. The value of the Class B exchangeable units on January 1, 2011 is equal to their carrying value on December 31, 2010, which is the same as their fair value on December 31, 2010. The carrying value of the Class B exchangeable units remain unchanged while they are classified as equity and all future distributions will be recorded in equity.

Additionally, $2,144 of distributions to unitholders were treated as interest expense for the year ended December 31, 2010.

The effect of these changes is a $26,710 decrease in shareholders' equity as at December 31, 2010 (January 1, 2010 – $19,854 decrease) and a $9,001 decrease in net income before tax for the year ended December 31, 2010.

iv. Equity portion of convertible debentures

The convertible debentures give the holders the right to convert into shares of the Corporation (prior to January 1, 2011 into trust units of the Fund). In accordance with IAS 32 and IAS 39, the instrument is to be separated into its financial component parts on inception, similar to Canadian GAAP.

Under Canadian GAAP, Capstone separated the $57,500 of convertible debentures into its component parts at fair value on inception of the instrument, $51,749 to debt and $5,751 to equity for the conversion option, excluding transaction costs of $2,880, which were netted against each respectively. The debt was accounted for at amortized cost and the equity portion does not change from the inception fair value, aside from conversions.

Under IFRS, the Corporation is required to account for the conversion option as a liability prior to converting to a corporation, as the debentures were convertible into trust units, which have a limited life, and therefore the instrument must be measured as held for trading and accounted for at fair value with the change recorded in the consolidated statement of income. In 2011 the conversion option is transferred to equity as it is convertible to shares of a corporation and the value of the conversion option on January 1, 2011 is equal to its carrying value on December 31, 2010, which is the same as its fair value of $12,640 on December 31, 2010, as there was a change from a trust to a corporate structure, a deferred tax liability of $1,086 was recorded and offset to shareholders' equity. The carrying value of the conversion option will remain unchanged, aside from conversions.

The effect of these changes is a $12,640 decrease in shareholders' equity as at December 31, 2010 (January 1, 2010 – $9,122 decrease) and a $3,459 decrease in net income before tax for the year ended December 31, 2010.

v. Deferred income taxes – rate adjustment

Prior to January 1, 2011, Capstone qualified as a mutual fund trust for income tax purposes. As a mutual fund trust, Capstone was entitled to deduct distributions to unitholders from taxable income for the determination of taxes payable. As Capstone distributed all of its taxable income, minimal current income taxes were payable.

Beginning January 1, 2011, distributions from a mutual fund trust were subject to specified investment flow-through entity ("SIFT") tax, which is substantially equivalent to the general corporate income tax rate. Under Canadian GAAP, future income taxes are accounted for using the liability method. This method requires Capstone to:

- determine its temporary differences;
- determine the periods over which those temporary differences are expected to reverse; and
- apply the income tax rates enacted at the date of the consolidated statement of financial position that will apply in the periods those temporary differences are expected to reverse.

Canadian GAAP required Capstone to recognize future income taxes based on temporary differences expected to reverse after January 1, 2011 and on the basis of its structure at the current balance sheet date. As a result, under Canadian GAAP, Capstone was required to recognize future income taxes based on the SIFT tax rate.

Under IFRS, mutual fund trusts are required to use the "undistributed" rate in the determination of income tax amounts for financial reporting. Consequently a mutual fund trust must use the applicable income tax rate assuming that no distributions are made to offset taxable income. As a result, mutual fund trusts are required to use the highest marginal personal income tax rate of 46% in the calculation of future income taxes. Capstone has applied this rate to the 2010 comparative financial statements.

The impact to Capstone is a $51,401 increase in deferred income tax liability in the January 1, 2010 opening IFRS consolidated statement of financial position to reflect the rate differential between the highest marginal personal income tax rate of 46% and the SIFT income tax rate of 25%. Under IFRS, this calculation will be applied to timing differences arising in 2010. On December 31, 2010 a $34,809 increase to the deferred income tax liability was recorded.

In 2011, the calculation of deferred income taxes has been affected by Capstone's conversion to a corporation on January 1, 2011. Under IFRS, the deferred income tax calculation will be based on the appropriate corporate tax rate. The impact to Capstone was a reversal of the rate change adjustment described above, resulting in a one-time deferred income tax recovery, which was a $36,990 increase in Capstone's 2011 net income.

vi. Deferred income taxes – other adjustments

Deferred income tax assets and liabilities have been adjusted to give effect to IFRS adjustments as follows:

($000s)	Notes	**Dec 31, 2010**	Jan 1, 2010
Major maintenance	i	**274**	423
Capitalized transaction costs	ii	**(55)**	(55)
Total		**219**	368

The adjustments increased deferred income tax expense recognized in both the consolidated statements of income and consolidated statements of comprehensive income as follows:

($000s)	Notes	Dec 31, 2010
Major maintenance	i	(149)

vii. Accretion of asset retirement obligations

Under Canadian GAAP, accretion was being included as part of operating and maintenance expenses while under IFRS it is required to be classified as a financing expense. Accretion expense of $179 for the year ended December 31, 2010 has been reclassified as finance costs with other interest expenses in accordance with International Financial Reporting Interpretation Committee 1. This change does not affect net income for the year ended December 31, 2010.

(C) Presentation of Cash Flows

The presentation of the consolidated statement of cash flows under IFRS differs from the presentation of the consolidated statement of cash under Canadian GAAP. The changes made to the consolidated statements of financial position and comprehensive income resulted in reclassifications of various amounts on the consolidated statements of cash flows.

The consolidated statement of cash flows were adjusted as follows:

($000s)	Transaction costs	Major maintenance and componen-tization	Class B exchangeable units	Dec 31, 2010
Cash flows from operating activities	2,092	(2,693)	2,145	1,544
Cash flows from investing activities	(2,092)	2,693	–	601
Cash flows from financing activities	–	–	(2,145)	(2,145)
	–	–	–	–

NOTE 5. ACQUISITIONS

Värmevärden

On March 31, 2011, the Corporation acquired a 33.3% indirect interest in a Swedish district heating business from subsidiaries of Fortum Corporation (collectively, "Fortum"), which now operate under the name Värmevärden, for approximately $109,146 (or 710,000 Swedish Kronor ("SEK")). The remaining 66.7% interest in Värmevärden was acquired by Macquarie European Infrastructure Fund II ("MEIF II"), a private unlisted infrastructure fund managed by a subsidiary of MGL. Refer to note 10 (Loans receivable) and note 13 (Equity accounted investments) for more detailed information on the investment in Värmevärden. Transaction costs paid by Capstone on acquisition of $1,258 were capitalized to the investment account in accordance with IAS 28.

Transaction costs on acquisition of $2,414 (or 15,667 SEK) were expensed in the consolidated statement of income as part of the equity accounted income of Värmevärden, as the entity paid the amounts to acquire the collective assets from Fortum.

Bristol Water

On October 5, 2011, Capstone acquired a 70% indirect interest in Bristol Water, a regulated water utility in the United Kingdom, from Suez Environnement through its subsidiary, Agbar (Sociedad General de Aguas de Barcelona), for $213,476. The purchase price was funded through a combination of existing credit facilities, cash on hand and a new $150,000 senior credit facility. The acquisition of Bristol Water supports the Corporation's long-term value proposition. As at December 31, 2011 the balance of the senior credit facility was $78,375.

The acquisition was accounted for using the purchase method of accounting. IFRS requires that Capstone recognize the identifiable assets acquired and liabilities assumed at their fair values. Goodwill is then recognized for the excess of the consideration paid over the net of the identifiable assets acquired and liabilities assumed measured at their fair values. Goodwill represents Capstone's ability to achieve financial and operational outperformance. The non-controlling interest has only been calculated on the fair value of the net identifiable assets.

Transaction costs on acquisition of $5,997 were expensed in the consolidated statement of income as part of administrative expenses.

The allocation of the purchase price is preliminary and may be revised up to twelve months after the purchase date.

The preliminary allocation of total consideration is to net assets acquired.

($000s)	£	$
Working capital	495	804
Tangible assets	312,179	506,792
Intangible assets – licence	13,300	21,591
Intangible assets – goodwill	85,780	139,255
Incremental deferred income tax asset on acquisition	9,416	15,285
Less: Net financial liabilities (net of cash received £24,324, $39,487)	(231,188)	(375,310)
Other	(31,657)	(51,392)
Incremental deferred income tax liability on acquisition	(7,231)	(11,739)
Non-controlling interest	(19,594)	(31,810)
Total cash consideration	131,500	213,476

The amount allocated to goodwill is not deductible for income tax purposes.

IFRS requires disclosure as though the acquisition date for the business combination had been at the beginning of the reporting period, as of January 1, 2011. The pro forma consolidated financial information of Capstone for the year ended December 31, 2011, was as follows:

($000s)	Revenue	Net Income (loss)
Capstone (excluding Bristol Water)	172,407	(8,453)
Bristol Water	169,152	25,795
	341,559	17,342

NOTE 6. CASH AND CASH EQUIVALENTS AND RESTRICTED CASH

($000s)	**Dec 31, 2011**	Dec 31, 2010	Jan 1, 2010
Bristol Water debt service reserve – one year of Artesian loans	**8,689**	–	–
Erie Shores debt service reserve – six months	**5,648**	2,304	2,304
Debt service reserves	**14,337**	2,304	2,304
Cash on deposit	**500**	500	–
Construction holdbacks	**38**	3,027	–
Cash backed letter of credit	**–**	4,011	–
Cash in escrow related to legacy obligations	**–**	760	3,186
Restricted cash	**14,875**	10,602	5,490
Unrestricted cash and cash equivalents	**57,587**	128,413	53,121
	72,462	139,015	58,611

NOTE 7. SHORT-TERM DEPOSITS

($000s)	**Dec 31, 2011**	Dec 31, 2010	Jan 1, 2010
Short-term cash deposits	**82,274**	–	–

The effective interest rate on short-term cash deposits was 1.1% and these deposits have an average maturity date of 164 days.

NOTE 8. TRADE AND OTHER RECEIVABLES

($000s)	**Dec 31, 2011**	Dec 31, 2010	Jan 1, 2010
Power	**30,485**	21,557	16,128
Utilities – Water	**41,981**	–	–
Corporate	**1,117**	139	–
Total trade and other receivables	**73,583**	21,696	16,128

Substantially all of the accounts receivable for the Power segment are with government authorities. Refer to note 12b and 12c for further details of credit risk and economic dependence.

The Utilities – Water segment accounts receivable are composed of:

($000s)	**Dec 31, 2011**
Trade receivables	**39,105**
Less: provision for impairment of receivables	**(21,438)**
Net trade receivables	**17,667**
Other receivables	**3,674**
Other prepayments and accrued income	**20,640**
	41,981

The aging of net trade receivables at Bristol Water was:

($000s)	Dec 31, 2011
Past due 0 – 30 days	6,424
Past due 31 – 120 days	1,660
Past due more than 120 days	9,583
	17,667

As at December 31, 2011, based on a review of collection rates, $21,438 of trade receivables in the Utilities – Water segment impaired and been provided for. The increase in the provision for impairment of trade receivables at Bristol Waters were comprised of:

($000s)	2011
As at January 1	–
As at business acquisition	(21,262)
Charge to statement of income	(1,206)
Amounts written off during the year as uncollectable	447
Net foreign exchange difference	583
As at December 31	(21,438)

Changes in the provision for impaired receivables have been included in the consolidated statement of income as part of operating expenses.

The other classes within trade and other receivables do not contain impaired assets.

Bristol Water has created IAS 39 portfolio provision, but it cannot identify which receivables specifically are the ones impaired. Bristol Water policy is to consider a receivable in a portfolio to which an impairment has been allocated on a collective basis as not being impaired for the purposes of IFRS 7 disclosures until the loss can be specifically identified with the receivable.

Bristol Water is required to continue providing residential customers with water regardless of payment.

NOTE 9. OTHER ASSETS

($000s)	Dec 31, 2011	Dec 31, 2010	Jan 1, 2010
Prepaid expenses	1,411	2,331	3,525
Inventory of spare parts and consumable supplies	3,308	1,221	246
	4,719	3,552	3,771

The cost of inventories recognized as expense and included in operating expenses amounted to $1,289.

NOTE 10. LOANS RECEIVABLE

The following table summarizes the loans receivable from Värmevärden and Chapais:

($000s)	Maturity	Interest Rate	Dec 31, 2011	Dec 31, 2010	Jan 1, 2010
Värmevärden	2021	7.965%	81,587	–	–
Chapais:					
Tranche A (original principal $9,391)	2015	10.8%	4,659	5,543	6,337
Tranche B (original principal $3,624)	2019	4.9%	562	562	562
Tranche C (original principal $2,558)	2016	0%	–	–	–
			86,808	6,105	6,899
Less: Current portion			(984)	(884)	(794)
Total long-term loans receivable			85,824	5,221	6,105

Accrued interest on the loans receivable in the amount of $42 for the year ended December 31, 2011 is included in accounts receivable (December 31, 2010 – $50).

The estimated fair value of the loans receivable as at December 31, 2011 and 2010 approximates their carrying values.

The following table summarizes the decrease in the shareholder loan receivable from Värmevärden during the year:

($000s)	SEK	$
Balance on origination as at March 31, 2011	551,808	84,828
Unrealized foreign exchange gain (loss)	–	(3,241)
Balance on origination as at December 31, 2011	551,808	81,587

The shareholder loan receivable from Värmevärden calls for semi-annual interest payments due on June 30 and December 31. Repayment of the outstanding principal will be in SEK and may be made in part or in full, on such date or dates as agreed between Värmevärden, Capstone and MEIF II, the controlling shareholder. The loan receivable is denominated in SEK and accordingly is re-measured at each reporting date. The change is recorded in the consolidated statement of income as part of unrealized foreign exchange.

Expected repayments of the Chapais loan receivable for the next five years and thereafter are as follows:

Year	Amount
2012	984
2013	1,096
2014	1,220
2015	1,359
2016	–
Thereafter	562
Total	5,221

NOTE 11. FINANCIAL INSTRUMENTS

(A) Fair Value of Financial Instruments

Financial instruments consist of cash and cash equivalents, restricted cash, short-term deposits, accounts receivable, loans receivable, accounts payable and other liabilities, loans payable, finance lease obligations, long-term debt, gas and interest rate swap contracts and foreign currency contracts. The Corporation also has embedded derivatives on one of its commodity contracts.

Financial Instruments Designated as Held-for-trading

The Corporation invests its cash and cash equivalents and restricted cash balances in financial instruments of highly rated financial institutions and government securities with original maturities of 90 days or less. Short-term deposits have original maturities of greater than 90 days.

As at December 31, 2011, the carrying values of cash and cash equivalents, restricted cash and short-term deposits are considered to be approximately at their fair value due to their short-term nature.

Derivative Financial Instruments and Hedging Instruments

The Corporation's gas swap contract effectively fixes the price for a portion of the revenue derived from the sales of excess gas. The contract mitigated exposure to natural gas price fluctuations for sales of excess natural gas in 2011. The natural gas swaps expired during the year ended December 31, 2011.

The Corporation has interest rate swap contracts on a notional amount of $85,000 to mitigate interest rate risk on the CPC-Cardinal credit facility until maturity. Under each contract, the Corporation will pay a fixed rate in return for a floating rate equal to the then current three-month BA rate.

The Corporation holds a residual interest rate swap contract on a notional amount of $20,000 originally entered into to mitigate the refinancing risk associated with the Erie Shores Tranche C project debt, which was refinanced April 1, 2011. Under this contract, the Corporation pays a fixed rate of 5.63% for a period of five years from December 1, 2011 to December 1, 2016. In return, the Corporation receives a floating rate equal to the then current three-month BA rate.

Capstone has an interest rate swap contract to mitigate the interest rate risk on the Amherstburg project debt. The interest rate swap has a notional amount of $94,267. Under the agreement, the Corporation will pay a fixed rate in return for a floating rate in order to effectively fix the rate under its floating rate facility.

The Corporation has an interest rate swap contract on a notional amount of £10,000 to hedge interest rate risk on a variable rate bank loan drawn in October 2008 by Bristol Water. The swap exchanges LIBOR rates on a six-month basis for a fixed rate of 5.025% and expires December 7, 2017. The swap meets the requirement to be accounted for as a cash flow hedge as it was assessed to be highly effective as at December 31, 2011.

The Corporation has foreign currency contracts to mitigate the currency risk for interest payments on the shareholder loan with Värmevärden in SEK and dividends from Bristol Water in pounds sterling. The options to sell 65,800 SEK to Canadian dollars over the next four years are at a fixed exchange rate of 6.5165 SEK. The options to sell £14,900 to Canadian dollars over the next four years are at a fixed exchange rate of £1.623.

The Corporation has determined that its gas purchase contract contains embedded derivative features, which include mitigation options and electricity indexing features requiring separation and measurement at fair value.

The Corporation has determined the fair value of derivative financial instruments as follows:

Gas swap	▸ The gas swap contracts fair value fluctuates with changes in market interest rates and prices for natural gas. ▸ A discounted cash flow analysis based on the forward gas price and the interest rate curve was used to determine their fair value.
Interest rate swap	▸ The interest rate swap contracts' fair value fluctuates with changes in market interest rates. ▸ A discounted cash flow analysis based on a forward interest rate curve was used to determine their fair value.
Interest rate swap (Cash flow hedges)	▸ The market price of comparable instruments at the balance sheet date is used to determine the fair value of cash flow hedges at Bristol Water.
Embedded derivative	▸ The determination of the fair value of the Corporation's embedded derivatives requires the use of option pricing models involving significant judgment based on management's estimates and assumptions.
Foreign currency contracts	▸ The foreign currency contracts fair value fluctuates with changes in the relative currencies to the Canadian dollar. ▸ A Black-Scholes model, based on the current spot price, discount rate, volatility in the underlying currency and time to maturity, is used to determine fair value.

Loans and Receivables

The Corporation's accounts receivable, which consist of trade and accrued interest receivable, are recorded at fair value.

The Corporation's loans receivable are measured at amortized cost using the effective interest method.

The fair value of the Corporation's loans receivable may differ from the carrying value due to changes in interest rates and the underlying risk associated with the debtor. It is determined using a discounted cash flow analysis. See note 10 for further details.

Other Liabilities

The Corporation's accounts payable and accrued liabilities and loans payable are short-term liabilities with carrying values that approximate their fair values as at December 31, 2011.

The Corporation's long-term debt, convertible debentures, levelization amounts and finance lease obligations are recorded at amortized cost using the effective interest method.

The carrying amount of indexed linked borrowings increases annually in line with the retail price index ("RPI") with accretion being charged to income statements as interest expense.

The carrying value of the Corporation's finance leases approximates fair value.

The fair value of the Corporation's floating rate debt and loans payable approximates carrying value.

The fair value of the Corporation's fixed-rate debt is determined through the use of a discounted cash flow analysis using relevant risk-free bond rates plus an estimated margin.

The fair value of the Corporation's convertible debentures is determined by multiplying the current market debenture price as per the Toronto Stock Exchange by the number of convertible shares outstanding as at year end. See note 20 for further details.

The Corporation's irredeemable preferred shares for Bristol Water plc (shown as debt within these financial statements) are listed on the London Stock Exchange. Their fair value is determined by the quoted market price.

The following table illustrates the classification of the Corporation's financial instruments that have been recorded at fair value as at December 31, 2011, within the fair value hierarchy:

	Level 1	Level 2	Level 3	**Dec 31, 2011**	Dec 31, 2010	Jan 1, 2010
Cash and cash equivalents	57,587	–	–	**57,587**	128,413	53,121
Restricted cash	14,875	–	–	**14,875**	10,602	5,490
Short-term deposits	82,274	–	–	**82,274**	–	–
Derivative contract assets:						
Foreign currency contracts	–	1,820	–	**1,820**	–	–
Gas swap contracts	–	–	–	**-**	1,918	2,131
Interest rate swap contracts	–	–	–	**-**	1,292	278
Embedded derivative asset	–	–	1,324	**1,324**	5,287	14,093
Less: Current portion	–	(261)	–	**(261)**	(1,918)	(1,026)
	–	1,559	1,324	**2,883**	6,579	15,476
Derivative contract liabilities:						
Interest rate swap contracts	–	15,237	–	**15,237**	8,402	2,594
Interest rate swap contracts for hedging	–	2,916	–	**2,916**	–	–
Embedded derivative liability	–	–	15,990	**15,990**	8,904	4,859
Less: Current portion	–	(3,088)	–	**(3,088)**	(2,505)	(1,310)
	–	15,065	15,990	**31,055**	14,801	6,143

The fair value for the gas swap contracts for the year-ended December 31, 2010 and January 1, 2010 are classified as Level 2, was derived using a discounted cash flow model that considers various observable inputs, including time to maturity, forward gas prices, foreign exchange curves and credit spreads. The fair value for the interest rate swap contracts, classified as Level 2, was derived using a discounted cash flow model that considers various observable inputs, including time to maturity, forward interest rates and credit spreads or was with reference to the market price of comparable instruments.

Due to the lack of observable market quotes on the Corporation's embedded derivatives, their fair values, classified as Level 3, were derived using valuation models that rely on a combination of observable and unobservable inputs, including time to maturity, forward gas prices and volatility, foreign exchange curves, credit spreads, estimates on gas volumes and sales, fixed and variable gas transportation costs and a forecasted Direct Customer Rate ("DCR") curve based on historical averages. Changes in one or a combination of these estimates may have a significant impact on the fair value of the embedded derivatives given the volume of gas and length of contract involved. As new information becomes available, management may choose to revise these estimates where there is an absence of reliable observable market data.

(B) Income and Expenses From Financial Instruments

	Dec 31, 2011	Dec 31, 2010
Financial instruments designated as held-for-trading:		
Interest income on cash and cash equivalents, restricted cash and short term deposits[1]	872	310
Financial instruments classified as held-for-trading:		
Unrealized loss on foreign currency contracts	(644)	–
Unrealized loss on gas swap contracts	(1,918)	(213)
Unrealized loss on interest rate swap contracts	(8,128)	(4,794)
	(10,690)	(5,007)
Unrealized loss on embedded derivative asset	(3,963)	(8,806)
Unrealized loss on embedded derivative liability	(7,089)	(4,045)
	(11,052)	(12,851)
Loans and receivables:		
Interest income from loans receivable[1]	5,571	638
Other liabilities:		
Interest expense on finance lease obligations	(108)	(104)
Interest expense on pension obligation (net expected return on assets)	(75)	–
Interest expense on long-term debt with maturities under 12 months	(9,826)	(2,020)
Interest expense on long-term debt[2]	(21,659)	(19,409)
	(31,668)	(21,533)

(1) Interest income for the year ended December 31, 2011 of $6,443 (2010 – $948) includes interest income from loans receivable and cash balances.

(2) Interest expense on the long-term debt for the year ended December 31, 2011 includes amortization of deferred financing fees of $3,485 (2010 – $1,951).

NOTE 12. FINANCIAL RISK MANAGEMENT

The Corporation's normal operating, investing and financing activities expose it to a variety of financial risks, including market risk (including commodity price risk, interest rate and inflation risk, and foreign exchange currency risk), credit risk, economic dependence and liquidity risk. The Corporation's overall risk management process is designed to identify, manage and mitigate business risk, which includes, among others, financial risk.

(A) Market Risk

Market risk is the risk or uncertainty arising from possible price movements and their impact on the future performance of the business. The Corporation is exposed to gas and power prices (commodity price risk), interest rates, foreign currency exchange rates and other indices that could adversely affect the value of the Corporation's financial assets, liabilities or expected future cash flows.

Commodity Price Risk

Cardinal's gas purchase agreement mitigates Cardinal's risk to exposure to changes in the market price of gas. This agreement expires on May 1, 2015. Upon expiry of the agreement, Cardinal will have to renegotiate the agreement or enter into a new agreement, and may not be able to do so on terms that are similar to the existing agreement, if at all, or buy gas at spot rates.

The majority of the electricity that is generated at the Power facilities is sold to large utilities or creditworthy customers under fixed long-term PPAs providing a specified rate for a defined period of time. The excess power capacity of Whitecourt may be sold in the open market exposing certain assets to fluctuations in energy prices.

Cardinal uses gas swap agreements to mitigate the effect of gas price fluctuations on the net proceeds that Cardinal receives for the sale of natural gas in excess of the plant's requirements.

Bristol Water is exposed to risk in prices for materials and services used in its treatment processes, including for chemicals and electricity. Risk is minimized through actively monitoring the market and by the use of fixed price supply contracts extending over more than one year where considered appropriate.

Interest Rate and Inflation Risk

Interest rate risk arises as changes in market interest rates affect the Corporations future payments on debt obligations. The Corporation is exposed to interest rate risk on its floating rate debt and levelization amounts. Currently, the Corporation has interest rate swap contracts to mitigate some of the risks associated with its long-term debt.

The terms of the contracts are as follows:

Counterparty	Maturity Date	Notional Amount	Swap Fixed Rate	Stamping Fee	Effective Interest Rate
Cardinal	June 29, 2012	11,700	3.12%	3.00%	6.12%
Cardinal	June 29, 2012	5,300	3.13%	3.00%	6.13%
CPC	June 29, 2012	18,000	3.13%	3.00%	6.13%
CPC	June 29, 2012	10,000	2.28%	3.00%	5.28%
CPC	June 29, 2012	40,000	2.14%	3.00%	5.14%
		85,000			
Erie Shores project debt	December 1, 2016	20,000	5.63%	–	5.63%
Amherstburg debt swap	June 30, 2028	94,267	4.19%	3.13%	7.32%
Bristol Water	December 7, 2017	£10,000	5.025%	–	5.025%

The interest rate swap contracts at Bristol Water have been designated for hedge accounting. No other derivative contracts above have been designated for hedge accounting.

Inflation risk arises as changes to inflation rates cause future cash flows from financial instruments to fluctuate. The index linked long-term debt at Bristol Water is subject to inflation risk. Inflation risk is mitigated by the indexation to RPI included in the determination of Bristol Water's regulated revenue. Refer to note 20(c)(ii) for further detail on this debt.

Foreign Currency Exchange Risk

The Corporation's exposure to foreign currency exchange risk is primarily related to the investment in Bristol Water and the SEK denominated shareholder loan with Värmevärden.

Changes in the Canadian and pound sterling currency rates impact the carrying value of assets, liabilities and components of the consolidated statement of income. Bristol Water has a foreign functional currency requiring movements in the pound sterling to be reflected by the Corporation on consolidation.

Capstone is also exposed to foreign exchange risk from the translation of foreign monetary assets. Changes in the Canadian and SEK currency rates impact the value of the shareholder loan with Värmevärden resulting in a foreign exchange gain or loss, which is included in the consolidated statement of income.

(B) Credit Risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to honour a financial obligation.

Financial instruments that potentially subject the Corporation to concentrations of credit risk consist of cash and cash equivalents, restricted cash, short-term deposits, accounts and loans receivable and derivative contracts.

The Corporation deposits its cash and holds its short-term investments with highly rated financial institutions, with a credit rating of R1 or higher, and therefore management believes the risk of loss to be remote.

Credit risk concentration with respect to Power trade receivables is limited due to the Corporation's customer base being predominantly government authorities. As at December 31, 2011, the maximum exposure with respect to receivables from the OEFC and OPA was $22,102 or 30.7% and $2,574 or 3.5% (2010 – $7,112 or 44.1%and $1,871 or 11.6%) and there are no accounts receivable that are past due. Since the OEFC and OPA are government agencies, management considers credit risk to be minimized.

Bristol Water is required to supply to all customers in its licenced area. Consequently, for residential customers Bristol Water is not able to disconnect services in the event of non-payment. For commercial customers, Bristol Water has the right of disconnection in the event of non-payment. For all customers Bristol Water has implemented policies and procedures to assess the risk of non-payment, recoup debts and establish appropriate provisions.

The Corporation's derivative agreements expose Capstone to losses under certain circumstances, such as the counterparty defaulting on its obligations under the swap agreements or if the swap agreements provide an imperfect hedge. Counterparties to the Corporation's derivative contracts are major financial institutions that have been accorded investment grade ratings. Consequently, management believes there to be minimal credit risk associated with its derivative contracts.

(C) Economic Dependence

Economic dependence arises when an enterprise relies on a significant volume of business with another party that cannot be easily transferred at similar terms and conditions or is abnormal relative to expectations of similar entities.

For the Power segment, during 2011, approximately 53% and 9.6% (2010 – 69.8% and 12.5%) of the Corporation's revenue was derived from the sale of electricity to the OEFC and OPA, respectively.

For the Utilities – Water segment no economic dependence exists. Bristol Water has a large number of customers and there is no significant loss on trade receivables that has not been provided for. Revenue is derived from water supply and related activities in the United Kingdom.

(D) Liquidity Risk

Liquidity risk is the risk that the Corporation may have insufficient cash or other resources to meet obligations as they come due.

Working capital deficit

As at December 31, 2011, the Corporation had current assets of $234,283 and current liabilities of $320,977. The working capital deficit is primarily the result of $230,899 of long-term debt falling due in 2012 (see note 20).

The Corporation is currently evaluating several alternatives to repay, refinance or extend the long-term debt maturing in 2012. These alternatives include, but are not limited to, issuing new debt, extending the maturity of existing debt or portfolio optimization initiatives. The Corporation is in discussions with various lenders to ensure sufficient liquidity and maximize long-term value for shareholders.

Although several options are available to the Corporation, the timing, amount and terms of any refinancing, extension or other efforts is not determinable with certainty at the present time. Refer to note 31 (Subsequent Events) for further detail on refinancing.

Compliance with debt covenants

The Corporation has financial liabilities in the Power and Utilities – Water operating segments, as well as at Corporate. Refer to notes 18 (Accounts payable and other liabilities), 19 (Finance lease obligations) and 20 (Long-term debt) for further detail on financial liabilities. These financial liabilities contain a number of standard financial and other covenants.

Failure to comply with terms and covenants of the Corporation's credit agreements could result in a default, which, if not cured or waived, could result in accelerated repayment or the suspension of dividends.

In the event of default, there can be no assurance that the Corporation could:

(i) Generate sufficient cash flow from operations or that future dividends will be available in amounts sufficient to pay outstanding indebtedness, or to fund any other liquidity needs; or

(ii) Refinance these credit agreements or obtain additional financing on commercially reasonable terms, if at all. The credit agreements, and future borrowings may be, at variable rates of interest, which exposes the Corporation to the risk of increased interest rates.

Contractual maturities

The contractual maturities of the Corporation's financial liabilities as at December 31, 2011 were as follows:

Financial Liabilities	Within one year	One year to five years	Beyond five years	Total
Accounts payable and accrued liabilities	81,734	–	–	81,734
Derivative financial instruments				
Embedded derivatives	–	–	15,990	15,990
Interest rate swaps	3,088	9,341	5,724	18,153
	3,088	9,341	21,714	34,143
Finance lease obligations	5,256	4,779	1,948	11,983
Long-term debt				
Power	94,826	123,645	90,042	308,513
Utilities – Water	23,698	–	456,641	480,339
Corporate	112,375	42,749	–	155,124
	230,899	166,394	546,683	943,976

(E) Sensitivity Analysis

The sensitivity analysis provided below discloses the effect on net income for the year ended December 31, 2011, assuming that a reasonably possible change in the relevant risk variable has occurred during the year and has been applied to the risk exposures in existence at that date to show the effects of reasonably possible changes. The reasonably possible changes in market variables used in the sensitivity analysis were determined based on implied volatilities where available or historical data.

The sensitivity analysis has been prepared based on December 31, 2011 balances and on the basis that the balances, the ratio of fixed to floating rates of debt and derivatives, the proportion of energy contracts that are financial instruments and the proportion of financial instruments in foreign currencies in place at December 31, 2011 are all constant. Excluded from this analysis are all non-financial assets and liabilities that are not classified as financial instruments under IFRS 7.

The sensitivity analysis provided is hypothetical and should be used with caution as the impacts provided are not necessarily indicative of the actual impacts that would be experienced because the Corporation's actual exposure to market rates is constantly changing as the Corporation's portfolio of commodity, debt, foreign currency and equity contracts changes. Changes in fair values or cash flows based on a variation in a market variable cannot be extrapolated because the relationship between the change in the market variable and the change in fair value or cash flows may not be linear. In addition, the effect of a change in a particular market variable on fair values or cash flows is calculated without considering interrelationships between the various market rates, hedging strategies employed by the Corporation or other mitigating actions that would be taken by the Corporation.

		Natural Gas Price Risk		DCR Risk	
Year ended December 31, 2011	Carrying Amount	(10%)	+ 10%	(1%)	+ 1%
Financial assets:					
Embedded derivative asset	1,324	(520)	678	2,739	(2,785)
Financial liabilities:					
Embedded derivative liability	15,990	–	–	115	(103)

		Interest Rate Risk		Canadian to SEK Foreign Exchange Rate Risk	
Year ended December 31, 2011	Carrying Amount	(0.5%)	+ 0.5%	(10%)	+ 10%
Financial assets:					
Cash and cash equivalents (1)	57,587	(288)	288	–	–
Restricted cash	14,875	(74)	74	–	–
Short-term deposits	82,274	(411)	411	–	–
Loans receivable	81,587	–	–	8,159	(8,159)
SEK – foreign exchange contracts	612	–	–	400	(311)
Financial liabilities:					
Finance lease obligations	11,983	4	(4)	–	–
Long-term debt (2)	178,186	891	(891)	–	–
Interest rate swap contracts, net	18,153	3,926	(3,738)	–	–

(1) Cash and cash equivalents include deposits at call, which are at floating interest rates.

(2) Long-term debt excludes all fixed-rate debt totalling $583,821 and variable rate debt that is covered by a swap instrument for fixed-rate debt totalling $179,267.

(3) Pounds sterling foreign exchange contracts have been excluded from this analysis as the change is considered insignificant with respect to currency fluctuation on consolidation.

Bristol Water sensitivity to changes in inflation and foreign exchange to the Canadian dollar was as follows:

	Inflation Rate Risk (RPI)		Canadian to £ Foreign Exchange Rate Risk	
Year ended December 31, 2011	+1%	(1%)	(1%)	+1%
Impact on net income before taxes	2,464	(2,464)	4,922	(4,922)
Impact on equity	1,848	(1,848)	3,691	(3,691)

NOTE 13. EQUITY ACCOUNTED INVESTMENTS

(A) Equity Accounted Investments

	Dec 31, 2011		Dec 31, 2010		Jan 1, 2010	
($000s)	Ownership %	Carrying value	Ownership %	Carrying value	Ownership %	Carrying value
Macquarie Long Term Care L.P. (“MLTCLP”)	45.0%	106	45.0%	54,789	45.0%	54,186
Värmevärden	33.3%	15,887	Nil	–	Nil	–
Chapais	31.3%	–	31.3%	–	31.3%	–
		15,993		54,789		54,186

See also note 10 for detail on loans receivable with Värmevärden and Chapais.

The change in the Corporation’s total equity accounted investments for 2011 and 2010 was as follows:

($000s)	Associate	Dec 31, 2011	Dec 31, 2010
Opening balance		54,789	54,186
Acquisition	Värmevärden	24,318	–
Return of capital	Värmevärden	(3,694)	–
Capitalized transaction costs	Värmevärden	1,258	–
Equity accounted income (loss)	Värmevärden	(5,270)	–
Equity share of other comprehensive loss	Värmevärden	(724)	–
Equity accounted income (loss)	MLTCLP	(6)	3,333
Equity share of other comprehensive loss	MLTCLP	–	(190)
Distributions received	MLTCLP	(54,666)	(2,541)
Other	MLTCLP	(12)	1
Ending balance		15,993	54,789
Loans payable	MLTCLP	–	(49,200)
Net investment		15,993	5,589

During 2011, the loans payable of $54,666 with MLTCLP was settled by a non-cash distribution that reduced the investment.

(B) Summarized Information for Equity Accounted Investments

The Corporation has summarized the information of its equity accounted investments at their gross values as follows:

	Dec 31, 2011		Dec 31, 2010	
($000s)	Assets	Liabilities	Assets	Liabilities
MLTCLP	227	–	121,754	–
Värmevärden(1)	383,367	332,344	–	–
Chapais	27,963	45,757	27,888	48,612

	Year ended Dec 31, 2011			Year ended Dec 31, 2010		
($000s)	Revenue	Income	Capstone’s Income	Revenue	Income	Capstone’s Income
MLTCLP	–	(46)	(6)	–	7,404	3,333
Värmevärden(1)	65,875	(15,776)	(5,270)	–	–	–
Chapais	18,730	2,933	–	18,171	2,386	–
	84,605	(12,889)	(5,276)	18,171	9,790	3,333

(1) Includes purchase accounting adjustments.

NOTE 14. CAPITAL ASSETS

($000s)	Jan 1, 2011	Business acquisition	Additions	Disposals	Net foreign exchange difference	Transfers	Dec 31, 2011
Cost							
Land	235	2,540	–	–	(68)	–	2,707
Equipment and vehicles	4,375	3,617	344	–	(102)	155	8,389
Property and plant	469,665	202,218	2,454	–	(5,485)	121,326	790,178
Infrastructure assets	–	270,931	7,963	–	(7,409)	–	271,485
Construction-in-progress	34,535	23,512	100,290	–	(859)	(121,728)	35,750
	508,810	502,818	111,051	–	(13,923)	(247)	1,108,509
Accumulated depreciation							
Equipment and vehicles	(3,000)	–	(576)	–	8	–	(3,568)
Property and plant	(97,187)	–	(29,378)	–	100	–	(126,465)
Infrastructure assets	–	–	(1,052)	–	32	–	(1,020)
Net carrying value	408,623	502,818	80,045	–	(13,783)	(247)	977,456

($000s)	Jan 1, 2010	Additions	Disposals	Transfers	Dec 31, 2010
Cost					
Land	235	–	–	–	235
Equipment and vehicles	3,743	632	–	–	4,375
Property and plant	467,422	2,243	–	–	469,665
Construction-in-progress	–	34,535	–	–	34,535
	471,400	37,410	–	–	508,810
Accumulated depreciation					
Equipment and vehicles	(2,515)	(485)	–	–	(3,000)
Property and plant	(72,547)	(24,640)	–	–	(97,187)
Net carrying value	396,338	12,285	–	–	408,623

The reconciliation of capital asset additions to cash additions on the consolidated statement of cash flow was:

($000s)	**Dec 31, 2011**	Dec 31, 2010
Additions	**111,051**	37,410
Add: Additions included in accounts payable and accrued liabilities at the beginning of year	**10,431**	950
Less: Additions included in accounts payable and accrued liabilities at the end of the year	**(1,144)**	(10,427)
Non-cash adjustment for asset retirement obligation	**962**	183
Additions to computer software (intangible assets)	**49**	–
Net foreign exchange difference	**1,036**	–
Cash additions	**122,385**	28,116

The net book value of property, plant and equipment includes $91 (£58) of borrowing costs capitalized in accordance with IAS 23 at Bristol Water. Capstone has used 4% as the interest rate to determine the amount of borrowing costs capitalized.

Amounts were transferred from construction-in-progress to the appropriate asset class as the asset becomes available for use at which time amortization over the asset useful life begins. Until such time, assets within construction-in-progress were not amortized.

Capital assets include amounts held under finance leases as follows:

($000s)	Land	Equipment and vehicles	Property and plant	Infrastructure Assets	Total
At December 31, 2011	–	29	18,242	1,820	20,091
At December 31, 2010	–	161	–	–	161

NOTE 15. INTANGIBLES

($000s)	Jan 1, 2011	Business acquisition	Additions	Net foreign exchange difference	Transfers	Dec 31, 2011
Assets						
Computer software	56	3,973	60	(116)	247	4,220
Electricity supply and gas purchase contracts	108,048	–	–	–	–	108,048
Water rights	73,018	–	–	–	–	73,018
Licence	–	21,591	–	(579)	–	21,012
Goodwill	–	139,255	–	(3,743)	–	135,512
Amortization						
Computer Software	(77)	–	(486)	13	–	(550)
Electricity supply and gas purchase contracts	(35,954)	–	(7,441)	–	–	(43,395)
Water rights	(7,445)	–	(2,116)	–	–	(9,561)
	137,646	164,819	(9,983)	(4,425)	247	288,304
Provisions						
Electricity supply and gas purchase contracts	12,257	–	–	–	–	12,257
Utilization	(5,733)	–	(1,630)	–	–	(7,363)
	6,524	–	(1,630)	–	–	4,894

($000s)	Jan 1,2010	Additions	Dec 31, 2010
Assets			
Computer software	27	29	56
Electricity supply and gas purchase contracts	101,832	6,216	108,048
Water rights	73,018	–	73,018
Amortization			
Computer software	(66)	(11)	(77)
Electricity supply and gas purchase contracts	(28,616)	(7,338)	(35,954)
Water rights	(5,329)	(2,116)	(7,445)
Net carrying value	140,866	(3,220)	137,646
Provisions			
Electricity supply and gas purchase contracts	12,257	–	12,257
Utilization	(4,103)	(1,630)	(5,733)
Net carrying value	8,154	(1,630)	6,524

On the acquisition of Bristol Water, Capstone recognized an indefinite life intangible asset for the value of the licence to operate the water network granted by the regulator ("Ofwat"). The licence is related to the exclusive right to operate and invest in the water network within the licenced geographic area. Ofwat grants a perpetual licence with a 25-year notice.

Goodwill is attributed to the Utilities – Water reporting segment, which forms a cash generating unit ("CGU"). The calculation of goodwill for Bristol Water is described in Note 5.

NOTE 16. RETIREMENT BENEFIT SURPLUS

Pension Arrangements

Defined Contribution Plan

Bristol Water operates a defined contribution retirement benefit plan for a number of employees. The total cost recorded in the statement of income was $215 (£134).

Defined Benefit Plan

Defined benefit pension arrangements for Bristol Water's employees are provided through Bristol Water's membership in the Water Companies' Pension Scheme ("WCPS"), which provides defined benefits based on final pensionable pay. Bristol Water's membership in the WCPS is through a separate section (the "Section") of the plan. The assets of the Section are held separately from those of Bristol Water and are invested by discretionary fund managers appointed by the trustees of the plan. The Section has been closed to new entrants and all new eligible employees are offered membership in the defined contribution pension plan.

In addition to providing benefits to employees and ex-employees of Bristol Water plc, the Section provides benefits to employees and ex-employees of Bristol Water Holdings Ltd and former Bristol Water plc employees who transferred to Bristol Wessex Billing Services Ltd. The majority of the Section assets and liabilities relate to Bristol Water plc employees and ex-employees.

Basis of Valuation

The formal actuarial valuation of the Bristol Water's section of the WCPS as at April 1, 2008 was updated to December 31, 2011, by Lane, Clark & Peacock LLP, using the following significant assumptions in accordance with IAS19:

Assumptions	2011
Inflation – Retail Price Index	3.2%
Inflation – Consumer Price Index	2.5%
Pension increases uncapped	2.5%
Pension increases capped at 5%	2.5%
Salary increases	4.2%
Discount rate	4.7%

Asset Distribution and Expected Return

The following table sets out the key assumptions used for the valuation of Bristol Water's Section of WCPS. The table also sets out as at the accounting date the fair value of the assets, a breakdown of the assets into the main asset classes, the present value of the Section liabilities, and the resulting surplus.

($000s)	Expected long-term rate of return	Current Allocation		Amount
Equities	7.5%	12%		32,260
Diversified growth funds	6.8%	4%		10,574
Bonds	3.5%	84%		223,362
Cash	3.5%	0%		918
Total	4.2%	100%	Market value of Section assets	267,114
			Present value of liabilities	(207,010)
			Surplus on IAS 19 basis	60,104

The overall expected rate of return on assets of 4.2% per annum was derived by taking the weighted average of the long-term expected rate of return on each of the above asset classes.

Demographic Assumptions

The mortality assumptions have been drawn from actuarial table PNA00 with a 110% adjustment to mortality rates and with future improvements in line with "medium cohort" projections from 2000, subject to a minimum increase of 1.0% per annum. These tables assume that the average life expectancy for a male pensioner currently aged 60 is 26.5 years and for a female pensioner currently aged 60 is 29.1 years.

The allowance made for future improvements in longevity is such that a male member retiring at age 60 in 2036 (i.e. in 25 years time) is assumed to have an increased average life expectancy from retirement of 29.1 years, and for a female retiring at age 60 in 2036 is assumed to have increased to 31.5 years.

Sensitivity

The assets and liabilities of the Section are subject to volatility as the assets are linked to government bonds and equity markets and the liabilities are linked to yields on AA-rated corporate bonds.

As an indication of sensitivity to changes in assumptions, all other things being equal:

- an increase in the discount rate of 0.1% would lead to a reduction in the value placed on the liabilities of the Section of approximately $3,213 (£2,000); and
- a 5% rise in the value of the Section's return seeking assets portfolio would increase the surplus (before the consideration of any balance sheet limitation that might apply) by approximately $2,124 (£1,322).

Contributions

Contributions paid in the year to the Section were $659 (£410). For normal employer contributions, during the year Bristol Water was required to contribute at the rates of 21% for the main sub Section and 10% for the alternative benefits sub Section of the relevant payroll costs.

The estimated amount of the total employer contribution expected to be paid to the Section for the year ending December 31, 2012 is $3,729 (£2,320).

Changes in Comprehensive Income

Analysis of operating expense, interest expense and amounts recognized in other comprehensive income:

($000s)	For the year ended Dec 31, 2011
Current service cost	477
Total operating expense	477
Expected return on Section assets	(2,455)
Interest expense on pension obligation	2,530
Interest expense	75
Gain on pension Section assets	19,182
Experience gains arising on Section liabilities	–
Gain/(loss) due to changes in assumptions	(6,689)
Actuarial gain/(loss) recognized in Statement of Comprehensive Income ("SCI")	12,493

The cumulative amount of actuarial gains and losses recognized outside profit or loss in the SCI as at December 31, 2011 is a gain of $12,493 (£7,772).

Changes in Financial Position

Movement in Section pre-tax financial position and defined benefit obligation during the year:

	For the year ended Dec 31, 2011		
($000s)	Asset	Liability	Total
Surplus in Section at January 1, 2011	–	–	–
Movement in year:			
Business acquisition	254,164	(204,951)	49,213
Current service cost: employee	–	(177)	(177)
Current service cost: employer	–	(477)	(477)
Aggregate regular contributions: employee	186	–	186
Aggregate regular contributions: employer	473	–	473
Benefits paid	(2,190)	2,190	–
Charge to interest expense	2,455	(2,530)	(75)
Actuarial gain/(loss) recognized in SCI	19,182	(6,689)	12,493
Foreign exchange	(7,156)	5,624	(1,532)
Surplus in Section at December 31, 2011	267,114	(207,010)	60,104

The actual return on the Section's assets over the period ended as at December 31, 2011 was a gain of $21,634 (£13,460).

Assumptions	Experience adjustments	As a % of balance
Asset	19,182	7%
Liability	(6,689)	3%
	12,493	21%

NOTE 17. INCOME TAXES

On January 1, 2011, following the change in the tax status of the Corporation, the calculation of the deferred income tax assets and liabilities was revised. The revisions were included in the consolidated statement of income, except for adjustments related to the convertible debentures, which were included in shareholders' equity on conversion to a corporation. As a result, shareholders' equity decreased by $1,086 and a deferred income tax recovery of $34,808 was recognized.

Effective January 1, 2011, pursuant to the reorganization of the Fund Capstone became a taxable corporation. The reconciliation of income tax expense for the year ended December 31, 2010 is not comparable with the current year because the majority of earnings prior to 2011 were not subject to income taxes. As a result, comparative figures are not included.

(A) Deferred Income Tax Assets

The tax effect of temporary differences is as follows:

($000s)	**Dec 31, 2011**	Dec 31, 2010	Jan 1, 2010
Non-capital loss carry-forwards	**1,523**	1,915	–
Levelization amounts	**2,942**	7,223	7,224
Financial instruments	**8,460**	4,989	465
Debt retirement	**1,818**	4,534	4,534
Intangible assets	**512**	1,478	1,882
Asset retirement obligations	**601**	1,413	1,415
Capital assets	**650**	1,304	1,391
Loan premium and deferred financing costs	**15,701**	1,355	1,224
Other	**690**	–	308
Deferred income tax assets	**32,897**	24,211	18,443

(B) Deferred Income Tax Liabilities

The tax effect of temporary differences is as follows:

($000s)	**Dec 31, 2011**	Dec 31, 2010	Jan 1, 2010
Capital assets	**125,888**	44,687	71,051
Intangible assets	**36,113**	59,893	61,121
Equity investment in Chapais	**301**	368	291
Loan premium and deferred financing costs	**93**	303	327
Pension surplus	**15,129**	–	–
Convertible debentures	**677**	–	–
Financial instruments	**–**	–	2,533
Deferred income tax liabilities	**178,201**	105,251	135,323

(C) Tax Loss Carry-forwards

Capstone's tax loss carry-forwards, and the portion recognized in deferred income tax assets were as follows:

($000s)	Expiry	Recognized	Unrecognized	**Dec 31, 2011**	Dec 31, 2010	Jan 1, 2010
Canadian – capital losses	No expiry	–	70,557	**70,557**	113,018	110,637
Canadian – non-capital losses	2025 – 2029	6,092	31,960	**38,052**	5,301	25,823
US – non-capital losses	2023 – 2027	–	17,942	**17,942**	17,547	20,692
UK – capital losses (£2,963)	No expiry	–	4,681	**4,681**	–	–
UK – advanced corporation tax (£3,922)	No expiry	–	6,196	**6,196**	–	–

(D) Rate Reconciliation

The reconciliation of the difference between the income tax expense using the statutory tax rate and the effective tax rate is:

($000s)	For the year ended Dec 31, 2011
Loss before income taxes	(39,021)
Statutory income tax rate	28.17%
Income tax expense based on statutory income tax rate	(10,992)
Permanent differences	4,950
Tax rate differentials	764
Change in tax status	(34,808)
Unrecognized losses arising in the year	5,186
Other	(858)
Total income tax recovery	(35,758)

NOTE 18. ACCOUNTS PAYABLE AND OTHER LIABILITIES

(A) Current Accounts Payable and Accrued Liabilities

($000s)	**Dec 31, 2011**	Dec 31, 2010	Jan 1, 2010
Accounts payable and accrued liabilities	**77,233**	25,630	18,609
Dividends payable	**4,501**	3,266	4,368
	81,734	28,896	22,977

(B) Deferred Revenue

Deferred income represented grants and contributions received in respect of non-infrastructure assets less amounts amortized to the statement of income:

($000s)	
As at January 1, 2011	–
Contributions received	1,396
Net foreign exchange difference	(33)
Ending deferred revenue	1,363

NOTE 19. FINANCE LEASE OBLIGATIONS

($000s)	Interest Rate	Maturity	Dec 31, 2011	Dec 31, 2010	Jan 1, 2010
Power: Equipment lease	7%	2012	129	249	367
Utilities – Water: Equipment leases	3.22 – 4.41%	2012 – 2020	11,854		–
			11,983	249	367
Less:current portion			5,256	120	119
Non-current portion			6,727	129	248

For the year ended December 31, 2011, the Corporation repaid $133 (2010 – $104) on finance leases, including interest of $108 (2010 – $22).

The present value of finance leases obligations in the next five years and thereafter:

Year of Repayment	Power	Utilities – Water	Corporate	Total
Within one year	129	5,127	–	5,256
One year to five years	–	4,779	–	4,779
Beyond 5 years	–	1,948	–	1,948
Total	129	11,854	–	11,983

NOTE 20. LONG-TERM DEBT

(A) Components of Long-term Debt

	Dec 31, 2011		Dec 31, 2010		Jan 1, 2010	
($000s)	Fair Value	Carrying Value	Fair Value	Carrying Value	Fair Value	Carrying Value
Power	314,196	308,513	245,911	246,777	214,107	216,346
Utilities – Water	504,479	480,339	–	–	–	–
Corporate	155,124	152,421	100,661	88,225	118,413	112,922
	973,799	941,273	346,572	335,002	332,520	329,268
Less: Deferred financing costs	–	(6,229)	–	(5,556)	–	(5,068)
Long-term debt	973,799	935,044	346,572	329,446	332,520	324,200
Less: current portion	(235,209)	(230,899)	(47,698)	(44,838)	(42,054)	(42,035)
	738,590	704,145	298,874	284,608	290,466	282,165

(B) Power

	Dec 31, 2011		Dec 31, 2010	
($000s)	Fair Value	Carrying Value	Fair Value	Carrying Value
CPC-Cardinal credit facility	85,000	85,000	85,000	85,000
Erie Shores project debt	108,616	102,933	106,197	107,063
Amherstburg Solar Park project debt	94,267	94,267	31,000	31,000
Levelization liability	26,313	26,313	23,714	23,714
	314,196	308,513	245,911	246,777
Less: Deferred financing costs	–	(3,248)	–	(2,865)
Long-term debt	314,196	305,265	245,911	243,912
Less: Current portion	(99,136)	(94,826)	(47,698)	(44,838)
	215,060	210,439	198,213	199,074

(i) CPC-Cardinal Credit Facility

The CPC-Cardinal credit facility is composed of a term facility and revolving facility as follows:

($000s)	Interest Rate	Maturity	**Dec 31, 2011**	Dec 31, 2010
Total available credit				
Term facility			**125,625**	141,875
Revolving facility			**40,625**	40,625
			166,250	182,500
Amounts drawn – Term facility				
Cardinal – Power portion	4.38%	June 29, 2012	**(17,000)**	(17,000)
CPC – Power portion	4.38%	June 29, 2012	**(68,000)**	(68,000)
CPC – Corporate portion	3.78%	June 29, 2012	**(34,000)**	–
Letters of credit – Revolving facility			**(7,863)**	(40,625)
Guarantee			**(5,000)**	(10,000)
Remaining available credit			**34,387**	46,875

Under the revolving credit facility there are four letters of credit authorized. Three letters of credit are for the benefit of Erie Shores totalling $2,533. One letter of credit of $5,330 for Amherstburg debt service reserve.

Advances under the credit facility are made in the form of a series of bankers' acceptances ("BA") and prime rate loans. Interest paid on BAs is based on the then current BA rate plus an applicable margin ("stamping fee") based on the ratio of consolidated total debt to consolidated earnings before interest, taxes, depreciation and amortization, and unrealized gains and losses ("EBITDA"). The weighted average contractual rate of interest at December 31, 2011 is included in the preceding table and the maturity date of the facility was June 29, 2012. The collateral for the facility is provided by first ranking security interest covering the assets of CPC, Cardinal and certain direct subsidiaries, collectively the "restricted group". The restricted group is subject to certain financial and non-financial covenants including limits on the interest coverage ratio and the ratio of consolidated total debt to consolidated EBITDA.

As at December 31, 2011, the CPC-Cardinal credit facility had various interest rate swap contracts to convert the floating rate obligations to a fixed rate obligation (see note 12(a)).

Collateral for the CPC-Cardinal credit facility is provided by a first ranking priority security interest covering the assets of CPC, Cardinal and certain direct subsidiaries, collectively the "restricted group". As at December 31, 2011, the carrying value of the assets of the restricted group exceeded total amounts drawn on the facility.

(ii) Erie Shores Wind Farm

The Corporation has a non-recourse amortizing project debt for Erie Shores through three tranches:

($000s)	Interest Rate	Maturity	**Dec 31, 2011**	Dec 31, 2010
Tranche A	5.96%	April 1, 2026	**59,721**	62,248
Tranche B	5.28%	April 1, 2016	**4,040**	4,815
Tranche C	6.15%	April 1, 2026	**39,172**	40,000
			102,933	107,063

On April 1, 2011, Capstone completed the refinancing of Tranche C of Erie Shores' non-recourse, project financing loan. Under the refinancing, the Erie Shores' Tranche C loan was replaced with a fully amortizing term loan in the amount of $40,000, with a fixed rate of interest at 6.145%, which matures on April 1, 2026. Transaction costs of $889 were deferred.

Under the agreement, six months of principal and interest payments must be held in debt service reserve account. As a result, $5,648 was included in restricted cash on the consolidated statement of financial position.

The Erie Shores project debt was secured only by the Erie Shores assets, with no recourse to the Corporation's other assets. As at December 31, 2011, the carrying value of the assets of Erie Shores exceeded the total amount of project debt outstanding.

As at December 31, 2010, the Erie Shores project debt had an interest rate swap contract to convert the Erie Shores obligation to a fixed rate (see note 12(a)).

(iii) Amherstburg Solar Park Project Debt

The Amherstburg Solar Park project debt is composed as follows:

($000s)	Interest Rate	Maturity	**Dec 31, 2011**	Dec 31, 2010
Project debt	7.32%	June 30, 2016	**94,267**	31,000

In July 2011, the outstanding balance of the construction facility was converted to a non-recourse term facility, which requires regular principal and interest payments, over 17 years, with a five-year maturity.

The Amherstburg Solar Park project debt was secured only by the assets of the Amherstburg Solar Park, with no recourse to the Corporation's other assets. As at December 31, 2011, the carrying value of the assets of the Amherstburg Solar Park exceeded the total amount of project debt outstanding.

As at December 31, 2011, the Amherstburg Solar Park project debt had an interest rate swap contract to mitigate interest rate risk (see note 12(a)).

(iv) Levelization Amounts

The carrying value of the levelization amounts was as follows:

($000s)	Interest Rate	Maturity	**Dec 31, 2011**	Dec 31, 2010
Principal	6.87%	June 2032	**13,902**	12,666
Accrued Interest			**12,411**	11,048
			26,313	23,714

The levelization liability related to payments received from the OEFC in excess of the revenue recorded using the base rates set out under the PPA for the Wawatay hydro power facility. In accordance with the PPA, the OEFC is required to make monthly guaranteed payments as well as variable payments based on actual electricity production. To the extent that these payments exceed the revenue recorded in a given month, the Corporation records an increase in the levelization amounts. To the extent that these payments are less than the revenue recorded, the Corporation records a reduction in the levelization amounts.

The interest on the levelization liability was accrued at the prescribed variable rate of 6.87% per annum (2010 – 6.94%).

(C) Utilities – Water

	Dec 31, 2011		Dec 31, 2010	
($000s)	**Fair Value**	**Carrying Value**	Fair Value	Carrying Value
Bank loans	**39,662**	**38,956**	–	–
Term loans	**436,205**	**413,702**	–	–
Debentures	**2,125**	**2,008**	–	–
Irredeemable cumulative preferred shares	**26,487**	**25,673**	–	–
Long-term debt	**504,479**	**480,339**	–	–
Less: current portion	**(23,698)**	**(23,698)**	–	–
	480,781	**456,641**	–	–

(i) Bank Loans

($000s)	Interest Rate	Maturity	**Dec 31, 2011 [£]**	**Dec 31, 2011 [$]**	Dec 31, 2010 [$]
HSBC Bank plc, secured (principal £15,000[(1)])	1.52%	October 22, 2012	**15,000**	**23,699**	–
The Royal Bank of Scotland plc, secured (principal £10,000[(1)])	1.43%	December 17, 2017	**9,657**	**15,257**	–
				38,956	–

(1) The principal due on maturity is different from the balance as at December 31, 2011 in pounds sterling as due to the fair value adjustment made to the long-term debt on acquisition.

The bank loans have variable interest rates at one month Libor, plus a margin. The bank loans are fully repayable on maturity, as a bullet payment. The bank loans carry non-utilisation fees if not renewed.

(ii) Term Loans

($000s)	Interest Rate	Maturity	Dec 31, 2011 [£]	Dec 31, 2011 [$]	Dec 31, 2010 [$]
Secured, variable interest at six-month LIBOR plus a margin (principal £10,000[(1)])	5.73%	December 17, 2017	9,657	15,257	–
Secured, principal index-linked to RPI, fixed interest at 3.635%* on the indexed principal (principal £118,800[(1)])	8.64%	September 30, 2032	144,156	227,752	–
Secured, fixed interest at 6.01%* (principal £57,300[(1)])	6.01%	September 30, 2033	63,541	100,388	–
Secured, principal index-linked to RPI, fixed interest at 2.701% on the indexed principal (principal £40,900[(1)])	7.89%	March 24, 2041	44,500	70,305	–
				413,702	–

(1) The principal due on maturity is different from the balance as at December 31, 2011 in pounds sterling as due to the fair value adjustment made to the long-term debt on acquisition.

* Coupons as specified in loan documentation.

The £10,000 variable rate term loan is fixed by an interest rate swap exchanging six-month LIBOR for a fixed rate of 5.025%. The fixing dates of the swap match those of the loan (see note 12(a)). The loan has a bullet repayment on maturity.

The £118,800 indexed linked loan indexation is applied every six months, in March and September, by reference to the Retail Price Index (RPI), with an eight-month lag.

The £40,900 indexed linked loan indexation is applied every six months, in March and September, by reference to the Retail Price Index (RPI), with a two-month lag.

(iii) Debentures

($000s)	Interest Rate	Maturity	Dec 31, 2011 [£]	Dec 31, 2011 [$]	Dec 31, 2010 [$]
Consolidated (principal £1,405[(1)])	4.00%	Irredeemable	1,106	1,748	–
Perpetual (principal £37[(1)])	4.25%	Irredeemable	37	58	–
Perpetual (principal £55[(1)])	4.00%	Irredeemable	55	87	–
Perpetual (principal £73[(1)])	3.50%	irredeemable	73	115	–
				2,008	–

(1) The principal due on maturity is different from the balance as at December 31, 2011 in pounds sterling as due to the fair value adjustment made to the long-term debt on acquisition.

Interest is fixed, payable every six months.

(iv) Irredeemable Cumulative Preferred Shares

($000s)	Interest Rate	Maturity	Dec 31, 2011 [£]	Dec 31, 2011 [$]	Dec 31, 2010 [$]
Preferred shares, cumulative (principal £12,500[(1)])	8.75%	irredeemable	16,250	25,673	–

(1) The principal due on maturity is different from the balance as at December 31, 2011 in pounds sterling as due to the fair value adjustment made to the long-term debt on acquisition.

Bristol Water is authorized to issue 14,000 irredeemable cumulative preferred shares at a value of £1 each, 12,500 have been issued and are fully paid for as at December 31, 2011.

The preferred shares, which do not carry any voting rights, were issued in 1992 at £1 per share. The preferred shareholders of Bristol Water are entitled to receive dividends at 8.75% per annum on the par value of these shares on a cumulative basis; these dividends are payable half yearly on 1 April and 1 October. On winding up, the preferred shareholders rank ahead of ordinary shareholders and are entitled to receive £1 per share and any dividends accrued but unpaid in respect of their shares. In the event that dividends on the preferred shares are in arrears for six months or more, holders of the preferred shares become entitled to vote at general meetings of members. In accordance with IAS 39 the shares are classified as long-term debt.

(v) Security for Borrowings

The majority of Bristol Water's financial liabilities are secured. In respect of Bristol Water plc:

- By way of first fixed charges over any of its freehold or leasehold property belonging to it now or acquired in the future (other than protected land under the Water Industry Act 1991), its present and future goodwill, all rights and claims in relation to charged bank accounts, all book debts all insurances, all rights, title and interest to all investments and all plant and machinery, and
- A floating charge over the whole of its undertaking

Prior to enforcement of the security by the lender, Bristol Water plc is entitled to exercise all its rights, and perform its obligations in relation to the charged assets in accordance with the provisions set out in the Security Trust and Intercreditor Deed.

In respect of Bristol Water Core Holdings Ltd (the immediate parent of Bristol Water plc), as security for the obligations of Bristol Water plc:

- A fixed charge over its shares in Bristol Water plc together with a floating charge over the whole of its undertaking.

(D) Corporate

		Dec 31, 2011		Dec 31, 2010	
($000s)	Notes	Fair Value	Carrying Value	Fair Value	Carrying Value
Senior debt facility		78,375	78,375	–	–
CPC-Cardinal credit facility	20 (b)(i)	34,000	34,000	–	–
Convertible debentures		42,749	40,046	61,311	48,875
Convertible debentures – conversion option		–	–	12,640	12,640
Class B exchangeable units	22 (b)	–	–	26,710	26,710
		155,124	152,421	100,661	88,225
Less: Deferred financing costs		–	(2,981)	–	(2,691)
		155,124	149,440	100,661	85,534
Less: Current portion		(112,375)	(112,375)	–	–
Long-term debt		42,749	37,065	100,661	85,534

(i) Senior Debt Facility

The senior debt facility is composed as follows:

($000s)	Interest Rate	Maturity	Dec 31, 2011	Dec 31, 2010
Senior debt facility	4.70%	October 3, 2012	78,375	–
Deferred financing costs			(920)	–
			77,455	–

The senior debt facility bears monthly interest at an annual rate equal to the Canadian Dealer Offered Rate ("CDOR") plus a specified margin. The margin increases each quarter until July 2, 2012 at which point the rate approximates 7.20%, assuming no change in CDOR during that period.

The senior debt facility is subject to a general security agreement and a securities pledge agreement from the Corporation and from each of MPT Utilities Corp. and MPT Utilities Europe Ltd. (the "Utilities companies") constituting a first priority encumbrance over the assets of the Utilities companies, including its equity interest in all subsidiaries of the Utilities companies.

The Senior debt facility restricts Capstone from funding Power segment operations from non-Power segment activities.

On November 10, 2011, Capstone completed a public offering to raise $75,000 (net proceeds of $71,625) from the issue of 12,000 common shares. The proceeds from the offering were used to repay a portion of the new $150,000 senior credit facility.

(ii) Convertible Debentures

The carrying values of the liability and the equity components of the debentures were as follows:

($000s)	Dec 31, 2011	Dec 31, 2010	Jan 1, 2010
Liability component	48,875	51,749	83,928
Conversion to shares, net of costs(1)	(9,547)	(3,721)	–
Amortization and accretion	718	847	18
	40,046	48,875	83,946
Deferred financing costs	(2,518)	(2,518)	(2,291)
	37,528	46,357	81,655
Convertible debentures – conversion option	–	12,640	9,122
	37,528	58,997	90,777
Equity component(2)	11,553	–	–
Conversion to shares(1), net of costs	(2,270)	–	–
	9,283	–	–
	46,811	58,997	90,077

(1) $11,819 of carrying value was converted to shares of the Corporation (note 22) ($4,390 – 2010), which is net of transaction costs incurred in connection with the issuance the convertible debentures.

(2) The carrying value of the convertible debentures – conversion option was re-measured to the fair value at January 1, 2010 and December 31, 2010. On January 1, 2011, the amount is classified as equity and no longer re-measured to fair value.

The Corporation has unsecured subordinated convertible debentures ("2016 Debentures") that are due on December 31, 2016. The Corporation originally issued $57,500 gross transaction costs of $2,880. The 2016 Debentures bear an interest rate of 6.50% per annum payable semi-annually in arrears on June 30 and December 31 of each year. The 2016 Debentures are convertible into shares of the Corporation at the option of the holder at a conversion price of $7.00 dollars per share. The face value of the debentures as of December 30, 2011 was $42,749 (December 31, 2010 – $53,221).

(F) Long-term Debt Covenants

For the year ended and as at December 31, 2011, the Corporation and its subsidiaries were in compliance with all financial and non-financial debt covenants.

(G) Long-term Debt Repayments

The following table summarizes total principal payments required under each of the Corporation's facilities in the next five years and thereafter:

Year of Repayment	Power	Utilities – Water	Corporate	Total
2012	94,826	23,698	112,375	230,899
2013	11,670	–	–	11,670
2014	12,248	–	–	12,248
2015	12,860	–	–	12,860
2016	86,867	–	42,749	129,616
Thereafter	90,042	456,641	–	546,683
Total	308,513	480,339	155,124	943,976

NOTE 21. LIABILITY FOR ASSET RETIREMENT

The carrying value of these obligations is based on estimated cash flows required to settle these obligations in present day costs. The costs relate to site restoration and decommissioning of Cardinal, Erie Shores and the Hydro power facilities.

The following table provides the underlying assumptions and reconciles the Corporation's total asset retirement obligation activity for the years ended December 31:

($000s)	Dec 31, 2011	Dec 31, 2010	Jan 1, 2010
Assumptions:			
Expected settlement date	2014 – 2042	2014 – 2042	2014 – 2042
Estimated settlement amount	Nil – $2,965	Nil – $2,865	Nil – $3,542
Inflation rate	2.0% – 2.1%	2.0%	1.7% – 2.0%
Credit-adjusted risk-free rate	8.0% – 9.5%	4.2% – 6.2%	5.5% – 5.9%
Balance, beginning of year	3,167	3,171	1,848
Revision of estimates	(962)	(183)	1,188
Accretion expense	207	179	135
Balance, end of year	2,412	3,167	3,171

NOTE 22. SHAREHOLDERS' EQUITY

Effective January 1, 2011, the Fund converted from a mutual fund trust to a corporation whereby each unit of Macquarie Power & Infrastructure Income Fund was automatically exchanged for one common share of the Corporation.

The share capital of the Corporation was as follows:

($000s)	Dec 31, 2011	Dec 31, 2010	Jan 1, 2010
Common shares	626,861	536,278	466,662
Preferred shares	72,020	–	–
Class B exchangeable units	26,710	–	–
	725,591	536,278	466,662

(A) Common Shares

Capstone is authorized to issue an unlimited number of common shares.

Continuity for the year ended	Dec 31, 2011		Dec 31, 2010	
($000s and 000s shares)	Shares	Carrying Value	Units	Carrying Value
Opening balance	56,352	536,278	46,665	466,662
Common shares issued(1) to (3)	12,856	77,526	9,079	65,249
Dividend reinvestment plan(4)	253	1,238	–	–
Conversion of convertible debentures, net of cost(5)	1,496	11,819	611	4,390
Units redeemed	–	–	(3)	(23)
Ending balance	70,957	626,861	56,352	536,278

(1) On December 22, 2010 the Corporation closed a private placement financing (the "Offering") of 9,079 units at a price of $7.60 dollars per unit for gross proceeds of approximately $69,000 before issue costs of $3,751. The net proceeds of the Offering were used by the Corporation for acquisitions and for general purposes. During 2011, $102 of the private placement transaction costs were included in share capital.

(2) On April 15, 2011 the Corporation issued 856 common shares subscribed to by MGL as part of the management internalization at $8.18 dollars per share for gross proceeds of approximately $7,000, which MGL will hold for at least one year.

(3) On November 10, 2011, the Corporation issued 12,000 common shares for gross proceeds of $75,000 before issues costs of $4,526.

(4) During 2011, 253 common shares at an aggregate value of $1,238 were issued by the Corporation under the Dividend Re-Investment Plan (DRIP).

(5) $11,819 of the convertible debentures were converted to shares of the Corporation (note 20(d)(ii)) ($4,390 – 2010), which is net of original issuance transaction costs.

(B) Class B Exchangeable Units

LTC Holding LP had 3,249 Class B exchangeable units outstanding as at December 31, 2011 and 2010. At December 31, 2010 the Class B exchangeable units were classified as a liability. On conversion to a Corporation these units were reclassified to equity. Each unit is exchangeable into one share of the Corporation. The Class B exchangeable units are eligible to receive distributions under the same terms and conditions as shares of the Corporation.

The holders of the Class B exchangeable units are not permitted to acquire any additional shares of the Corporation (other than pursuant to the exchange of the Class B exchangeable units or pursuant to a distribution reinvestment plan) without the consent of the Corporation until October 18, 2020. Each Class B exchangeable unit will convert into a share of the Corporation on October 18, 2020 unless converted earlier at the option of the Class B exchangeable unitholders. The Class B exchangeable unitholders are not permitted to sell more than 5% of their aggregate outstanding shares in any four-month period and are not eligible to vote with any shares they receive on exchange of their Class B exchangeable units until they together hold 1% or less of the aggregate outstanding shares.

(C) Preferred Shares

Capstone is authorized to issue preferred shares equal to 50% of the outstanding common shares. As at December 31, 2011, there were 3,000 series A preferred shares issued and outstanding, with a carrying value of $72,020.

The series A preferred shares have a 5% cumulative discretionary dividend, which resets on each five-year anniversary. The shares are non-voting and redeemable at the Corporation's discretion. Subsequent to the initial five-year fixed rate period, the issuer will determine the annual dividend for the next 5-year period based on the five-year Government of Canada Bond Yield plus 2.71%. After September 30, 2016, the series A preferred shares are convertible on-a-one for one basis to series B cumulative, floating rate first preferred shares at the holder's option. The series B preferred shares are redeemable at the Corporation's discretion after June 20, 2021 and every five years thereafter at $25.00 dollars per share plus accrued and unpaid dividends.

(D) Dividends

Dividends to shareholders are paid monthly in arrears on the 15th day of each month or the next business day. For the year ended 2011, dividends declared totalled $42,026 for common shareholders and the holders of the Class B exchangeable units (for the year ended December 31, 2010 – distributions of $31,331 to unitholders and $2,144 to holders of the Class B exchangeable units).

Dividends on the series A preferred shares are payable quarterly and totalled to $1,264 in 2011.

In 2010, the distributions to the Class B exchangeable unitholders were included in interest expense in the statements of income as described in note 4(b)(iii).

(E) Capital Management

The Corporation defines its capital as its long-term debt and shareholders' (unitholders' in 2010) equity as follows:

($000's)	**Dec 31, 2011**	Dec 31, 2010	Jan 1, 2010
Long-term debt	**941,273**	335,002	329,268
Shareholders' / Unitholders' equity(1)	**413,520**	264,095	210,099
Total capitalization	**1,354,793**	599,097	539,367

(1) Capstone does not include the non-controlling interest of $34,450 in Shareholders' equity.

The Corporation manages its capital to achieve the following objectives:

(i) maintain a capital structure that provides financing flexibility to the Corporation to ensure access to capital, on commercially reasonable terms, without exceeding its debt capacity;

(ii) maintain financial flexibility in order to preserve its ability to meet financial obligations, including debt servicing payments and distribution payments; and

(iii) deploy capital to provide an appropriate investment return to its shareholders.

The Corporation's financial strategy is designed to maintain a capital structure consistent with the objectives stated above and to respond to changes in economic conditions. In doing so, the Corporation may issue additional shares, issue additional debt, issue debt to replace existing debt with similar or different characteristics, or adjust the amount of dividends paid to shareholders. The Corporation's financing and refinancing decisions are made on a specific transaction basis and depend on such things as the Corporation's needs and economic conditions at the time of the transaction.

The Corporation is not subject to any external capital requirements and is in compliance with all debt covenants as described in note 20.

NOTE 23. EARNINGS PER SHARE

Basic and Diluted Earnings Per Share

($000s)	For the year ended Dec 31, 2011	Dec 31, 2010
Net income (loss)	**(3,263)**	15,901
Non-controlling interest	**(2,449)**	–
Dividends declared on preferred shares	**(1,264)**	–
Net income (loss) available to common shareholders	**(6,976)**	15,901
Weighted average number of common shares outstanding	**64,465**	46,933
Basic and diluted earnings per share	**(0.108)**	0.339

For the year-ended December 31, 2011 and 2010 the convertible debentures were anti-dilutive. Additionally, the Class B exchangeable units were anti-dilutive for the year-ended December 31, 2010.

NOTE 24. SHARE-BASED COMPENSATION

(A) Deferred Share Units

Effective January 1, 2011, fixed grants equivalent to $3,750 dollars on the first day of each quarter were made to eligible directors and converted to Deferred Share Units ("DSUs") at the five-day volume weighted average price ("VWAP") on the grant date. These grants vest immediately upon the last trading day of each quarter. In addition, directors may elect to receive their quarterly trustee fees in the form of DSUs, which vest at the time of granting. Dividend equivalents are granted as of each record date for dividends on shares in accordance with Capstone's dividend policy on common shares. DSUs do not have an exercise price and can only be settled in cash at the time a director ceases to be a board member.

The average VWAP per DSU granted during the 2011 was $7.60 dollars. As at December 31 the carrying value of the DSUs, based on a market price of $3.81 dollars, was $32 and is included in accounts payable and other liabilities in the consolidated statement of financial position. The resulting DSU expense for 2011 was $32 and is recorded as compensation expense in the consolidated statement of income.

($000s, except unit amounts)	For the year ended Dec 31, 2011 Number of units	Fair Value
Outstanding at January 1, 2011	–	–
Fixed quarterly grants during the period	7,896	60
Dividend equivalents	511	3
	8,407	63
Unrealized gain (loss) on revaluation	–	(31)
Outstanding at December 31, 2011	8,407	32

(B) Long-Term Incentive Plan

On June 17, 2011, 67 Restricted Stock Units ("RSUs") and 67 Performance Share Units ("PSUs") were granted at the five-day VWAP to the senior management of the Corporation. These grants cliff vest on December 31, 2013. Dividend equivalents are granted as of each record date for dividends on shares in accordance with Capstone's dividend policy on common shares. RSUs and PSUs do not have an exercise price and can be settled in shares or cash at the Board's discretion. Additionally, the valuation also takes into consideration that the amount of the PSUs is subject to Capstone's total return over the period relative to a peer group.

The VWAP per RSU and PSU granted on June 17, 2011 was $7.87 dollars. As at December 31, the carrying value of the RSUs and PSUs, based on a market price of $3.81 dollars, was $228 and is included in accounts payable and other liabilities in the consolidated statement of financial position. The RSU and PSU compensation expense of $228 is recorded as compensation expense in the consolidated statement of income for 2011.

($000s, except unit amounts)	For the year ended Dec 31, 2011 Notional number of units	Fair Value
Outstanding at January 1, 2011	–	–
Grants during the period	134,116	1,062
Dividend equivalents	7,776	45
	141,892	1,107
Unrealized loss on revaluation	–	(566)
Outstanding at December 31, 2011	141,892	541

NOTE 25. EXPENSES – ANALYSIS BY NATURE

For the year ended	Dec 31, 2011			Dec 31, 2010		
($000s)	Operating	Administrative	Total	Operating	Administrative	Total
Fuel	77,838	–	77,838	69,282	–	69,282
Internalization	–	19,675	19,675	–	886	886
Chemicals and supplies	16,438	–	16,438	798	–	798
Wages and benefits	11,911	4,126	16,037	7,577	–	7,577
Business development	–	8,289	8,289	–	2,606	2,606
Maintenance	5,053	–	5,053	8,676	–	8,676
Manager fees	–	1,825	1,825	–	5,193	5,193
Insurance	1,610	–	1,610	1,365	–	1,365
Property taxes	1,383	–	1,383	820	–	820
Other operating expenses	7,853	–	7,853	5,787	–	5,787
Other administrative expenses	–	4,051	4,051	–	3,193	3,193
Total	122,086	37,966	160,052	94,305	11,878	106,183

NOTE 26. OTHER GAINS AND LOSSES

($000s)	For the year ended Dec 31, 2011	Dec 31, 2010
Amherstburg gain on acquisition	–	4,234
Unrealized gain on derivative financial instruments (note 11(b))	(21,742)	(17,858)
Unrealized loss on Class B exchangeable unit liability	–	(6,856)
Unrealized loss on convertible debentures – conversion option	–	(3,459)
Other gains and (losses), (net)	(21,742)	(23,939)

NOTE 27. COMMITMENTS AND CONTINGENCIES

The Corporation, either directly or indirectly through its subsidiaries, has entered into various contracts and commitments as at December 31, 2011 as described below:

(A) Swap Contracts

The Corporation has various swap contracts for gas and interest, which have been further disclosed in notes 11 and 12.

(B) Leases

The following table summarizes the minimum operating lease payments:

($000s)	Within one year	One year to five years	Beyond five years	Total
Operating leases	932	3,741	8,952	13,625

Cardinal leases the site on which the facility is located from Canada Starch Operating Company Inc. ("Casco"). Under the lease, Cardinal pays nominal rent. The lease extends to 2016 and expires concurrently with the energy savings agreement between Casco and Cardinal.

A subsidiary of Capstone has lease agreements with the Provinces of Ontario and British Columbia with respect to certain lands, lands under water and water rights necessary for the operation of its hydro facilities. The payments with respect to these agreements vary based on actual power production. The terms of the lease agreements extend between 2023 and 2042.

Amherstburg leases the land on which its operating facilities are located. The terms of the lease agreements extend to 2031.

Erie Shores has lease and easement agreements with local landowners, municipalities and other parties with respect to certain lands for the operation of the wind farm. The terms of the lease agreements extend to 2025, with a 20-year renewal option.

During 2011, the Corporation entered an operating lease for premises, which have a term to 2018 with an option to extend to 2023.

(C) Energy Savings Agreement

Under the terms of an energy savings agreement between Cardinal and Casco, Cardinal is required to sell up to 723 million pounds of steam per year to Casco for its plant operations. The energy savings agreement matures on December 31, 2014, but may be extended by up to two years at the option of Cardinal.

(D) Wood Waste Supply Agreement

Whitecourt has a long-term agreement with Millar Western Industries Ltd. and Millar Western Pulp Ltd. (collectively, "Millar Western") to ensure an adequate supply of wood waste. The agreement expires in 2016.

(E) Gas Purchase Contract

Cardinal has a long-term purchase agreement for natural gas that expires on May 1, 2015. The minimum purchase commitment for natural gas under the agreement is 9,289,104 MMBtu per year through to expiration in 2015, which is equivalent to 80% of the contract maximum.

(F) Operations and Management Agreement

A subsidiary of Capstone has an operations and management agreement with Regional Power OPCO Inc. ("Regional") to operate and maintain the hydro power facilities, expiring on November 15, 2016 with an automatic renewal term. Regional is paid a monthly management fee and is eligible for an annual incentive fee.

A subsidiary of Capstone has an O&M agreement with SunPower Energy Systems Canada Corporation to operate and maintain the Amherstburg Solar Park, expiring on June 30, 2031. Capstone has the ability to terminate the agreement during the term of the contract.

A subsidiary of Capstone has an O&M agreement with Agbar to provide management support to Bristol Water with an initial 5-year term, which automatically extends indefinitely. Capstone has the ability to terminate the contract.

(G) Capital Commitments

Bristol Water had commitments for capital expenditures at December 31, 2011 contracted for but not provided were $29,396.

(H) Guarantees

From the date of Clean Power Income Fund's investment in the landfill gas business on October 31, 2002, it provided three guarantees. Two of these guarantees were in favour of a municipality, guaranteeing obligations under the relevant PPAs with the municipality. The other guarantee was in favour of a lessor of one of the sites upon which one of the landfill gas facilities projects operated, guaranteeing certain obligations under the relevant lease. The municipality and the lessor both have policies of not relieving guarantors from their guarantees for periods in which they were invested in the underlying projects. Capstone has received indemnification from Fortistar Renewable Group LLC ("Fortistar"), the purchaser of the landfill gas business, for the period commencing from the sale to Fortistar on September 15, 2006. As at December 31, 2011, no claims had been made on these guarantees.

NOTE 28. RELATED PARTY TRANSACTIONS

In the second quarter, the management and administration agreements that established the related party relationship with Macquarie Power Management Ltd. ("MPML" or "the Manager") a subsidiary of MGL were terminated. As such, after April 15, 2011 all transactions with MGL and its subsidiaries were not considered to be related. All amounts included in 2011 are related to the period before April 15, 2011.

All related party transactions were carried out under normal arm's length commercial terms.

(A) Transactions with MGL

Included in the table below are the related party transactions with MPML:

	For the year ended	
($000s)	**Dec 31, 2011**	Dec 31, 2010
Management fees[1]	**13,821**	1,611
Administrative fees[2]	**1,053**	122
Cost reimbursement	**1,881**	4,112
	16,755	5,845

(1) Includes $13,101 paid to MGL to terminate the management and administration agreements and $220 as reimbursement for staff vacation pay.
(2) Includes $1,016 paid to MGL to terminate the administrative agreement.

In addition to the above amounts, in March 2011, due diligence and legal fees of $1,313 (8,334 SEK) were reimbursed to a subsidiary of MGL with respect to the acquisition of Värmevärden in Sweden. This cost has been expensed in the consolidated statement of income as at December 31, 2011 as part of equity accounted income as it was incurred by Värmevärden.

In March 2011, $646 became payable to MEIF II for the reimbursement of due diligence costs with respect to the acquisition of Värmevärden in Sweden. These costs have been accrued in accounts payable and other liabilities and capitalized to equity accounted investments as at December 31, 2011.

In March 2011, a financial advisory fee of $500 was payable to a subsidiary of MGL with respect to the refinancing of Tranche C of the Erie Shores project debt. These costs have been paid and capitalized to the long-term debt as at December 31, 2011.

On April 15, 2011, upon the internalization of management, Capstone and its subsidiaries paid MGL $14,117 as consideration for terminating all management and administration agreements and $220 as reimbursement for vacation payments to staff who joined Capstone. MGL immediately used $7,000 of the money it received to subscribe for Capstone common shares.

(B) Compensation of Key Management

Key management includes the Corporation's directors, Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"). Compensation awarded to key management consisted of salaries, directors fees and short-term employee benefits, which include fees paid to directors. Eligible directors and senior management of the Corporation also receive forms of stock-based compensation as described in note 24.

The following table summarizes key management compensation:

	For the year ended	
($000s)	**Dec 31, 2011**	Dec 31, 2010
Salaries, directors' fees and short-term employee benefits	**2,973**	585
Share-based compensation	**102**	–
	3,075	585

Prior to April 15, 2011, the CEO and CFO of Capstone and other employees were employed by the Manager. Accordingly, no employee compensation prior to April 15, 2011 was included directly in these consolidated financial statements.

NOTE 29. SEGMENTED INFORMATION

The Corporation has three reportable segments (2010 – two reportable segments – the Social segment pertains to comparative information when Capstone held an interest in Leisureworld) based on how management has organized the business to assess performance and for operating and capital allocation. Each reportable segment has similar economic characteristics based on the nature of the products or services, type of customers, method of distributing their products or services and regulatory environment. Management evaluates the performance of these segments primarily on revenue and cash flows from operations.

Infrastructure segments consist of:	Geographical location 2011	2010
Power		
The Corporation's investments in gas cogeneration, wind, hydro, biomass power and solar power assets.	Canada	Canada
Utilities – Water		
The regulated water services business (Bristol Water), in which the Corporation acquired a 70% indirect interest on October 5, 2011.	United Kingdom	n/a
Utilities – District Heating ("DH")		
The district heating business (Värmevärden), in which the Corporation acquired a 33.3% indirect interest on March 31, 2011.	Sweden	n/a
Social		
For the Corporation's 45% indirect interest in Leisureworld until it was sold in March 2010 as reported in the comparative figures.	n/a	Canada

As at and for the year ended	Dec 31, 2011					Dec 31, 2010			
		Utilities							
($000s)	Power	Water	DH	Corporate	Total	Power	Social	Corporate	Total
Revenue	172,407	43,560	–	–	215,967	158,512	–	–	158,512
Depreciation of capital assets	(26,428)	(4,611)	–	33	(31,006)	(25,125)	–	–	(25,125)
Amortization of intangible assets	(7,882)	(440)	–	(91)	(8,413)	(7,813)	–	(21)	(7,834)
Interest income	787	291	5,024	341	6,443	639	–	309	948
Interest expense	(20,534)	(6,417)	–	(4,717)	(31,668)	(14,629)	–	(6,904)	(21,533)
Income tax recovery	–	(2,665)	–	38,423	35,753	73	–	37,668	37,741
Net income (loss)	(13,316)	5,002	(3,541)	8,592	(3,263)	(2,739)	3,088	15,552	15,901
Cash flow from operations	66,769	25,352	5,024	(46,264)	50,881	51,768	–	(22,757)	29,011
Additions to capital assets	(97,974)	(23,998)	–	(413)	(122,385)	(28,116)	–	–	(28,116)
Total assets	656,871	913,811	97,458	29,604	1,697,744	597,790	–	206,344	804,134
Total liabilities	287,780	663,455	–	298,540	1,249,774	338,124	49,302	152,613	540,039

NOTE 30. NON-CASH WORKING CAPITAL

The change in non-cash working capital is composed of the following:

($000s)	For the year ended Dec 31, 2011	Dec 31, 2010
Accounts receivable	**(20,014)**	(5,568)
Other assets	**864**	1,350
Accounts payable and other liabilities	**31,962**	(2,081)
	12,812	(6,299)

NOTE 31. SUBSEQUENT EVENTS

On February 24, 2012, Värmevärden's parent company, Sefyr Värme AB, in which Capstone holds a 33.3% indirect investment, completed a $138,000 (922,000 SEK) offering of senior secured bonds to select institutional investors. The bonds have a five-year term, are non-amortizing and carry a coupon of 7.0%. Sefyr Värme AB has the option to issue up to an additional $12,000 (78,000 SEK) of senior secured bonds at any time over the next five years, bringing the offering to an aggregate size of up to approximately $150,000 (1,000,000 SEK).

Proceeds from the issuance were distributed to the owners of Sefyr Värme AB, with Capstone receiving one third or $46,000, which was used to repay a portion of the $78,375 outstanding on the senior credit facility as at December 31, 2011.

SUPPLEMENTARY INFORMATION

DIVIDEND POLICY

Capstone's dividend policy is determined and evaluated periodically by the Corporation's Board of Directors. Capstone's dividends are designated eligible for purposes of the *Income Tax Act* (Canada). An enhanced dividend tax credit applies to eligible dividends paid to Canadian residents.

DIVIDEND REINVESTMENT PLAN (DRIP)

The DRIP provides eligible common shareholders with a convenient, affordable way to reinvest their cash dividends in Capstone's common shares without incurring commissions, service charges or brokerage fees.

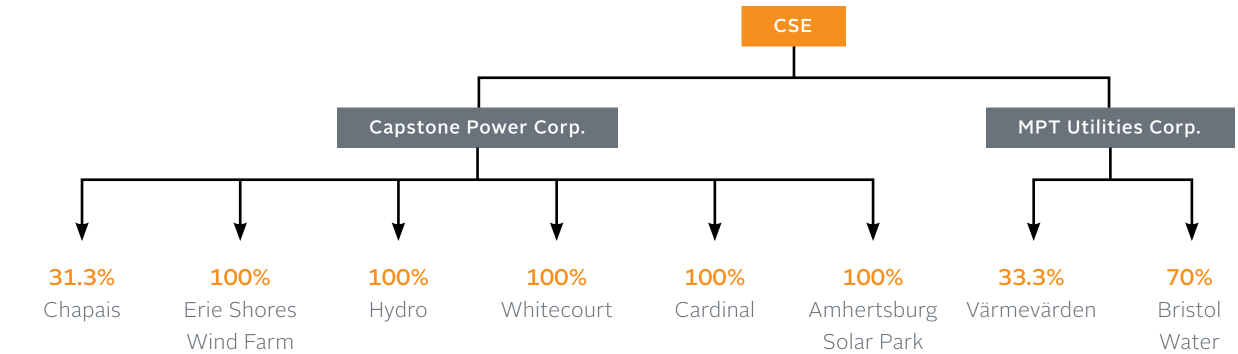
The common shares acquired under the DRIP are either purchased on the open market through the Toronto Stock Exchange (TSX) and/or any alternative market or issued by the Corporation from treasury. Accordingly, the DRIP provides an effective means by which Capstone may retain and reinvest dividends by issuing additional equity. In the case of treasury purchases, the price of common shares purchased under the DRIP is the average of the daily volume weighted average price of common shares traded on the TSX for the five trading days immediately preceding the applicable common share dividend payment date less a discount of up to 5%. For more information about Capstone's DRIP, please visit our website at http://www.capstoneinfrastructure.com/InvestorCentre/StockInformation/DRIP.aspx or contact:

Computershare Trust Company of Canada
100 University Avenue, 9th Floor, North Tower
Toronto, Ontario M5J 2Y1
Attention: Dividend Reinvestment Department

Tel: 1 (800) 564-6253

www.computershare.com/service
www.computershare.com/investorcentrecanada

ORGANIZATIONAL STRUCTURE



GLOSSARY

AMP
Asset management plan, which is developed by water utilities in the United Kingdom every five years and approved by Ofwat.

Annual long-term average production
An average production figure based on the actual electricity production of a facility since the start of full operations.

Availability
Availability is the number of hours that a generating unit is able to provide service at full output, whether or not it is actually in service, as a percentage of total hours in the period.

Base load facility
A base load facility produces electricity at an essentially constant rate and runs continuously.

Capacity
Capacity is the net amount of electricity generated by a generating unit as a percentage of the total possible generation over the period.

Cogeneration
Cogeneration refers to the simultaneous production of electricity and thermal energy in the form of heat or steam from a single fuel source, a process that results in high efficiency and an effective use of energy.

Consumer Price Index (CPI)
The CPI is an indicator of inflation that measures the change in the cost of a fixed basket of products and services, including housing, electricity, food and transportation.

Curtailment
A period during which a power facility continues to operate but at less than capacity.

Direct Customer Rate (DCR)
The Direct Customer Rate, which is set by the Ontario Electricity Financial Corporation, is calculated based on a three-year average of the total market cost of electricity to industrial customers.

Gigajoule (GJ)
One GJ is equivalent to the amount of energy available from 26.1 m^3 of natural gas.

Gigawatt hour (GWh)
A unit of electrical energy equal to 1,000 megawatt hours.

Green metric tonne (GMT)
A unit of weight equal to 1,000 kilograms.

Hydrology
The effect of precipitation and evaporation upon the occurrence and distribution of water in streams, lakes and on or below the land surface.

K Factor
The regulated annual rate by which each licenced water company can increase its charges annually on top of inflation.

Kilowatt (kW)
This commercial unit of electrical power refers to 1,000 watts of electrical power. This is the total amount of power needed to light 10 light bulbs of 100 watts each.

KLbs
Thousands of pounds of steam.

Megawatt (MW)
A megawatt is 1,000 kilowatts.

Megawatt hour (MWh)
This is a measure of energy production or consumption equal to one million watts produced or consumed in one hour (total amount of power required to light 10,000 100-watt light bulbs).

ML/d
Millions of litres of water per day.

MMBtu
A unit of heat equal to one million British thermal units. A British thermal unit is the quantity of energy necessary to raise the temperature of one pound of water by one degree Fahrenheit.

Ofwat
The UK Water Services Regulation Authority.

Outage
A period of time when a power generation facility does not produce any electricity.

Payout ratio
Payout ratio refers to the percentage of cash flow paid out in dividends to holders of common shares.

Peaking facility
A peaking power facility is reserved for operation during the hours of highest daily, weekly or seasonal loads.

Power Purchase Agreement (PPA)
A PPA is an agreement to purchase electricity at a specified rate for a defined period of time.

RCV
The regulated capital value, or capital base, that is used by Ofwat to set the prices a water utility may charge its customers in each asset management plan period.

SIM
Service Incentive Mechanism, a new incentive mechanism introduced by Ofwat to reward or penalize water companies' service performance.

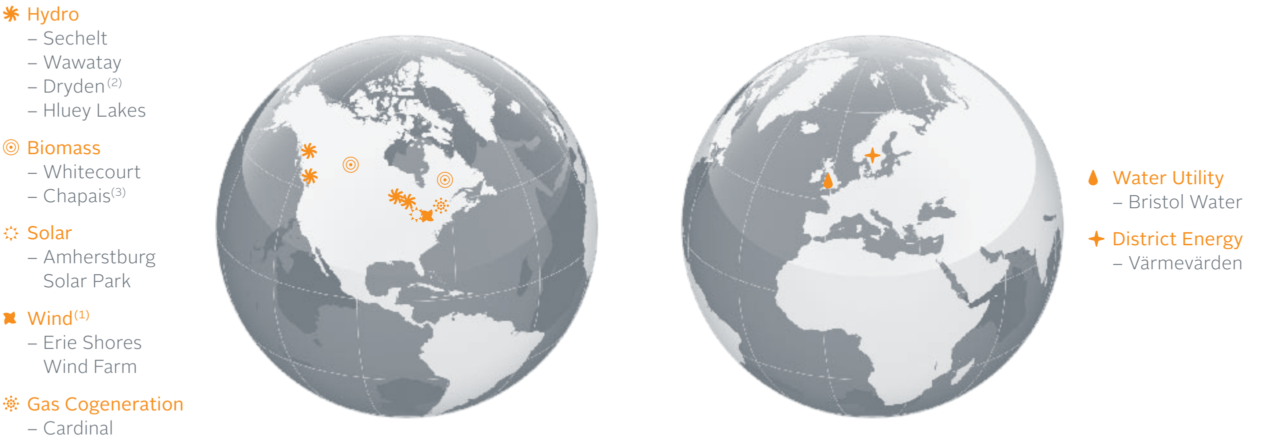
Solar photovoltaic (PV) power
The generation of electricity directly from sunlight.

Total return
The total return on an investment includes income from dividends, as well as share price appreciation or depreciation, over a given time period.

Watt
A watt is the scientific unit of electric power.

Yield
Yield refers to the amount of dividends paid per share over the course of a year divided by the trading price of the common shares.

PORTFOLIO OVERVIEW



Power

Business	Year Built	Interest	Net Capacity (MW)	PPA Counterparty	PPA Expiry	Fuel Supply Counterparty	Fuel Supply Expiry	Employees
Cardinal	1994	100%	156	OEFC	2014	Husky	2015	18
Erie Shores (1)	2006	100%	99	OPA	2026	n/a	n/a	9
Whitecourt	1994	100%	25	TransAlta	2014	Millar Western	2016	33
Sechelt	1997	100%	16	BC Hydro	2017	n/a	n/a	n/a
Wawatay	1992	100%	14	OEFC	2042	n/a	n/a	n/a
Hluey Lakes	2000	100%	3	BC Hydro	2020	n/a	n/a	n/a
Dryden (2)	Various	100%	3	OEFC	2020	n/a	n/a	n/a
Amherstburg	2011	100%	20	OPA	2031	n/a	n/a	n/a
Chapais (3)	1995	31.3%	28	Hydro-Québec	2015	Barrette/ Chantiers/ Société en commandite Scierie Opitciwan	2015	n/a

Utilities

Business	Interest	Capacity	Counterparties	Network	Length of Served	Population Regulated	Employees
Värmevärden	33.3%	Heat production capacity of 786 MWth	Mix of industrial and retail customers, with industrial counterparties representing 25% of revenue	317 kilometres	163,000	No	84
Bristol Water (4)	70%	Average daily supply of 278 million litres	Domestic or residential customers represent 75% of revenue with non-domestic customers representing the balance	6,670 kilometres	1.16 million	UK Water Services Regulation Authority	441 – FTEs

(1) One 1.5 MW turbine is owned by a landowner.
(2) The Dryden facility is composed of three facilities, built in 1922 (Wainwright), 1928 (Eagle) and 1938 (McKenzie). These facilities were refurbished in 1986.
(3) CSE's investment in Chapais consists of a 31.3% interest in one of two classes of preferred shares, a 24.8% interest in Tranche A and B debt, and a 50% interest in Tranche C debt.
(4) Bristol Water was acquired on October 5, 2011.

FINANCIAL HIGHLIGHTS

PERFORMANCE MEASURES

Information for 2004 to 2009 is presented in Canadian GAAP and may not be comparable with information provided under IFRS for 2010 and 2011.

Earnings Measures ($000s)	**2011**	2010	2009	2008	2007	2006	2005	2004
Revenue	**215,967**	158,512	148,384	153,186	122,811	89,940	90,325	55,848
Net income (loss)	**(3,263)**	15,901	11,259	(26,534)	5,426	8,411	8,372	7,236
Basic earnings per share	**(0.108)**	0.339	0.226	(0.531)	0.135	0.280	0.364	0.342

Cash Flow Measures ($000s)	**2011**	2010	2009	2008	2007	2006	2005	2004
Cash flows from operating activities	**50,881**	29,011	38,040	50,516	29,663	21,044	20,230	14,729
Adjusted EBITDA[1]	**55,673**	55,818	61,244	67,324	61,250	34,104	27,912	16,304
Adjusted funds from operations (AFFO)[1]	**17,606**	34,774	42,989	50,626	72,835	33,267	27,708	15,821
Payout ratio	**238.7%**	96.3%	121.92%	103.61%	58.96%	91.45%	80.19%	85.10%

(1) These performance measures are not defined by International Financial Reporting Standards ("IFRS"). Please see pages 26 to 27 for a definition of each measure.

Capital Structure ($000s)	**2011**	2010	2009	2008	2007	2006	2005	2004
Long-term debt – Power	**308,513**	246,777	216,346	242,703	219,162	35,000	35,000	35,000
Long-term debt – Utilities – Water	**480,339**	–	–	–	–	–	–	–
Long-term debt – Corporate	**152,421**	88,225	57,500	38,918	38,918	–	–	–
Class B exchangeable units – market value	**12,380**	26,710	19,854	15,565	30,642	32,656	33,501	–
Preferred shares – market value	**52,500**	–	–	–	–	–	–	–
Common shares – market value	**270,348**	463,217	273,161	310,066	376,275	214,231	235,382	188,680

INVESTOR INFORMATION

Quick Facts

Common shares outstanding	70,957,368
Preferred shares outstanding	3,000,000
Convertible debentures outstanding	42,749
Class B exchangeable units	3,249,390
Securities symbols and exchange	Toronto Stock Exchange: CSE, CSE.PR.A, CSE.DB.A
Index inclusion	S&P TSX Clean Technology Index
Ownership	Approximately 21,000 common shareholders

QUARTERLY TRADING INFORMATION

	2011				2010			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Common shares								
High share price (intraday)	6.60	7.85	8.29	8.80	8.39	7.35	7.30	7.34
Low share price (intraday)	3.26	6.12	7.60	7.50	7.14	6.73	4.50	6.09
Closing share price	3.81	6.33	7.82	7.94	8.22	7.30	6.95	7.21
Average daily trading volume	678,233	154,499	126,407	125,861	92,678	52,943	63,465	100,648
Dividend paid	0.165	0.165	0.165	0.165	0.165	0.165	0.165	0.165
Preferred shares								
High share price (intraday)	21.14	24.20	24.75	–	–	–	–	–
Low share price (intraday)	15.83	18.76	24.00	–	–	–	–	–
Closing share price	17.50	20.10	24.19	–	–	–	–	–
Average daily trading volume	9,583	8,136	13,150	–	–	–	–	–
Dividend paid	0.4212	–	–	–	–	–	–	–
Debentures								
High share price (intraday)	102.00	112.00	117.40	123.00	116.03	111.59	106.50	105.50
Low share price (intraday)	90.25	99.05	110.00	108.50	105.00	103.26	100.00	100.80
Closing share price	100.00	103.00	112.90	114.00	115.20	106.50	103.98	105.00
Average daily trading volume	3,074	5,687	837	1,960	1,152	632	1,014	1,727

CORPORATE INFORMATION

MANAGEMENT

Michael Bernstein
President and Chief Executive Officer

Michael Smerdon
Executive Vice President and Chief Financial Officer

Stu Miller
Executive Vice President, General Counsel and Secretary

Jack Bittan
Senior Vice President, Business Development

Rob Roberti
Senior Vice President, Power Generation

Jens Ehlers
Senior Vice President, Finance

Sarah Borg-Olivier
Senior Vice President, Communications

BOARD OF DIRECTORS

V. James Sardo
Chairman of the Board

Derek Brown

James Cowan

Patrick J. Lavelle

François R. Roy

HEAD OFFICE

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RBC Centre
Suite 2930
Toronto, Ontario M5V 3H1

Tel: 416-649-1300
Fax: 416-649-1335

INVESTOR INFORMATION

Stock Exchange and Symbols
Toronto Stock Exchange
Common shares: CSE
Preferred shares: CSE.PR.A
Convertible debentures: CSE.DB.A

Transfer Agent
Computershare Investor Services Inc.
1500 University Street, Suite 700
Montreal, Quebec H3A 3S9

Toll-free number (within Canada and the United States):
1-800-564-6253
International number: 514-982-7555

AUDITORS

PricewaterhouseCoopers LLP
Toronto, Ontario

INVESTOR RELATIONS CONTACT

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Senior Vice President, Communications

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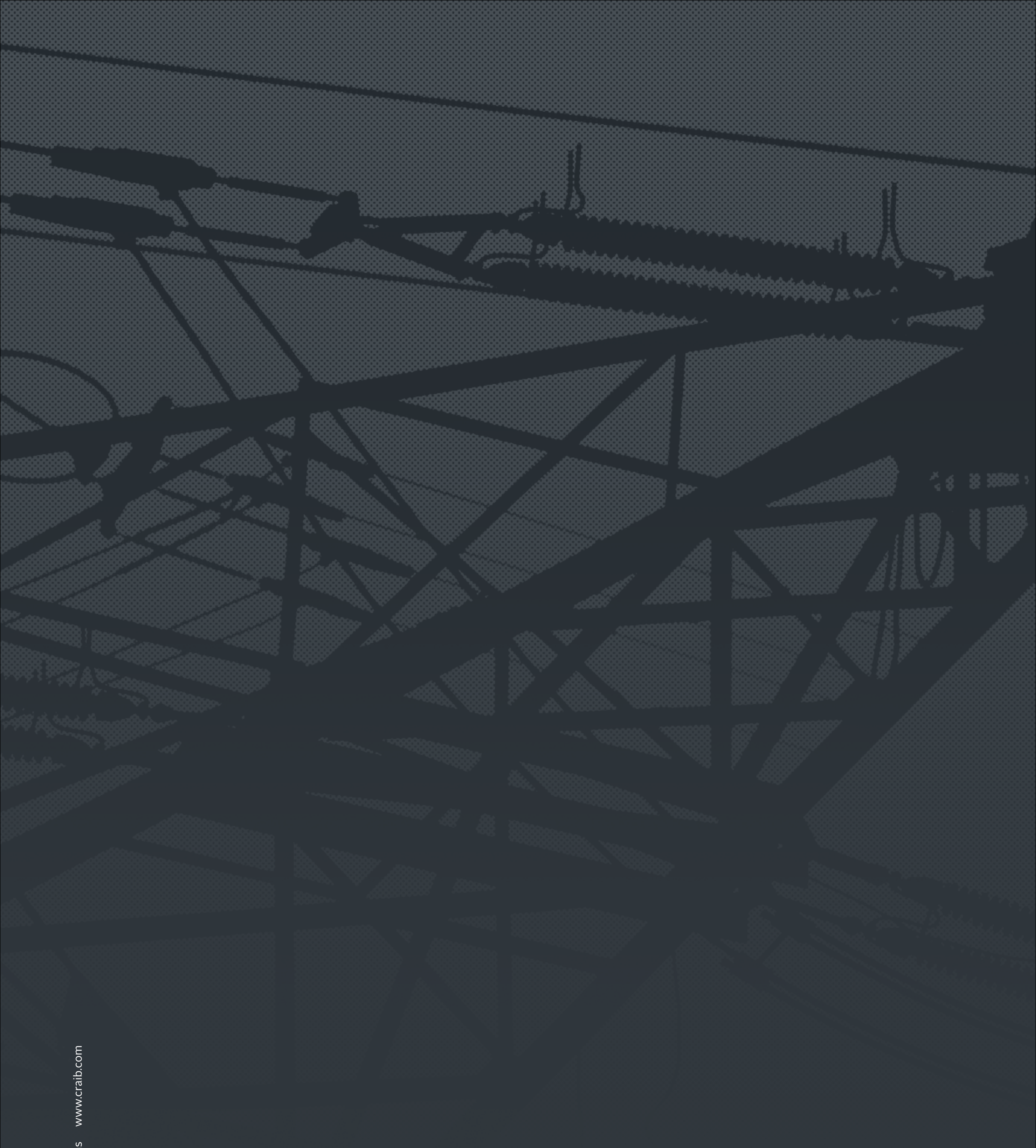
Toll free: 1-855-649-1300
Email: info@capstoneinfrastructure.com

ANNUAL GENERAL MEETING OF SHAREHOLDERS

Tuesday, June 5, 2012
10 a.m. ET
TMX Broadcast Centre Gallery
130 King Street West
Toronto, Ontario

Visit our website at www.capstoneinfrastructure.com for information about Capstone's businesses and to access investor materials, including annual and quarterly financial reports, recent news and investor presentations, including a webcast of the annual general meeting.



DISCLAIMER

Readers are advised that this annual report may contain forward-looking information and a financial outlook that reflects management's current expectations regarding Capstone's future growth, results of operations, performance and business based on information currently available to Capstone. These forward-looking statements are subject to known and unknown risks and uncertainties that may cause actual results or events to differ materially from those expressed or implied by such statements and, accordingly, should not be read as guarantees of future performance or results. Except as may be required by applicable law, Capstone does not undertake any obligation to publicly update or revise any forward-looking statements or financial outlook.

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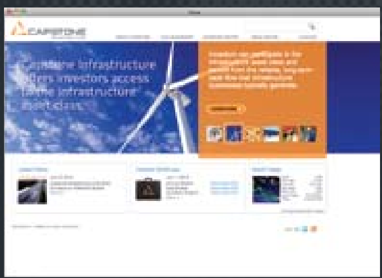
WHAT'S IN A NAME?

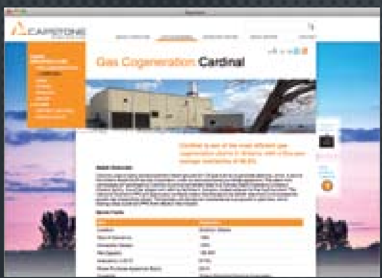
Architecturally speaking, a capstone is the top stone of a building. As an adjective, it describes a significant achievement. Our new brand reflects Capstone's commitment to:

- Achieving excellence in our operations;
- Building our portfolio with a focus on delivering an attractive total return to shareholders; and
- Realizing our vision to become the pre-eminent diversified infrastructure company in Canada.

Our new logo represents Capstone's stable foundation for continuing growth while our signature colour, orange, captures our team's creativity and determination. Watch as our new chapter unfolds.

CAPSTONE
INFRASTRUCTURE





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