VALUE EVERY DAY ›

Annual Report 2012

CAPSTONE INFRASTRUCTURE

Infrastructure is the backbone of the economy and society, from the electricity that lights or heats our homes to the water we drink to the roads we travel.

By investing in essential infrastructure businesses, including power generation, district heating and a regulated water utility, Capstone offers shareholders unique access to the infrastructure asset class and the steady income and potential for capital growth it typically provides.

Every day, we're working to create value for shareholders by:

- Actively managing our businesses;
- Delivering strong financial performance; and
- Uncovering the best opportunities to grow and diversify our portfolio.

At the same time, the businesses we invest in are helping to sustain, shape and strengthen communities, local economies and quality of life in the regions they serve in Canada, the United Kingdom and Europe.

Our businesses deliver safe drinking water to 1.2 million people, generate enough clean electricity to power about 190,000 households, and distribute heat to more than 4,000 supply points to warm homes and businesses. Read more about the value we deliver every day at ***capstoneinfrastructure.com/ar2012****.*

FINANCIAL HIGHLIGHTS

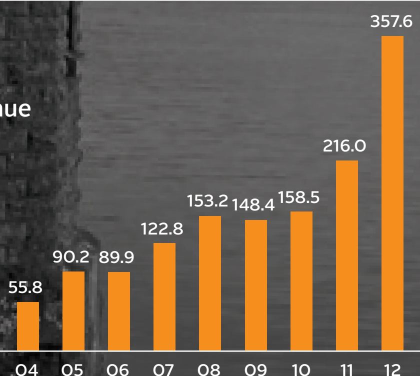
Capstone's mission is to build and responsibly manage a high quality portfolio of infrastructure businesses in Canada and internationally in order to deliver a superior total return to shareholders by providing reliable income and capital appreciation.

Since 2004, we have significantly diversified our investments, increased revenue and grown cash flow.

HISTORICAL REVENUE (in millions of dollars)[2]

26.1%

CAGR in revenue since 2004.



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

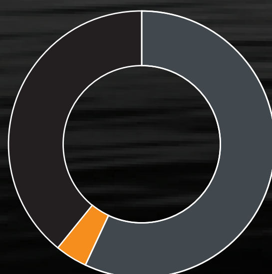
28.4%

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").

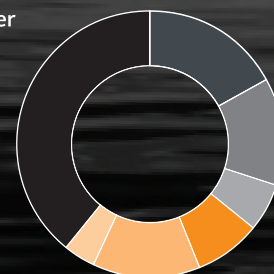
ADJUSTED EBITDA IN 2012 BY GEOGRAPHY[3]

- 57% Canada
- 4% Sweden
- 39% United Kingdom



ADJUSTED EBITDA IN 2012 BY BUSINESS[3]

- 17% Gas Cogeneration Power
- 13% Wind Power
- 6% Biomass Power
- 8% Hydro Power
- 13% Solar Power
- 4% District Heating
- 39% Water Utility



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

MESSAGE TO SHAREHOLDERS

Capstone has strong fundamentals, including a diversified and high quality portfolio, a solid balance sheet, an experienced and motivated team, and broader scope to pursue growth initiatives.

Dear Fellow Shareholders,

Capstone had a solid year in 2012. We delivered Adjusted EBITDA of $120.7 million, which was slightly ahead of our expectations and reflected strong operational performance across our businesses. We also took important steps to lower our risk profile and position our company for a bright future.

We set five priorities for ourselves at the start of 2012 and successfully delivered on four of them.

Priorities Addressed

De-risking our balance sheet

We refinanced or repaid nearly $200 million of debt set to mature in 2012 through a variety of initiatives, including the recapitalization of Värmevärden and our hydro power facilities, the sale of a 20% interest in Bristol Water to ITOCHU Corporation at an attractive premium, and the establishment of a new corporate credit facility. As a result, we eliminated significant risk from our balance sheet and renewed our flexibility for growth.

Establishing a new dividend

In June, we established a new dividend level of $0.30 per common share on an annualized basis. Our new dividend reflects our view on the long-term cash flow profile of our current portfolio following the expiry of Cardinal's power purchase agreement at the end of 2014. We have also gained the flexibility to retain more cash to reinvest in new businesses that will improve the value, quality and cash-generating potential of our portfolio.

Preserving and enhancing the value of our businesses

We continuously work to maximize the operating performance of our businesses, which includes preventive maintenance, detailed planning for capital expenditures that boost their value, and finding ways to increase cash flow. In 2012, initiatives included selling renewable energy credits (RECs) at the Whitecourt biomass facility, which generated additional revenue. At Bristol Water, we worked closely with management to execute the company's capital investment program, which is aimed at improving and expanding its network of reservoirs, treatment facilities, water mains and pipes. This capital program will drive growth in Bristol Water's regulated capital value, and, accordingly, value for Capstone and our shareholders. And at Värmevärden, we saw improvements in plant availability and greater use of lower-cost fuels, which are key performance drivers for this business.

I am also pleased to report that our businesses continued to have strong safety records in 2012, which is one of Capstone's key objectives and central to our success.

“WE CONTINUALLY WORK TO MAXIMIZE THE OPERATING PERFORMANCE OF OUR BUSINESSES.”

Continuing to build our platform for growth and diversification

In December, we established a new, complementary development capability with the formation of Capstone Power Development, a subsidiary focused on developing, acquiring and repowering clean electricity generation projects in North America with an emphasis on Western Canada and the United States. By getting more involved in early-stage development projects, we have the potential to deliver greater returns to our shareholders and to create a new pipeline of growth opportunities for Capstone.

Our Challenges

We were not successful in 2012 in achieving a new power purchase agreement for Cardinal with the Ontario Power Authority (OPA). While we made steady progress in our discussions with the OPA and various government ministries, and continued to broaden stakeholder support for a new contract, we have not yet agreed on an outcome that recognizes Cardinal's value and its industrial, economic, social and community importance. Negotiations are continuing and we remain confident that Cardinal delivers significant value to Ontario and to ratepayers – today, tomorrow and for years to come.

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 Strengths

Active Management

We actively manage our operations to maximize their long-term value by working closely with our asset-level personnel to drive continuous improvement, direct capital management initiatives and establish strategic plans.

Disciplined Approach

Capstone is extremely disciplined in its approach to selecting growth opportunities to pursue because we are focused on enhancing returns for shareholders. For example, we realized an approximately 10% premium on the sale of a minority, non-controlling stake in Bristol Water, proving our ability to make smart acquisitions.

Exceptional Capabilities

Collectively, our team has decades of experience in financing and managing infrastructure businesses with strong relationships across the sector in Canada and internationally.

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 shareholders, which includes acting as a good corporate citizen in the communities where our businesses operate.

Fulfillment for our People
We foster a professional, safe 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 shareholders.

While we are pleased with the operational and financial performance we achieved in 2012, we know that the uncertainty related to Cardinal's future is concerning for shareholders. Securing a new contract for Cardinal remains our top priority for 2013.

Our Opportunities
Capstone has strong fundamentals, including a diversified and high quality portfolio, a solid balance sheet, an experienced and motivated team, and broader scope to pursue growth initiatives. In particular, our investment in Bristol Water has essentially changed Capstone's risk profile by offering perpetual, growing cash flow and the potential for significant organic growth.

Our investment in Bristol Water has also allied us with two multinational partners, Agbar and ITOCHU, while at Värmevärden we have invested alongside a private infrastructure fund managed by Macquarie Group Limited. These associations prove our ability to forge partnerships across borders and to cultivate relationships that can help to stimulate deal flow and access to unique opportunities.

Our strategy to unearth new infrastructure investment opportunities includes:

- Concentrating our business development efforts primarily on Canada, the United States, the United Kingdom and Western Europe in alignment with our focus on investing only in countries that are members of the Organization for Economic Cooperation and Development (OECD) and feature stable fiscal and political environments;
- Pursuing regulated or contractually defined core infrastructure businesses, which typically generate stable cash flow throughout the economic cycle. This category includes power generation, electricity distribution and transmission, utilities, transportation and public-private partnerships;
- Seeking a blend of operating infrastructure businesses and development opportunities that offer an appropriate risk-adjusted rate of return; and
- Focusing on wholly-owned businesses while remaining open to collaborating with like-minded partners, an approach that has been successful for us.

"SECURING A NEW CONTRACT FOR CARDINAL REMAINS OUR TOP PRIORITY FOR 2013."

We are pursuing this strategy at a time of great global demand for new infrastructure spending fuelled by fiscal austerity, large and growing government deficits, and demographic trends. Global infrastructure requirements for transport, energy, water and communications between 2013 and 2030 are estimated at more than US$57 trillion. The private sector has a vital role in improving and building the new, more sustainable infrastructure that is required to unleash renewed economic growth and an improved quality of life in Canada and internationally: better roads, greener power generation facilities; higher quality and modern water systems, and more efficient public transportation. Capstone is poised to participate in this sizable opportunity.

Creating Value

With our focus on quality, low-risk infrastructure businesses that provide essential services, Capstone offers shareholders access to a unique and growing asset class that has historically exhibited low volatility relative to the broader equity market.

In 2013, we are focused on returning to historical levels of business development activity and on creating value for shareholders, imperatives that are supported by:

- An exceptionally high quality infrastructure portfolio of contractually defined, income-producing power facilities as well as utilities that deliver long-term, inflation-linked cash flow.
- A significantly strengthened balance sheet and a long-term dividend payout ratio target of approximately 70% to 80%, which together provide a solid foundation to support our company's continuing growth.
- And a top-notch team with more than six decades of combined expertise in infrastructure asset and investment management, which represents a tremendous competitive advantage for Capstone.

In closing, I would like to thank our directors for their support and guidance in 2012 and our employees for their commitment to excellence in executing our strategy. The deep relationships nurtured by our employees with partners, customers, suppliers, landowners and local communities help us to operate thoughtfully, responsibly and safely, and enhance our competitive position. Our people are paramount to Capstone's success and we are grateful for their dedication.

We have the experience and drive to successfully deliver on our strategy. We are confident in our ability to create value for you, our shareholders, and we thank you for your continuing support.

Sincerely,

MICHAEL BERNSTEIN
President and Chief Executive Officer

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

MESSAGE FROM THE CHAIRMAN

Our governance practices constantly evolve in step with the business and regulatory environments in which Capstone operates.

Dear Fellow Shareholders,

Fiscal 2012 was a busy year for Capstone during which we tackled various challenges and positioned the company for its next phase of growth.

We strengthened our financial position, welcomed a new international partner and launched a power development subsidiary to help source growth opportunities that will increase the value of our company. We also established a new dividend that is intended to provide stable income for shareholders with the potential for capital appreciation as we realize our vision to be Canada's pre-eminent diversified infrastructure company.

As we pursue that vision, the Board of Directors is committed to ensuring that Capstone is managed and governed — and continues to grow — in a prudent way. We take our role as stewards of your investment very seriously.

The Board's mandate includes working with management to establish Capstone's strategy and objectives, approving significant decisions that affect Capstone and its results, monitoring the company's financial performance and risk management practices, setting the dividend policy and overseeing Capstone's stakeholder relationships and reporting obligations.

A few highlights of our approach to governance include:

- Audit, Governance and Compensation Committees that must be entirely composed of independent directors (as defined by applicable securities laws);
- Governance policies and procedures that apply equally to the individual businesses in Capstone's portfolio, which ensures consistency and reliability in reporting and risk management;
- A Code of Ethics that encourages and promotes a culture of ethical business conduct and must be followed by all directors, executive officers and employees of Capstone;
- An annual evaluation of the effectiveness of the Board and individual directors to ensure the Board is fulfilling its oversight role in the most effective manner; and
- A majority voting policy, which requires director nominees to be elected by a majority of shareholder votes.

Our governance practices constantly evolve in step with the business and regulatory environments in which Capstone operates and we regularly seek opportunities to strengthen our governance framework. In 2012, for example, the company reviewed, refined and strengthened its enterprise risk management practices and implemented an internal audit function. Our governance and risk management processes support achievement of our strategic performance objectives.

Resolving the question of Cardinal's future remains a key strategic objective — one that we are working tirelessly to accomplish. At the same time, we are keenly focused on further diversifying our portfolio and increasing its size, scope and long-term value for shareholders. I am optimistic about our company's future for four compelling reasons.

Key Principles

Independence
At all times, a majority of directors must be independent directors (as defined under applicable securities regulations). A director is independent when he or she does not have a direct or indirect material relationship with Capstone or its subsidiaries.

Integrity and Professionalism
We seek out directors who have demonstrated integrity and high ethical standards, a proven record of sound business judgment and who committed to representing the long-term interests of Capstone's shareholders.

Performance
We seek to build a Board on a diversity of backgrounds, skills and experience and annually review the competencies, skills and personal qualities of each director to maintain the composition of the Board in a way that bolsters the overall stewardship of the company.

First, Capstone has a history of meticulous asset management, continues to achieve stable, and in some cases, improving, operational performance and has significantly strengthened its financial position, all of which are pillars vital to the long-term stability of our company, and, accordingly, our dividend.

Second, we have augmented our skill set with proven power development personnel who bring a wealth of capabilities to Capstone and broaden our business development reach. This new initiative puts us in an excellent position to build a pipeline of accretive projects in the years to come.

Third, backed by our strong balance sheet, we expect to be able to access the capital we need to finance investments that meet our strategic and financial return criteria.

And fourth, massive investment and private sector participation is required in Canada and internationally to maintain and build the core infrastructure that is critical to elevating quality of life and economic prosperity. Our company is ready to participate in these opportunities with a leadership team that is knowledgeable, enjoys strong relationships at home and abroad, and has attained a competitive advantage through decades of combined investment and management experience across power generation and transmission businesses, utilities, transportation and toll roads, and public-private partnerships.

Our senior management team is also highly motivated and aligned with shareholders' interests. A significant proportion of management's short-term incentive compensation is bound to financial performance metrics while compensation under the long-term incentive plan is directly tied to both the performance of our shares and to the total return we deliver to shareholders, consisting of share price performance and dividend yield, relative to a group of comparable peers. This structure promotes responsible decision-making that maximizes long-term value.

I would like to thank my fellow directors for their diligence in guiding Capstone through 2012. I would especially like to recognize Derek Brown, who resigned from the Board in February 2013, for his nine years of distinguished service to Capstone. In addition to being one of our longest-serving directors, Derek made significant contributions to our company during his tenure. We were very fortunate to benefit from Derek's counsel and guidance and we wish him the very best in his future endeavours.

Finally, I must thank our shareholders for their continuing support and confidence in Capstone and the Board of Directors. I also extend my appreciation to our employees at all levels of the organization for their dedication to pursuing excellence. Together, we are working to deliver a superior total return to our shareholders.

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

Capstone's core competencies give us the capability to deliver on our mission. These strengths include our record of operational excellence and discipline in how we screen, pursue and execute on growth opportunities as well as strong leadership and financial flexibility. As a result, Capstone is well positioned to capitalize on opportunities currently emerging in the growing infrastructure sector.

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 50% 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 1.2 million people. Our objectives for Bristol Water are to provide safe, reliable drinking water that is cost-effective for customers, to operate efficiently and in compliance with all regulatory and environmental requirements, and to invest capital to grow its RCV.

We also hold a 33.3% equity interest in Värmevärden, a district heating business in Sweden that serves residential customers, which includes multi-residential complexes and municipal users, and also has long-term contracts with industrial customers. Our objectives for Värmevärden are to manage fuel costs by using more cost-effective fuels, maintain strong customer relationships, and ensure high plant availability and operational efficiency.

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; transportation, such as roads; and public private-partnerships.

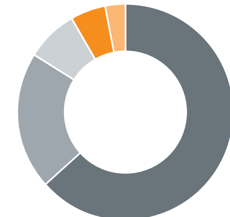
AVAILABILITY (%)

Facility	2012	Five-Year Average
Cardinal	**95.0**	96.7
Erie Shores	**97.9**	96.7
Hydro Power Facilities	**98.5**	98.0
Whitecourt	**95.9**	91.3
Amherstburg (1)	**97.4**	96.5

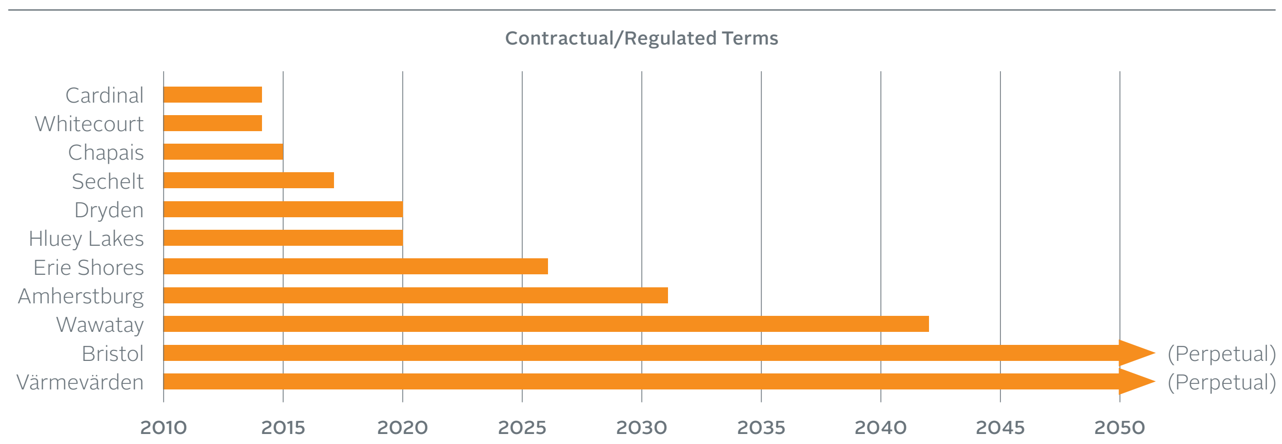
(1) Amherstburg commenced operations in June 2011.

PERCENTAGE OF 2012 POWER REVENUE BY COUNTERPARTY

- 63.5% Ontario Electricity Financial Corporation
- 20.6% Ontario Power Authority
- 7.8% TransAlta
- 5.1% BC Hydro
- 3.0% Other



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 and capital expenditure program, which contributes significantly to long-term value.

Deliver strong financial performance

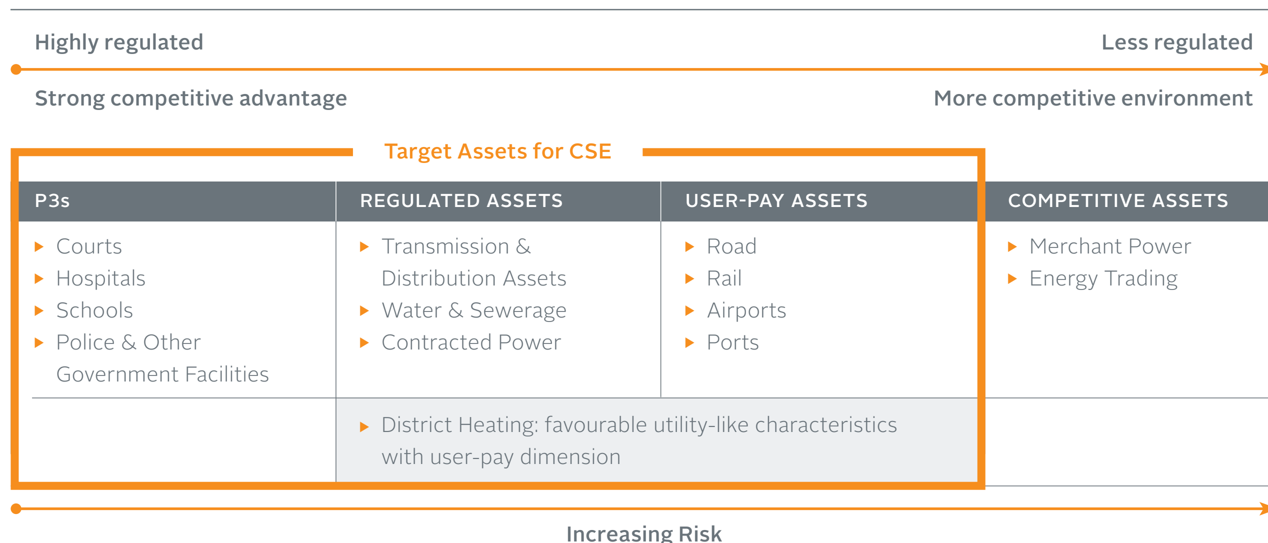
Our infrastructure businesses provide essential services for which there is consistent demand throughout the economic cycle. They also operate within contractual frameworks or environments where they benefit from high barriers to entry. Combined, these attributes result in an inherently stable foundation and, accordingly, relatively predictable operating cash flow. We seek to maximize our businesses' cash flow by employing a long-term approach to strategic planing and capital expenditures and by focusing on identifying new efficiencies and opportunities for enhancements capable of driving revenue growth.

Achieve prudent growth

Capstone's strategy includes:

- Concentrating our business development efforts primarily on Canada, the United States, the United Kingdom and western Europe in alignment with our focus on investing only in countries that are members of the Organization for Economic Cooperation and Development (OECD) and feature stable fiscal and political environments;
- Pursuing regulated or contractually defined core infrastructure businesses, which typically generate stable cash flow throughout the economic cycle. This category includes power generation, electricity distribution and transmission, utilities, transportation and public-private partnerships;
- Seeking a blend of operating infrastructure businesses and development opportunities that offer an appropriate risk-adjusted rate of return; and
- Focusing on wholly-owned businesses while remaining open to collaborating with like-minded partners, an approach that has historically been successful for us.

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



Minimizing financial risk

We continually monitor, analyze and seek to minimize the risks within our capital structure with a view to maintaining an optimal financing mix that aligns with the cash flows, risk profile and duration of our businesses and that generates value for shareholders. We seek to manage our capital structure so that it remains flexible and offers room for expansion. In 2012, we refinanced or repaid approximately $200 million coming due under various credit facilities, thereby significantly strengthening our balance sheet.

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

In a 2013 report, the McKinsey Global Institute estimated that US$57 trillion in infrastructure investment is required between 2013 and 2030 simply to keep up with projected growth in global gross domestic product ("GDP"), including investments for transport (road, rail, ports and airports), power, water and telecommunications. 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

According to the International Energy Agency, the global power generation, distribution and transmission infrastructure sector requires US$17 trillion in existing and new capacity by 2035. The Canadian Electricity Association estimates that the Canadian electricity sector is expected to invest about $294 billion between 2010 and 2030 to maintain existing generation, transmission and distribution infrastructure, meet market growth and accommodate a changing generation mix. In addition, the renewable energy sector is expected to continue to experience growth in North America reflecting government policy imperatives with respect to carbon reduction, climate change management and job creation.

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 treatment and delivery and wastewater infrastructure systems throughout the OECD. The Federation of Canadian Municipalities estimates that Canada's water infrastructure deficit is approximately $31 billion with the amount of new investment required projected to be an additional $57 billion. The U.S. Environmental Protection Agency estimates water infrastructure investment needs in the United States over the next 20 years at more than US$500 billion.

Growing public support for private sector investment in infrastructure

Throughout much of the OECD, constrained government budgets and aging core infrastructure are expected to result in opportunities for additional private sector investment in infrastructure, including potential asset privatizations. In Canada, private sector investment in infrastructure is well established, with 185 public-private partnership (“P3”) projects at various stages currently underway, 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.

Combined, these market drivers contribute to the potential for increasing private sector participation in infrastructure renewal and expansion in Canada and the other OECD markets we target. Several attributes position Capstone to capitalize on these emerging opportunities, including our:

- Significant expertise in infrastructure investment and management across core infrastructure categories in Canada and internationally, which equips us to offer tangible, proven knowledge and experience to governments and prospective partners;
- New power development capability, which complements our existing skill set and will enable us to participate in earlier-stage greenfield or brownfield opportunities;
- Strong relationships within the infrastructure industry and with multinational partners, which enhance our ability to forge new partnerships across borders and to stimulate deal flow and access to unique opportunities; and
- Flexibility in how we work with prospective investment partners, which is a competitive advantage that has enabled us to effectively navigate less conventional, more complex opportunities such as our investment in Bristol Water. We acquired a controlling interest in Bristol Water, and a foothold in an attractive infrastructure category, while preserving a role for our new partner in the business.

By investing in regulated or contractually defined core infrastructure businesses, Capstone strives to offer shareholders reliable income and capital appreciation.

KEY PERFORMANCE DRIVERS

Across our businesses, we are focused on a number of performance drivers that support the quality, stability and long-term cash flow profile of our portfolio, and, accordingly, our ability to deliver value to shareholders.

Power

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

Maintaining 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. In 2012, our facilities achieved availability in line with or slightly ahead of their historical five-year average availability.

Entering into 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 remaining 1.3% of power, which represents approximately 4 MW of net capacity at Whitecourt, is sold at the Alberta Power Pool spot price. The weighted average PPA term remaining is approximately 7.3 years.

Conducting preventive maintenance and continually improving operations

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. Initiatives in 2012 included completing a gear box oil exchange program at Erie Shores that is expected to reduce the number of oil changes required over the life of the facility, thereby lowering costs.

Counterparty Credit Ratings

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

Improving Operations at Erie Shores

In 2012, Erie Shores made operational enhancements that are expected to result in lower costs over the long term.

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 achievement of operational excellence and cost efficiencies.

Advancing capital investment program

In the current regulatory period, which runs from April 2010 to March 2015 ("AMP5"), Bristol Water will complete an approximately $441 million (£276 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 over time will increase the cash flow we receive from this investment and its overall value for Capstone's shareholders.

Achieving 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 :

Key Regulatory Output	AMP5 Objective	Actual Performance (1)
Reduce amount of water that leaks from the network's pipes and mains	Reduce water leakage to 49 million litres of water per day ("Ml/d") with a 2013 target of less than 50 Ml/d	Achieved water leakage of 43 Ml/day due to a mild winter with fewer pipe bursts
Save water	Achieve a base service water efficiency target of 4.0 Ml/d	1.22 Ml/d
Strong performance on regulator's security of supply index, which measures reliability of water supply	Achieve a 100% grade	100%
Stable serviceability	Maintain stable serviceability	Achieved stable serviceability
Exceptional customer service as measured by regulator's Service Incentive Mechanism ("SIM")	Deliver top-quartile performance as measured through customer satisfaction surveys and quantitative data	Bristol Water ranked second out of 21 companies

(1) In the regulatory year ended March 31, 2012.

District heating

Managing fuel costs

Fuel costs are the largest expense for Värmevärden, accounting for approximately 37% of revenue. As a result, efficient management of fuel costs is a key driver of financial stability. Värmevärden's long-term contracts with industrial users include price escalators linked to a combination of inflation and fuel price increases. Contracts with residential users allow for rates to be set annually, which provides the business with flexibility to manage fuel price increases.

Maintaining strong customer relationships

Värmevärden's industrial customers provide approximately 25% 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. The balance of Värmevärden's customers are categorized as residential, which includes multi-residential complexes as well as municipal users. Contracts with residential customers typically automatically renew annually but may be terminated with appropriate notice, which provides a strong incentive for Värmevärden to deliver highly reliable and quality service to its customers.

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 managerial team or our investment partners to improve productivity, manage costs and enhance long-term operations. Across our power facilities, for example, in 2012 we achieved an average availability of95.8%, which was consistent with 2011. Our consistently strong availability is the product of effective, ongoing maintenance programs and the overall high quality of each facility.

Proven ability to execute on growth opportunities

Capstone has proven its ability to successfully pursue growth opportunities and to integrate new businesses into its portfolio, with the 2010 acquisitions of Amherstburg Solar Park and the 2011 acquisitions of our interests in Värmevärden and Bristol Water. We subsequently sold a portion of our investment in Bristol Water in May 2012.

Also in 2012, we established Capstone Power Development, a wholly owned subsidiary focused on sourcing, cultivating and pursuing power development opportunities in western Canada and the United States. This new capability will enable us to participate in earlier-stage opportunities and supports our objective of enhancing returns to shareholders.

Disciplined approach to pursuing growth

We bring a highly disciplined approach to selecting which growth opportunities we pursue and maintain a focus on high quality, low risk businesses that will enhance value for shareholders. Our discipline in selecting growth opportunities is evidenced by the attractive premium we achieved on the sale of a minority, non-controlling interest in Bristol Water just months after our initial acquisition.

Strong leadership

Capstone's corporate management team comprises executives with decades of combined expertise in managing and financing infrastructure businesses. Our newest employees with Capstone Power Development also bring decades of experience in successfully developing and delivering power projects in Canada and the United States. Our Board of Directors comprises seasoned executives with a broad mix of skills in finance, operations, strategy, government and corporate governance. In addition, employees throughout our organization are dedicated to operational excellence and continuous improvement.

Financial strength and flexibility

A key focus for us in 2012 was to refinance approximately $200 million in debt coming due during the year under various credit facilities. Through a variety of financing initiatives, we have successfully reduced our total leverage, lowered our refinancing risk and have limited exposure to movements in interest rates. Our debt to capitalization ratio at year end was 62.7%, which is conservative relative to the low risk profile and long life of our businesses.

We also seek to maintain a flexible capital structure that enables us to capitalize on growth opportunities when they arise. We are focused on:

- Ensuring an appropriate capital structure at the corporate and subsidiary level that aligns with the cash flow profile and duration of our businesses;
- Maintaining sufficient liquidity to meet short- and medium-term operating needs; and
- Building and maintaining strong relationships with investors and lenders.

As a result, we believe we have access to the resources we need to support growth.

In addition, we expect our dividend policy to result in a long-term payout ratio of 70% to 80% of Adjusted Funds from Operations, which will allow us to retain cash that can be reinvested in new growth opportunities.

CONTENTS

Financial Highlights 17
Legal Notice 18
Introduction 19
Basis of Presentation 19
Changes in the Business 19
Non-GAAP and Additional GAAP Performance Measure Definitions 20
Results of Operations 22
Financial Position Review 32
Derivative Financial Instruments 39
Foreign Exchange 39
Risks and Uncertainties 40
Environmental, Health and Safety Regulation 47
Related Party Transactions 48
Summary of Quarterly Results 49
Fourth Quarter 2012 Highlights 50
Accounting Policies and Internal Control 51

MANAGEMENT'S DISCUSSION AND ANALYSIS

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 an inherently stable foundation and, accordingly, relatively predictable operating cash flow.

Financial Highlights

	As at and for the year ended December 31		
	2012	2011	2010
Revenue	**357,610**	**215,967**	158,512
Net income (loss)	**43,724**	(3,263)	15,901
Earnings (loss) per share			
Basic and diluted	**0.298**	(0.108)	0.339
AFFO per share	**0.473**	**0.541**	0.693
Cash dividends per share			
Common	**0.450**	**0.660**	0.660
Preferred	**1.250**	**0.421**	n/a
Total assets	**1,652,539**	**1,697,744**	804,134
Total long-term liabilities	**1,013,729**	**928,797**	414,480
Total liabilities	**1,142,081**	**1,249,774**	540,039

LEGAL NOTICE

Caution Regarding Forward-Looking Statements

Certain of the statements contained within this document are forward-looking and reflect management's expectations regarding the future growth, results of operations, performance and business of Capstone Infrastructure Corporation (the "Corporation") 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 and financial outlook use forward-looking words, such as "anticipate", "continue", "could", "expect", "may", "will", "estimate", "plan", "believe" or other similar words, and include, among other things, statements found in "Strategic Overview" and "Results of Operations". These statements and financial outlook 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 financial outlook 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 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, 2012 under the heading "Results of Operations", as updated in subsequently filed MD&A of the Corporation (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 or relate to 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; that the power infrastructure facilities will experience normal wind, hydrological and solar irradiation conditions, and ambient temperature and humidity levels; an effective TCPL gas transportation toll of approximately $1.76 per gigajoule in 2013; that there will be no material change in the level of gas mitigation revenue historically earned by the Cardinal facility; that there will be no material changes to the Corporation's facilities, equipment or contractual arrangements, no material changes in the legislative, regulatory and operating framework for the Corporation's businesses, no delays in obtaining required approvals, no material changes in rate orders or rate structures for the power infrastructure facilities, Värmevärden or Bristol Water, no material changes in environmental regulations for the power infrastructure facilities, Värmevärden or Bristol Water and no significant event occurring outside the ordinary course of business; that the amendments to the regulations governing the mechanism for calculating the Global Adjustment (which affects the calculation of the DCR escalator under the PPA for the Cardinal facility and price escalators under the hydro power facilities located in Ontario) will continue in force; that there will be no material change to the accounting treatment for Bristol Water's business under International Financial Reporting Standards, particularly with respect to accounting for maintenance capital expenditures; that there will be no material change to the amount and timing of capital expenditures by Bristol Water; that there will be no material changes to the Swedish Krona to Canadian dollar and UK pound sterling to Canadian dollar exchange rates; and that Bristol Water will operate and perform in a manner consistent with the regulatory assumptions underlying AMP5, 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 being achieved.

Although the Corporation believes that it has a reasonable basis for the expectations reflected in these forward-looking statements and financial outlook, actual results may differ from those suggested by the forward-looking statements for various reasons, including: risks related to the Corporation's securities (dividends on common shares and preferred shares are not guaranteed; volatile market price for the Corporation's securities; shareholder dilution; and convertible debentures credit risk, subordination and absence of covenant protection); risks related to the Corporation and its businesses (availability of debt and equity financing; default under credit agreements and debt instruments; geographic concentration; foreign currency exchange; acquisitions and development; environmental, health and safety; changes in legislation and administrative policy; and reliance on key personnel); risks related to the Power Infrastructure Facilities (power purchase agreements; operational performance; fuel costs and supply; contract performance; land tenure and related rights; environmental; regulatory environment); risks related to Bristol Water (Ofwat price determinations; failure to deliver capital investment programs; economic conditions; operational performance; failure to deliver water leakage target; SIM and the serviceability assessment; pension plan obligations; regulatory environment; competition; seasonality and climate change; and labour relations); and risks related to Värmevärden (operational performance; fuel costs and availability; industrial and residential contracts; environmental; regulatory environment; and labour relations).

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 and financial outlook 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 and financial outlook.

This document is not an offer or invitation for the subscription or purchase of or a recommendation of securities. It does not take into account the investment objectives, financial situation and particular needs of any investors. Before making an investment in the Corporation, an investor or prospective investor should consider whether such an investment is appropriate to their particular investment needs, objectives and financial circumstances and consult an investment adviser if necessary.

INTRODUCTION

Management's discussion and analysis ("MD&A") summarizes Capstone Infrastructure Corporation's (the "Corporation" or "Capstone") consolidated financial position, operating results and cash flows as at and for the years ended December 31, 2012 and 2011.

This MD&A should be read in conjunction with the accompanying audited consolidated financial statements of the Corporation and notes thereto as at and for the years ended December 31, 2012 and 2011. Additional information about the Corporation, including its Annual Information Form ("AIF") for the year ended December 31, 2011, quarterly financial reports of Capstone and other public filings of the Corporation will be available under the Corporation's profile on the Canadian Securities Administrators' System for Electronic Document Analysis and Retrieval ("SEDAR") website at www.sedar.com.

The information contained in this MD&A reflects all material events up to March 7, 2013, the date on which this MD&A was approved by the Corporation's Board of Directors.

BASIS OF PRESENTATION

Financial information in this MD&A is prepared in accordance with International Financial Reporting Standards ("IFRS") and amounts are in Canadian thousands of dollars or thousands of share amounts unless otherwise indicated.

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:

	Swedish krona (SEK)		Pound sterling (£)	
As at and for the year ended	Average	Spot	Average	Spot
Dec 31, 2011	0.1525 (1)	0.1479	1.6076 (2)	1.5799
Dec 31, 2012	**0.1476**	**0.1528**	**1.5840**	**1.6178**

(1) Nine-month period from acquisition on March 31, 2011 to December 31, 2011.

(2) Period from acquisition on October 5, 2011 to December 31, 2011.

CHANGES IN THE BUSINESS

In 2012, Capstone addressed maturing debt and positioned the company for future growth. At the end of 2011, Capstone had $197,375 of debt maturing in 2012, excluding amounts at Bristol Water. Capstone repaid or refinanced this amount through the initiatives described below. In addition, the Corporation implemented a new dividend policy in June 2012 reflecting the expected cash flow profile of the company post-2014, which includes the impact of lower cash flow from Cardinal following expiry of its current power purchase agreement.

Värmevärden Recapitalization

In March 2012, Värmevärden, the district heating business, issued approximately $150,000 (1,000,000 SEK) of senior secured bonds to institutional investors. Värmevärden repaid a portion of the shareholder loans from the bond proceeds. Capstone received $49,400 as partial repayment of its shareholder loan and accrued interest which is its pro rata share resulting from Capstone's one-third interest in Värmevärden. Capstone used these proceeds to repay a portion of its senior debt facility. As a result of the recapitalization, Capstone continues to own a one-third interest in Värmevärden, however its total investment in Värmevärden was reduced to $52,028, comprising $34,336 in loans receivable and $17,692 in equity accounted investment.

Partial Sale of Interest in Bristol Water

On May 10, 2012, Capstone sold to I-Environment Investments Ltd, a subsidiary of ITOCHU Corporation, a 20% indirect interest in Bristol Water plc. I-Environment Investments Ltd acquired a 2/7ths ownership interest in CSE Water UK Limited, which indirectly owns a 70% interest in Bristol Water plc. Capstone received $68,952 of net proceeds from the sale and used the funds to repay the remaining $28,975 on the senior debt facility and $39,000 on the CPC-Cardinal credit facility, retaining cash of $977.

Capstone retains a 50% indirect interest in Bristol Water and continues to consolidate based on retention of control. In accordance with IFRS, Capstone recorded the transaction as a transfer of equity to non-controlling interest holders. The excess net proceeds of $15,694 over the value of equity transferred to the non-controlling interest and $850 of taxes were recorded directly to retained earnings.

Financing of Hydro Facilities

On June 6, 2012, MPT Hydro LP, an indirect wholly-owned subsidiary of Capstone, which owns the Dryden, Hluey Lakes, Sechelt and Wawatay hydro facilities (the "hydro facilities"), completed a $100,621 debt offering to recapitalize the hydro facilities. The debt offering comprised $80,379 of senior secured bonds and $20,242 of subordinated secured bonds.

Proceeds from the offering were used to repay the $27,239 balance of levelization debt at the Wawatay hydro facility and to pay $1,785 of transaction costs, which were capitalized. In addition, Capstone cash funded $3,846 for debt service and maintenance reserve accounts in accordance with the bond indenture and used $67,700 of net proceeds to repay a portion of the CPC-Cardinal credit facility. The remaining balance of $12,300 was subsequently refinanced in September 2012, as part of the new credit facility.

New Dividend Policy

On June 1, 2012, the Board of Directors of the Corporation established a new policy with respect to the timing and amount of its dividend, commencing with the month ended June 2012. Under the new dividend policy, the Corporation intends to pay a quarterly dividend of $0.075 per common share, or $0.30 per common share on an annualized basis. Among other things, the Corporation's dividend policy reflects management's view on current Ontario power market and fiscal dynamics and its expectation for the cash flow the Cardinal facility will generate following the expiry of its current power purchase arrangement at the end of 2014.

The Corporation's dividend policy is determined by the Board of Directors of the Corporation and is based on the Corporation's cash flows, financial requirements, the satisfaction of solvency tests imposed under corporate law for the declaration of dividends and other relevant factors. With the implementation of the new dividend policy, the Corporation expects to retain additional cash that can be reinvested in new growth opportunities.

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 useful 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 ("NCI") 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 or distributions received from equity accounted investments. Amounts attributed to any non-controlling interest are deducted. Adjusted EBITDA for the investment in Bristol Water is included at Capstone's proportionate ownership interest. For the period from October 5, 2011 to May 10, 2012, Capstone held a 70% ownership interest. This ownership interest was reduced to 50% upon the partial sale of Bristol Water on May 10, 2012. 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 or distributions from equity accounted investments.

Adjusted Funds from Operations ("AFFO")

Capstone's definition of AFFO measures cash generated by its infrastructure business investments that is available for dividends and general corporate purposes. For wholly owned businesses, AFFO is equal to Adjusted EBITDA less interest paid, repayment of principal on debt, income, taxes paid and maintenance capital expenditures. For businesses that are not wholly owned, the cash generated by the business is only available to Capstone through periodic dividends. For these businesses, AFFO is equal to distributions received. Also deducted are corporate expenses and dividends on preferred shares.

AFFO is calculated from Adjusted EBITDA by:

Deducting:

- Adjusted EBITDA generated from businesses with significant non-controlling interests

Adding:

- Dividends received from businesses with significant non-controlling interests
- Scheduled repayments of principal on loans receivable from equity accounted investments

Deducting items for businesses without significant non-controlling interests:

- Interest paid
- Income taxes paid
- Dividends paid on the preferred shares included in shareholders' equity
- Maintenance capital expenditure payments
- Scheduled repayments of principal on debt, net of changes to the levelization liability up to repayment on June 6, 2012

Payout Ratio

Payout ratio measures the proportion of AFFO that is paid as dividends to common shareholders. The payout ratio is calculated as dividends declared divided by AFFO.

Reconciliation of Non-GAAP Performance Measures

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

	For the year ended	
	Dec 31, 2012	Dec 31, 2011
EBITDA	**161,091**	32,066
Foreign exchange (gain) loss	**(1,620)**	3,274
Other (gains) and losses, net	**(1,294)**	21,742
Equity accounted (income) loss	**(2,294)**	5,276
Distributions from equity accounted investments	**2,001**	—
Non-controlling interest ("NCI") portion of Adjusted EBITDA	**(37,227)**	(6,685)
Adjusted EBITDA	**120,657**	55,673
Cash flow from operating activities	**114,678**	50,881
Bristol Water cash flow from operating activities	**(76,474)**	(22,192)
Bristol Water dividends paid to Capstone	**8,091**	3,971
Värmevärden dividends paid to Capstone	**2,001**	—
Foreign exchange (gain) loss on loans receivable from Värmevärden	**(415)**	33
Chapais loans receivable principal repayments	**984**	884
Power maintenance capital expenditures	**(5,398)**	(4,129)
Power and corporate scheduled principal repayments	**(12,581)**	(4,688)
Power and corporate working capital changes	**8,427**	(8,287)
Dividends on redeemable preferred shares	**(3,750)**	(1,264)
AFFO	**35,563**	15,209

RESULTS OF OPERATIONS

Overview

Capstone's Adjusted EBITDA and AFFO in 2012 were both higher than in 2011 as reflected in the following table.

	For the year ended	
	Dec 31, 2012	Dec 31, 2011
Revenue	**357,610**	215,967
Expenses	**(206,613)**	(160,052)
Interest income	**4,886**	6,443
Distributions from equity accounted investments	**2,001**	—
Less: non-controlling interest ("NCI")	**(37,227)**	(6,685)
Adjusted EBITDA	**120,657**	55,673
Adjusted EBITDA of consolidated businesses with NCI	**(48,516)**	(15,597)
Dividends from businesses with non-controlling interests	**8,091**	3,971
Principal from loans receivable	**984**	884
Interest paid	**(23,312)**	(19,641)
Dividends paid on Capstone's preferred shares	**(3,750)**	(1,264)
Income taxes (paid) recovery	**(612)**	—
Maintenance capital expenditures	**(5,398)**	(4,129)
Scheduled repayment of debt principal	**(12,581)**	(4,688)
AFFO	**35,563**	15,209
Internalization costs	**—**	19,675
AFFO before internalization costs	**35,563**	34,884
Before internalization costs		
AFFO per share	**0.473**	0.541
Payout ratio [(1)]	**94.9%**	120.5%
Dividends declared per share	**0.450**	0.660

(1) Capstone's payout ratio for the year ended December 31, 2012 would have been 63.4% if the new dividend policy of $0.30/share had been effective for all of 2012.

Revenue increased by $141,643, or 65.6%, primarily due to full year contributions from businesses acquired or commencing operations during 2011. Bristol Water and Amherstburg contributed $132,797 and $8,582 representing nine and six months, respectively, of additional revenue.

Expenses increased by $46,561, or 29.1%, including internalization costs, and $66,236, or 47.2%, excluding these costs.

- Operating expenses increased by $73,092 or 59.9%, primarily due to a full year of Bristol Water, which added $68,486 during the first nine months of 2012.
- Administrative expenses increased by $1,068, or 10.7%, from 2011, excluding internalization costs, primarily due to the inclusion of a full year of corporate costs such as rent, IT, and staff compensation. Prior to April 15, 2011, such costs were covered by the management fee paid to Macquarie Group Limited ("MGL").
- Project development costs decreased by $7,924, or 95.6%, as Capstone had less business acquisition activity in 2012 as management focused on financing and asset management initiatives.

Interest income decreased by $1,557, or 24.2%, primarily due to Värmevärden repaying $48,100 of the shareholder loan balance from the proceeds of the bond issuance. The reduction in interest income was partially offset by the receipt of an additional quarter of interest from Värmevärden for the first quarter of 2012 compared with the prior year as the business was acquired on March 31, 2011. The remaining difference was attributable to interest income variances on cash balances at Bristol Water and corporate.

Distributions from equity accounted investments increased by $2,001, or 100%, as Värmevärden began paying dividends to Capstone in 2012. The new dividends offset the lower interest income received from Värmevärden.

Interest paid increased by $3,671, or 18.7%, primarily due to additional interest costs at Amherstburg since commencement of operations in June 2011, new long-term debt at the hydro power facilities beginning in June 2012, and interest on the corporate senior debt facility up until May 2012 when it was repaid. Interest paid by Bristol Water is excluded from Capstone's definition of AFFO and is the primary difference between interest expense included in consolidated net income (loss) and interest paid in AFFO. The remaining difference between interest expense and interest paid was attributable to amortization of financing costs and timing differences between accrual and payment basis.

Scheduled debt repayments increased by $7,893, or 168%, primarily due to higher debt service payments at Amherstburg during the first full year of operations, along with new debt for the hydro facilities and a full year of debt amortization in 2012 on tranche C of the Erie Shores project debt.

Maintenance capital expenditures increased by $1,269, or 30.7%, primarily due to Cardinal's scheduled hot gas path inspection, which occurs every three years.

Results by Segment

Capstone's results are segmented into power facilities across Canada, a water utility in Europe and a district heating utility in Europe. All remaining results relate to corporate activities. The power segment includes gas cogeneration, hydro, wind, biomass and solar power, as well as project development. In 2011, Capstone made investments in the utilities segment through the acquisition of an interest in Bristol Water, a regulated water utility in the United Kingdom, and the acquisition of a 33.3% interest in Värmevärden, a district heating business in Sweden. The financial results of Bristol Water are consolidated with Capstone's other businesses before deducting the portion of Adjusted EBITDA attributable to non-controlling interests. Capstone's non-controlling interest in Värmevärden provides interest income and dividends.

Non-GAAP performance measures

Non-GAAP performance measures results for each business segment were as follows:

Adjusted EBITDA	For the year ended		
	Dec 31, 2012	Dec 31, 2011	Change
Power	**78,178**	72,677	5,501
Utilities – water	**48,516**	15,597	32,919
Utilities – district heating	**5,357**	5,024	333
Corporate [1]	**(11,394)**	(17,950)	6,556
Total	**120,657**	75,348	45,309

AFFO	For the year ended		
	Dec 31, 2012	Dec 31, 2011	Change
Power	**43,859**	50,048	(6,189)
Utilities – water	**8,091**	3,971	4,120
Utilities – district heating	**5,357**	5,024	333
Corporate [1]	**(21,744)**	(24,159)	2,415
Total	**35,563**	34,884	679

(1) Excludes internalization costs of $19,675 for 2011.

Power

The following table shows the significant changes in Adjusted EBITDA and AFFO from 2011:

Change	Explanations
8,210	Amherstburg contributed an additional six months of Adjusted EBITDA in 2012.
(1,561)	Cardinal's hot gas path inspection required more days of maintenance than the combustion inspection completed in 2011, which resulted in lower revenue and lower operating expenses.
(1,079)	Higher fuel transportation costs at Cardinal as TransCanada Pipelines ("TCPL") tolls increased from $1.64 per GJ to $2.24 per GJ in March 2011.
843	Whitecourt's sales of additional renewable energy credits ("RECs") produced higher revenue.
(912)	Various other changes.
5,501	Change in Adjusted EBITDA.
(5,604)	Amherstburg had an additional six months of debt servicing costs in 2012.
(4,462)	The hydro facilities and Erie Shores had additional debt servicing costs. The increase was due to the recapitalization of the hydro facilities in June 2012 and the refinancing of Erie Shores in April 2011.
(959)	Cardinal's hot gas path inspection resulted in higher maintenance capital expenditures than in 2011.
(665)	Various other changes.
(6,189)	Change in AFFO.

Utilities – water

The following table shows the significant changes in Adjusted EBITDA and AFFO from 2011:

Change	Explanations
38,372	Bristol Water contributed nine months of additional Adjusted EBITDA in 2012.
(4,340)	Sale of Bristol Water interest to ITOCHU resulted in less Adjusted EBITDA from Bristol Water in the fourth quarter of 2012.
(1,113)	Various other changes.
32,919	Change in Adjusted EBITDA.
(32,919)	Remove Bristol Water Adjusted EBITDA changes.
4,868	Higher AFFO from a full year of dividends from Bristol Water, which was acquired in October 2011.
(1,135)	Lower dividend to Capstone due to a reduced ownership interest after the sale of a partial interest in Bristol Water.
387	Various other changes.
4,120	Change in AFFO.

Utilities – district heating

The following table shows the significant changes in Adjusted EBITDA and AFFO from 2011:

Change	Explanations
(3,020)	Lower interest income due to repayments of the shareholder loan from proceeds of the refinancing.
2,001	Higher dividends received in 2012.
1,352	Additional quarter of interest income for the first quarter in 2012 because the business was acquired at the end of the first quarter of 2011.
333	Change in Adjusted EBITDA and AFFO.

Corporate

The following table shows the significant changes in Adjusted EBITDA and AFFO from 2011, excluding internalization costs:

Change	Explanations
7,947	Lower business development expenses were incurred in 2012 as Capstone focused on various refinancing and asset management initiatives. In addition, Capstone initiated development capabilities within the power segment. In 2011, Capstone incurred one-time costs for the acquisition of Bristol Water and Värmevärden.
(2,623)	Inclusion of a full year of staffing costs since internalization April 15, 2011.
1,232	Various other changes.
6,556	Change in Adjusted EBITDA.
(3,098)	Preferred share dividends and related taxes were higher in 2012 as the preferred shares were issued on June 30, 2011.
(1,043)	Debt interest was higher in 2012 which was primarily due to the senior debt facility established for the Bristol Water acquisition, which was outstanding from October 2011 to May 2012.
2,415	Change in AFFO.

Net income (loss)

Net income (loss) for each business segment was as follows:

Net Income (loss)	For the year ended	
	Dec 31, 2012	Dec 31, 2011
Power	**19,788**	27,757
Utilities – water	**38,805**	5,002
Utilities – district heating	**7,936**	(3,541)
Corporate	**(22,805)**	(32,481)
Total	**43,724**	(3,263)

Capstone's net income (loss) comprises cash measures included in Adjusted EBITDA and non-cash measures required by IFRS. The major items are summarized below:

	For the year ended	
	Dec 31, 2012	Dec 31, 2011
Adjusted EBITDA	**120,657**	55,673 (1)
Adjustment of Värmevärden distributions to equity accounted income	**293**	(5,276)
NCI portion of Adjusted EBITDA	**37,227**	6,685
Other gains and (losses), net	**1,294**	(21,742)
Foreign exchange gain (loss)	**1,620**	(3,274)
Interest expense	**(49,707)**	(31,668)
Depreciation and amortization	**(57,552)**	(39,419)
Income tax recovery (expense)	**(10,108)**	35,758
Net Income (loss)	**43,724**	(3,263)

(1) Includes internalization costs of $19,675 for 2011.

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:

4.8%

Percentage of total installed wind capacity in Ontario currently represented by Erie Shores.

11%

Percentage increase in Adjusted EBITDA at Whitecourt primarily due to $843 in additional revenue from the sale of renewable energy credits.

4,000

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

For the year ended December 31, 2012

	Gas	Wind	Biomass[1]	Hydro	Solar	Development	Total
Power generated (GWh)	**1,231.9**	**233.4**	**197.0**	**157.0**	**39.5**	**n/a**	**1,858.8**
Capacity factor	**92.9%**	**26.8%**	**95.3%**	**50.1%**	**22.5%**	**n/a**	**n.m.f**
Availability	**95.0%**	**97.9%**	**95.9%**	**98.5%**	**97.4%**	**n/a**	**n.m.f**
Revenue	110,926	22,876	15,202	13,826	16,388	—	179,218
Expenses	(84,088)	(4,265)	(8,890)	(3,289)	(1,246)	(23)	(101,801)
Interest income	64	54	588	22	33	—	761
Adjusted EBITDA	26,902	18,665	6,900	10,559	15,175	(23)	78,178
Principal from loans receivable	—	—	984	—	—	n/a	984
Interest paid	(672)	(6,065)	(5)	(3,778)	(6,804)	n/a	(17,324)
Income taxes (paid) recovery	—	—	—	—	—	n/a	—
Maintenance capital expenditures	(2,576)	(536)	(1,130)	(1,156)	—	—	(5,398)
Scheduled repayment of debt principal	(250)	(5,231)	(128)	(3,265)	(3,707)	—	(12,581)
AFFO	23,404	6,833	6,621	2,360	4,664	(23)	43,859

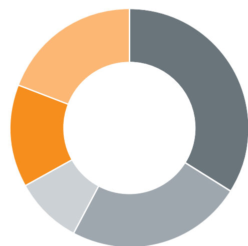
For the year ended December 31, 2011

	Gas	Wind	Biomass[1]	Hydro	Solar	Development	Total
Power generated (GWh)	**1,256.1**	**236.7**	**202.4**	**161.6**	**17.6**	**n/a**	**1,874.4**
Capacity factor	**95.0%**	**27.2%**	**95.9%**	**51.4%**	**19.9%**	**n/a**	**n.m.f**
Availability	**97.6%**	**96.9%**	**96.6%**	**98.8%**	**95.6%**	**n/a**	**n.m.f**
Revenue	114,311	23,093	14,217	13,497	7,289	—	172,407
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) recovery	—	—	—	—	—	—	—
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

(1) Includes receipts from interest and loan receivable on Capstone's 31.3% equity interest in the Chapais facility. Statistics for power generated, capacity factors and availability do not include the Chapais facility.

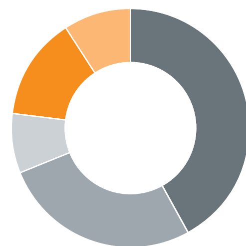
The following charts show the composition of the power segment's Adjusted EBITDA and AFFO for the years ended December 31, 2012 and 2011:

ADJUSTED EBITDA 2012



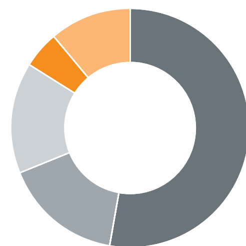
- 34% Gas
- 24% Wind
- 9% Biomass
- 14% Hydro
- 19% Solar

ADJUSTED EBITDA 2011



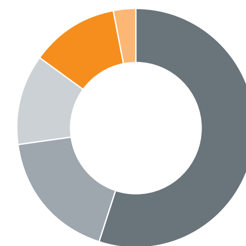
- 42% Gas
- 27% Wind
- 8% Biomass
- 14% Hydro
- 9% Solar

AFFO 2012



- 53% Gas
- 16% Wind
- 15% Biomass
- 5% Hydro
- 11% Solar

AFFO 2011



- 55% Gas
- 18% Wind
- 12% Biomass
- 12% Hydro
- 3% Solar

Revenue was $6,811, or 4.0%, higher compared with 2011, primarily due to the inclusion of $8,582 from an additional six months of operations at Amherstburg. In addition, Whitecourt increased revenue by $985 over 2011, primarily due to the increased sale of renewable energy credits. Lower revenue of $3,385 at Cardinal partially offset these gains.

The $3,385, or 3.0%, decrease at Cardinal was primarily attributable to lower power generation, which decreased electricity sales by $1,318, and a $2,151 decline in gas sales as Cardinal had previously entered into gas swaps at higher prices, with the last one expiring in 2011. Cardinal's power generation was lower by 24.2 GWh, or 1.9%, reflecting the impact of the scheduled hot gas path inspection in the second quarter, which occurs every three years and requires more time than other annual outages. In addition, power production was reduced as a result of higher ambient temperatures in 2012.

Expenses increased by $1,284, or 1.3%, over 2011. Excluding Amherstburg, the increase was primarily attributable to repairs and maintenance expenditures at Erie Shores and Whitecourt, which contributed a combined increase of $1,187. The remaining expenses at Cardinal and hydro facilities were consistent with 2011. In December 2012, Capstone established a power development subsidiary focused on developing and acquiring renewable and clean electricity generation projects in western Canada and the United States.

Interest paid was $2,628, or 17.9%, higher than in 2011, primarily due to Amherstburg, which paid $3,430 more in interest in 2012. Higher interest paid during 2012 was partially offset by $355 less interest on the CPC-Cardinal credit facility, which had a lower average balance in 2012, and a $250 decline at Erie Shores due to a lower debt balance following scheduled debt repayment.

Maintenance capital expenditures increased by $1,269 over 2011, primarily due to the hot gas path inspection at Cardinal.

Scheduled repayments of debt principal were $7,893, or 168%, higher than in 2011. The increase was primarily due to:

- A $2,174 increase in debt payments at Amherstburg, reflecting a full year of repayments compared with six months in 2011;
- Hydro debt repayments of $4,239 beginning in June 2012; and
- An increase of $1,102 in debt repayments at Erie Shores as the Tranche C debt became fully amortizing in the second quarter of 2011.

Seasonality

Results for Capstone's power segment fluctuate during the year due to seasonal factors that affect quarterly production at each facility. These factors include scheduled maintenance, seasonal electricity demands and environmental factors such as water flows, sunlight, wind speeds and density, ambient temperature and humidity, which affect the amount of electricity generated. In aggregate, these factors have historically resulted in higher electricity production during the first and fourth quarters as shown in the following table:

			Actual	Average long-term production (GWh)[1]				
Type	Facility	PPA Expiry	**2012**	Q1	Q2	Q3	Q4	Annual
Gas	Cardinal	2014	**1,231.9**	342.9	278.1	303.5	333.3	1,257.8
Wind	Erie Shores	2026	**233.4**	76.3	52.5	34.0	76.9	239.7
Biomass	Whitecourt	2014	**197.0**	50.3	45.3	50.1	49.3	195.0
Hydro	Various	2017 – 2042	**157.0**	32.2	57.1	29.0	40.9	159.2
Solar	Amherstburg	2031	**39.5**	6.8	13.7	12.5	5.9	38.9
Total			**1,858.8**	508.5	446.7	429.1	506.3	1,890.6

(1) Average long-term production is from March 2005 to December 31, 2012, except for Erie Shores, which is from June 2006, and Amherstburg, which is from July 2011.

Outlook

In 2013, Capstone expects slightly higher revenue from higher power production, which will be partially offset by increased development costs.

Capstone's power facilities are expected to perform consistently with long-term average production, subject to variations in wind, water flows, ambient temperatures and sunlight.

Capstone expects Cardinal's production to return to its long-term average and that the facility will incur lower average fuel transportation costs due to:

- Higher power generation reflecting less maintenance time planned in 2013; and
- A lower average effective gas transportation rate in 2013 of $1.76 per GJ compared with $2.24 per GJ in 2012, based on the expected outcome from the National Energy Board.

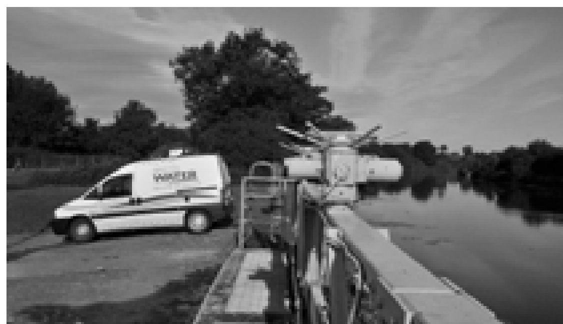
Capstone's new power development subsidiary is expected to increase costs within the power segment related to the pursuit and development of new business opportunities.

Overall, Capstone expects the net impact of these factors to result in a slightly higher Adjusted EBITDA for the power segment in 2013 compared with 2012.

Infrastructure – Utilities

Water

Capstone's water utilities segment includes a 50% investment in Bristol Water, which is located in the United Kingdom. Capstone initially acquired a 70% interest on October 5, 2011, prior to which no results were reported in Capstone's comparative figures. On May 10, 2012, Capstone sold a 20% indirect interest in Bristol Water to a subsidiary of ITOCHU Corporation while retaining the remaining 50%.



	For the year ended [2]	
	Dec 31, 2012	Dec 31, 2011
Water supplied (megalitres)	**81,245**	19,700
Revenue	**178,392**	43,560
Operating expenses	**(93,400)**	(21,569)
Interest income	**751**	291
Less: non-controlling interest[1]	**(37,227)**	(6,685)
Adjusted EBITDA	**48,516**	15,597
Adjusted EBITDA of consolidated businesses with non-controlling interests	**(48,516)**	(15,597)
Dividends from businesses with non-controlling interests	**8,091**	3,971
AFFO	**8,091**	3,971

(1) Starting from May 10, 2012, the non-controlling interest increased to 50% from 30%.
(2) 2011 only includes three months of activity from the date of acquisition.

Revenue was $134,832, or 310%, higher compared with 2011, due to receiving a full year of contribution in 2012 versus one quarter in 2011. Bristol Water derived over 97% of its revenue during the year from the sale of water, consistent with 2011.

Operating expenses increased by $71,831, or 333%, primarily due to a full year of inclusion in Capstone's result. Approximately $77,455 of operating expenses related to raw materials, consumables, bad debts and other charges less recoveries. Labour costs to maintain the network and deliver water services to retail and commercial customers represented $15,945. Additionally, increases in the capital expansion program contributed to the higher proportion of operating expenses to revenue compared with 2011.

Non-controlling interest was increased on May 10, 2012 to reflect the partial sale of Bristol Water. Capstone's Adjusted EBITDA is reduced for Agbar's 30% interest over the entire period and ITOCHU's 20% interest beginning May 10, 2012.

Capital expenditures

The approved and planned capital expenditures for the current asset management plan ("AMP5") period, which concludes in March 2015, is approximately $441,000, or £276,000 (base price of £261,000 adjusted for inflation for new regulatory fiscal year). As at December 31, 2012, the cumulative capital expenditure incurred for AMP5 was $224,000, which was $50,000 less than planned. The shortfall was primarily the result of delays at the start of AMP5 as commencement of expenditures was dependent on a Competition Commission ruling. Bristol Water expects its expenditures over the remainder of AMP5 to achieve the cumulative approved capital expenditure. Bristol Water made $140,555 in capital expenditures in 2012 as detailed on page 37 of this MD&A.

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 and the quantity of water requiring treatment as a result of dry weather and pipe bursts, which are more common in periods when freezing and thawing occur.

Regulatory

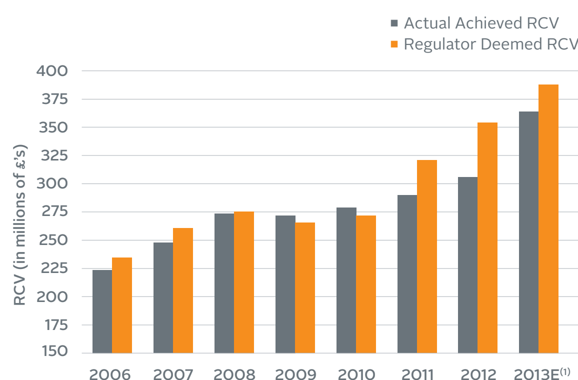
Bristol Water is a regulated business subject to supervision by the Water Services Regulation Authority ("Ofwat").

Bristol Water completed the second year of AMP5 as at March 31, 2012. Management has started planning for the company's regulatory submission for Price Review 14 ("PR14"), during which Ofwat will approve Bristol Water's capital program and set the prices Bristol Water may charge customers in the five-year AMP6 period commencing in April 2015. Bristol Water has agreed to Ofwat's proposed licence changes, which were devised as part of the introduction of competition within the retail business for non-household customers. This change affects less than 3% of Bristol Water's business.

Management continues to focus on achieving key regulatory output targets, including leakage of less than 50 million litres of water per day ("Ml/d") in 2012/2013, and is striving for a top quartile ranking in Ofwat's Service Incentive Mechanism ("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.

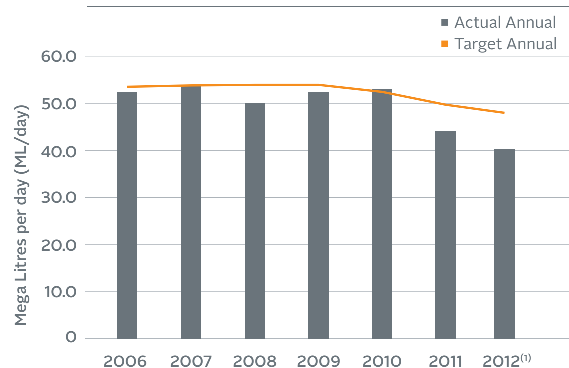
For the regulatory year ended March 31, 2012, Bristol Water achieved leakage levels of 43 Ml/d due to a mild winter, and had a SIM score of 85, which ranked second overall in the industry. For the nine months ended December 31, 2012 of the current regulatory year, which is a seasonally low period for pipe bursts, Bristol Water had leakage levels of 40 Ml/d and is currently ranked eight based on year-to-date SIM survey scores.

GROWTH IN REGULATED CAPITAL VALUE



(1) Expected position as at March 31, 2013.

WATER LEAKAGE VERSUS TARGET



(1) For the year ended December 31, 2012.

Outlook

In 2013, Capstone's results will reflect a 50% interest in Bristol Water for the full year following the partial sale of Capstone's previous 70% interest in May 2012.

Bristol Water is expected to continue its strong operational performance, which will generate cash flow for dividends and for reinvestment in the capital expenditure program. Bristol Water expects to:

- Achieve increased revenue due to an approximately 6.9% rise in the regulated water tariff from April 1 2013;
- Complete capital expenditures of approximately $115,000 (£72,000). Capstone expects between 5% and 6% growth in Ofwat's deemed regulated capital value ("RCV") in 2013, which is expected to lead to future revenue growth; and
- Incur additional expenses in preparation for the coming price review.

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.

Overall, Capstone expects the net impact of these factors, primarily the reduction in ownership interest, to result in lower Adjusted EBITDA for the utilities-water segment in 2013 compared with 2012.

Infrastructure – Utilities

District heating

Capstone's district heating utilities segment includes a 33.3% interest in Värmevärden, located in Sweden, which was acquired on March 31, 2011.

During 2012, Värmevärden focused on maintaining strong customer relationships, managing fuel costs and recapitalizing its business, which led to a portion of the shareholder loans being repaid.

During the year, Värmevärden successfully renewed contracts with industrial customers. In addition, Värmevärden adjusted prices for 2013 for the majority of residential customers with increases in excess of inflation. Management has also enhanced plant availability, thereby minimizing the use of more expensive fuel.

	For the year ended (1)	
	Dec 31, 2012	Dec 31, 2011
Heat and steam production (GWh)	**1,078**	712
Equity accounted income (loss)	**2,315**	(5,270)
Interest income	**3,356**	5,024
Dividends	**2,001**	—
Adjusted EBITDA and AFFO	**5,357**	5,024

(1) 2011 only includes nine months of activity from the date of acquisition.

Interest income

Interest is earned on the outstanding balance of the shareholder loan receivable from Värmevärden. Värmevärden used the bond issuance proceeds in early 2012 to reduce the shareholder loan by $48,100 and pay accrued interest, resulting in lower interest income for Capstone for the remainder of the year. For further details, refer to the changes in the business section on page 19 of this MD&A. In 2012, Capstone received $3,356 in interest income from Värmevärden.

Dividends

In 2012, Värmevärden paid Capstone a $983 dividend in June and a $1,018 dividend in December. No dividends were paid to Capstone in 2011, the year of acquisition.

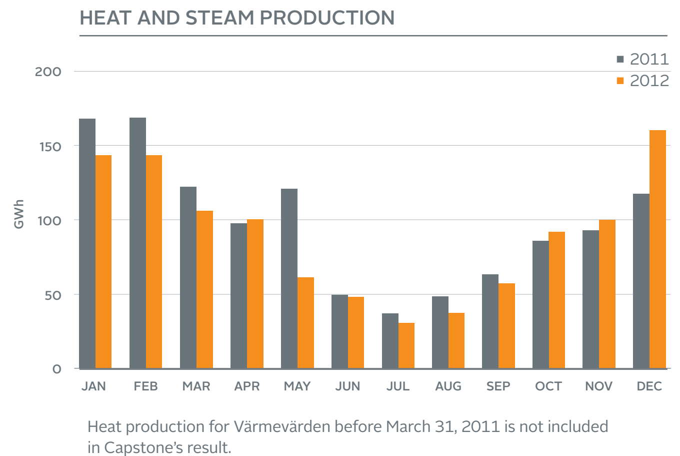
Equity accounted income

Värmevärden contributed $2,315 of equity accounted income in 2012 versus a loss of $5,270 for 2011. The loss in 2011, primarily reflected $2,414 of acquisition costs. Additionally, Capstone did not benefit from the seasonally high first quarter, as this was prior to acquisition.

Seasonality

Heat production is typically highest during the first quarter of the year, which represents the coldest months of the year. The first and fourth quarters combined have historically accounted for approximately 65% of Värmevärden's annual revenue.

HEAT AND STEAM PRODUCTION

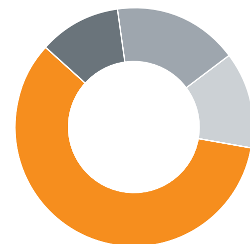


Heat production for Värmevärden before March 31, 2011 is not included in Capstone's result.

FUEL MIX BREAKDOWN BY MWh – 2012

- 4% Electricity
- 6% Fossil Fuel
- 77% Bio and Waste Fuel
- 13% Industrial Heat

FUEL MIX BREAKDOWN BY COST (SEK) – 2012



- 17% Electricity
- 13% Fossil Fuel
- 59% Bio and Waste Fuel
- 11% Industrial Heat

Outlook

In 2013, Värmevärden's performance is expected to continue to support fixed interest payments on Capstone's loan receivable and dividends on Capstone's equity investment.

Interest income from shareholder loans receivable is expected to be lower due to a reduction in the receivable balance in the second quarter of 2012.

As a result, Capstone expects lower Adjusted EBITDA from the district heating segment compared with 2012.

Corporate

Corporate activities primarily comprise growth initiatives, capital structure expenses not specifically attributed to the businesses, and costs to manage, oversee and report on the businesses.

	For the year ended	
	Dec 31, 2012	Dec 31, 2011
Administrative expenses	**(11,070)**	(29,677)
Project development costs	**(342)**	(8,289)
Interest income	**18**	341
Adjusted EBITDA	**(11,394)**	(37,625)
Interest paid	**(5,988)**	(4,945)
Dividends paid on Capstone's preferred shares	**(3,750)**	(1,264)
Income taxes (paid) recovery	**(612)**	—
AFFO	**(21,744)**	(43,834)
Internalization costs	**—**	19,675
AFFO before internalization costs	**(21,744)**	(24,159)

Administrative expenses

	For the year ended	
	Dec 31, 2012	Dec 31, 2011
Internalization expenses and manager fees	**—**	21,500
Staff costs	**6,749**	4,126
Other administrative expenses	**4,321**	4,051
	11,070	29,677

Staff costs reflect amounts paid or accrued for corporate employees beginning April 15, 2011, following the internalization of management. Staff costs were $2,623, or 63.6%, higher than in 2011, primarily reflecting three and a half additional months in 2012. Internalization expenses represented amounts paid for professional fees and other administrative costs along with the termination fee for the management contracts with MGL. Accordingly, Capstone did not incur any internalization expenses or fees to MGL in 2012.

Other administrative expenses were $270, or 6.7%, higher compared with 2011, primarily due to office administration and premises costs required post internalization. Other administrative expenses include audit fees, investor relations costs, office administration and premises costs and professional fees other than for business development.

Project development costs within corporate relate to business acquisition activities. For 2012. these costs were $7,947, or 95.9%, lower compared with 2011. This variance reflected lower business acquisition activity as the corporate focus was on completing various refinancing and asset management initiatives in 2012. In 2011, Capstone closed the acquisition of Bristol Water and Värmevärden, which incurred closing costs that did not recur in 2012.

Interest income is primarily earned on surplus cash balances. Interest income was $323, or 94.7%, lower than in 2011 reflecting lower average cash balances in 2012.

Interest paid was $1,043, or 21.1%, higher compared with 2011 due to higher balances on the CPC-Cardinal credit facility and the senior debt facility following the acquisition of Bristol Water. The debt to acquire Bristol Water was repaid in the second quarter of 2012. In addition, the average balance on the convertible debentures was lower in 2012 due to conversions during 2011 reducing the balance outstanding leading to less interest paid on the convertible debentures.

Preferred share dividends paid and taxes paid

On June 30, 2011, Capstone issued preferred shares that pay $938 of dividends quarterly at a fixed rate of 5.0% per year. Taxes paid relate to preferred share dividends and are available to offset future tax of the Corporation.

Outlook

In 2013, Capstone expects business development and marketing efforts to return to a more normal level, while maintaining staffing levels

Capstone's staff costs are expected to increase due to the accrual of an additional year of grants under the long-term incentive plan.

Overall, Capstone expects these variables to result in higher corporate expenses compared with 2012.

FINANCIAL POSITION REVIEW

Overview

As at December 31, 2012, Capstone had a consolidated working capital surplus of $30,821 compared with a deficit of $86,694 at December 31, 2011. The improvement of $117,515 primarily reflected debt repayments and refinancing activity during the year. The total comprises$10,123 and $31,041 surpluses for the utilities – water and power segments, respectively, and a deficit of $10,343 at corporate.

Unrestricted cash and equivalents totaled $49,599 on a consolidated basis with the utilities – water and power segments contributing $25,315 and $20,941, respectively.

During 2012, Capstone's debt to capitalization ratio (refer to page 33) improved from71.0% to 62.7% on a fair value basis and from 65.7% to 57.6% on a book value basis. On a fair value basis, the decline was primarily due to a $212,712 decrease in the fair value of debt. This variance was largely attributable to a $110,708 reduction in corporate debt following the repayment of debt incurred to acquire Bristol Water and a $93,305 reduction of the utilities – water segment debt arising from Capstone's reduced ownership interest in Bristol Water, which lowered its proportionate share of the company's debt. As at December 31, 2012, Capstone and its subsidiaries were in compliance with all debt covenants.

Liquidity

Working capital

As at	Dec 31, 2012	Dec 31, 2011
Power	**31,041**	(64,566)
Utilities – water	**10,123**	91,864
Corporate	**(10,343)**	(113,992)
Working capital	**30,821**	(86,694)

The working capital surplus of $30,821 increased by $117,515 from December 31, 2011. The improvement at the power segment primarily reflected refinanced debt, which was classified as long term at the end of 2012. For corporate, the reduction was due to repayments during the year. This was partially offset by a $81,741 working capital decrease in the utilities – water segment as available cash was used to fund the capital asset expansion program.

Cash and cash equivalents

As at	Dec 31, 2012	Dec 31, 2011
Power	**20,941**	13,972
Utilities – water	**25,315**	35,434
Corporate	**3,343**	8,181
Unrestricted cash and cash equivalents	**49,599**	57,587
Less: cash with access limitations		
Power	**(8,386)**	(10,135)
Utilities – water (1)	**(25,315)**	(35,434)
Cash and cash equivalents available to Capstone	**15,898**	12,018

(1) Cash and cash equivalents is in addition to $6,471 short-term deposits at December 31, 2012 (December 31, 2011 – $82,202). The decrease in short-term deposits was a result of funds used for capital projects.

Unrestricted cash represents funds available for operating activities, capital expenditures and future acquisitions. The $7,988 decrease in cash from December 31, 2011 was primarily attributable to the timing of cash required to fund Bristol Water's capital asset expansion program.

Cash and cash equivalents available to Capstone are funds available for general purposes, including payment of dividends to shareholders. Bristol Water's $25,315 of cash and cash equivalents as at December 31, 2012 are primarily earmarked for capital expenditure projects for the company's five-year asset management plan approved by the regulator. In addition, Bristol Water obtained $111,083 of credit availability during the third quarter to fund the long-term cash requirements of the capital projects. For the power segment, $8,386 is only periodically accessible to Capstone through distributions under the terms of the credit agreements for the hydro facilities, Erie Shores and Amherstburg.

Restricted cash increased by $4,282 from December 31, 2011 to $19,229 at December 31, 2012. The increase was mainly attributable to new debt service and maintenance reserve accounts required by the credit agreement for the hydro facilities. Restricted cash represents reserve accounts of $10,331 and $8,898 at the power segment and Bristol Water, respectively.

Cash flow

Capstone's consolidated cash and cash equivalents decreased by $7,988 in 2012 compared with a decrease of $70,826 in 2011. Details of the decrease are presented in the consolidated statement of cash flows and are summarized as follows:

For the year ended	**Dec 31, 2012**	Dec 31, 2011
Operating activities	**114,678**	50,881
Investing activities	**(4,949)**	(401,344)
Financing activities (excluding dividends to shareholders)	**(92,503)**	322,782
Dividends paid to shareholders	**(26,131)**	(42,051)
Effect of exchange rate changes on cash and cash equivalents	**917**	(1,094)
Change in cash and cash equivalents	**(7,988)**	(70,826)

Cash flow from operating activities generated $63,797 more cash than in 2011, primarily because Bristol Water contributed $54,282. Capstone's power segment generated $10,596 less cash flow in 2012, primarily due to lower operating income and working capital requirements, partially offset by the commencement of operations at Amherstburg. In addition, corporate operating activities were $21,779 higher in 2012, resulting mainly from internalization costs occurring only in 2011.

Cash flow from investing activities was $396,395 higher in 2012 than in 2011, primarily due to the significant investments in Värmevärden, Bristol Water and Amherstburg occurring in 2011 in addition to the recapitalization of Värmevärden in 2012. The changes in investing activities are summarized as follows:

Värmevärden
- Capstone invested $109,146 in 2011, comprising shareholder loans and equity investment, for a one-third interest in Värmevärden.
- In 2012, Värmevärden repaid $48,943 of the shareholder loans from the bond issue proceeds at Sefyr Värme.

Bristol Water
- Capstone invested $173,989 ($213,476 purchase price less $39,487 of cash at Bristol Water on acquisition) in 2011.
- During 2012, Bristol Water used $72,010 of short-term investments to fund capital expenditures.

Amherstburg
- Capstone invested $94,635 in 2011 to complete construction of Amherstburg.

Cash flow from financing activities was $415,285 lower in 2012 than in the prior year primarily because Capstone repaid $253,311 of debt in 2012 while adding $100,621 of long-term debt for the hydro facilities. This was partially offset by the receipt of $70,274 from ITOCHU for a 20% interest in Bristol Water before transaction costs of $1,322. In 2011, Capstone added $172,328 of long-term debt to finance the Bristol Water investment and to fund the construction of Amherstburg along with raising $72,020 of preferred shares and $71,625 of common shares, net of costs. The remaining difference was due to reduction of principal on debt and common shares issued in 2011 to MGL related to the internalization transaction.

Capital Structure

Capstone considers shareholders' equity and long-term debt (proportionately attributable to Capstone's shareholders), both the current and non-current portions, to be the basis of its capital structure. Capstone measures its capitalization ratio based on the fair values of long-term debt and shareholders' equity. Capstone's capitalization ratio using fair values and carrying values was as follows:

	Dec 31, 2012		Dec 31, 2011	
As at	**Fair Value**	**Carrying Value**	Fair Value	Carrying Value
Long-term debt				
Power	**305,497**	**297,792**	314,196	308,513
Utilities – water (1)	**259,830**	**236,768**	353,135	336,237
Corporate	**44,416**	**40,631**	155,124	152,613
Deferred financing fees	**—**	**(7,328)**	—	(6,421)
	609,743	**567,863**	822,455	790,942
Equity				
Shareholders' equity (2)	**363,248**	**418,848**	335,228	413,520
Total capitalization	**972,991**	**986,711**	1,157,683	1,204,462
Debt to capitalization	**62.7%**	**57.6%**	71.0%	65.7%

(1) Only 50% of the long-term debt at Bristol Water has been included in the calculation to reflect the impact of the non-controlling interest (December 31, 2011 – 70%).

(2) The carrying value of shareholders' equity does not include the amount attributed to the non-controlling interest.

Power

The composition of the power segment's long-term debt was:

As at			**Dec 31, 2012**		Dec 31, 2011	
	Maturity	Interest Rate	**Fair Value**	**Carrying Value**	Fair Value	Carrying Value
CPC-Cardinal credit facility	2014	4.53%	**12,050**	**12,050**	85,000	85,000
Erie Shores project debt	2016 & 2026	5.28 – 6.15%	**106,538**	**97,703**	108,616	102,933
Amherstburg Solar Park project debt	2016	7.32%	**90,560**	**90,560**	94,267	94,267
Hydro facilities senior secured bonds	2040	4.56%	**76,347**	**77,237**	—	—
Hydro facilities subordinated secured bonds	2041	7.00%	**20,002**	**20,242**	—	—
Wawatay facility's levelization liability	Settled	6.87%	**—**	**—**	26,313	26,313
			305,497	**297,792**	314,196	308,513

On September 17, 2012, Capstone repaid $12,300 of the old CPC-Cardinal credit facility and entered into an amended and restated facility in the aggregate amount of $27,300, comprising a $12,300 term loan and a $15,000 revolving facility. The facility has covenants that include limits on the consolidated debt-to-capitalization ratio and require CPC and certain subsidiaries to maintain a minimum EBITDA.

The $10,721 decrease in the carrying value of power segment's long-term debt is summarized in the following table:

Dec 31, 2011	Unscheduled Repayments[1]	Scheduled Repayments[2]	Debt Proceeds[3]	Other[4]	**Dec 31, 2012**
308,513	(99,672)	(12,331)	100,621	661	**297,792**

(1) Unscheduled debt repayments included $72,700 to settle the power portion of CPC-Cardinal credit facility along with the $27,239 to settle the Wawatay facility's levelization liability. Additionally, a $267 receivable with the OEFC as at June 30, 2012 partially offsets the Wawatay facility's levelization liability repayment.

(2) Scheduled repayments are regular repayments under the credit agreements.

(3) Debt proceeds include the issue of senior and subordinated secured bonds for the hydro facilities, net of deferred financing costs.

(4) Other includes $688 of accrued interest partially offset by a reduction in the Wawatay facility's levelization liability of $27.

Covenant compliance

All of the power segment's long-term debt is subject to financial covenant requirements. The Erie Shores project debt, hydro facilities senior secured and subordinated secured bonds, and Amherstburg project debt are individually required to maintain minimum debt service coverage ratios to allow for distributions to the Corporation. During 2012, Capstone's power segment complied with all covenants.

Utilities – water

The composition of the utilities – water segment's long-term debt was as follows:

As at			**Dec 31, 2012**		Dec 31, 2011	
	Maturity	Interest Rate	**Fair Value**	**Carrying Value**	Fair Value	Carrying Value
Bank loans	2017	1.18%- 5.73%	**31,540**	**31,430**	55,625	54,213
Term loans	2032 – 2041	5.77 – 6.79%[1]	**457,563**	**413,746**	420,242	398,445
Debentures	Irredeemable	3.50 – 4.25%	**2,346**	**2,072**	2,125	2,008
Cumulative preferred shares	Irredeemable	8.75%	**28,211**	**26,289**	26,487	25,673
Consolidated long-term debt			**519,660**	**473,537**	504,479	480,339
Less: non-controlling interest			**(259,830)**	**(236,769)**	(151,344)	(144,102)
Capstone share of long-term debt			**259,830**	**236,768**	353,135	336,237

(1) The interest rate on certain term loans includes an index-linked component to RPI, which was 3.9% after April 1, 2012 (for January 1 to March 31, 2012 – 5%).

Long-term debt for the utilities – water segment was used to fund current and ongoing capital expenditures to improve Bristol Water's network. During the third quarter, Bristol Water repaid a $23,699 bank loan from cash on hand and entered into bank loans of $31,738 and $79,345, maturing August 17, 2015 and 2017, respectively. The new loans are earmarked for long-term cash requirements related to the capital expansion. As at December 31, 2012, Bristol Water has not drawn on these loans. The preferred shares are classified as long-term debt on the basis that they are irredeemable. All Bristol Water debt is non-recourse to Capstone.

Covenant compliance

The principal debt agreements require Bristol Water to comply with covenants relating to the minimum levels of interest coverage and net debt in relation to regulatory capital value. During 2012, Bristol Water complied with all its covenants.

Corporate

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

			Dec 31, 2012		Dec 31, 2011	
As at	Maturity	Interest Rate	**Fair Value**	**Carrying Value**	Fair Value	Carrying Value
Senior debt facility	Settled	6.73%	**—**	**—**	78,375	78,375
CPC-Cardinal credit facility	2014	4.53%	**—**	**—**	34,000	34,000
Convertible debentures	2016	6.50%	**44,416**	**40,631**	42,749	40,238
			44,416	**40,631**	155,124	152,613

Long-term debt decreased by $111,982 in the first year of 2012. Capstone repaid the full $78,375 of the senior debt facility and $34,000 of the CPC-Cardinal credit facility using funds received from the Värmevärden recapitalization, sale proceeds from the Bristol Water partial sale and financing proceeds from the hydro facilities.

Covenant compliance

During 2012, Capstone complied with all covenants.

Shareholders' equity

Shareholders' equity comprised:

As at	Dec 31, 2012	Dec 31, 2011
Common shares	**632,474**	626,861
Class B exchangeable units	**26,710**	26,710
Preferred shares	**72,020**	72,020
	731,204	725,591
Equity portion of convertible debentures	**9,284**	9,284
Accumulated other comprehensive income (loss)	**(809)**	(6,729)
Retained earnings (deficit)	**(320,831)**	(314,626)
Equity to Capstone shareholders	**418,848**	413,520
Non-controlling interests	**91,610**	34,450
Total shareholders' equity	**510,458**	447,970

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

	Year ended Dec 31, 2012		Year ended Dec 31, 2011	
($000s and 000s of shares)	**Shares**	**Amount**	Shares	Amount
Opening balance	**70,957**	**626,861**	56,352	536,278
Shares issued[(1)]	**—**	**(89)**	12,856	77,526
Dividend reinvestment plan (DRIP)	**1,488**	**5,702**	253	1,238
Conversion of convertible debentures	**—**	**—**	1,496	11,819
Ending balance	**72,445**	**632,474**	70,957	626,861

(1) During 2012, additional transaction costs of $89 were included in share capital in relation to the November 10, 2011 common share offering.

The composition of fair value for shareholders' equity was as follows:

As at	Dec 31, 2012			Dec 31, 2011		
($000s, except per share amounts)	**Market Price per Share**	**Outstanding Amount**	**Fair Value**	Market Price per Share	Outstanding Amount	Fair Value
Common shares	**$4.03**	**72,445**	**291,955**	$3.81	70,957	270,348
Class B units	**$4.03**	**3,249**	**13,093**	$3.81	3,249	12,380
Preferred shares	**$19.40**	**3,000**	**58,200**	$17.50	3,000	52,500
			363,248			335,228

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

Contractual Obligations

As at December 31, 2012, Capstone's outstanding contractual obligations are due in the following periods:

	Within one year	One year to five years	Beyond five years	Total
Long-term debt	14,977	180,087	619,014	814,078
Finance lease obligations	3,528	2,689	2,572	8,789
Operating leases	939	3,765	8,443	13,147
Asset retirement obligations	—	—	5,657	5,657
Purchase obligations	67,393	107,453	7,189	182,035
Total contractual obligations	86,837	293,994	642,875	1,023,706

Long-term debt

Long-term debt is discussed as a part of the Capital Structure section on page 33 of this MD&A.

Leases

Cardinal leases the site on which it is located from Ingredion Canada Incorporated ("Ingredion"), formerly Casco Inc. Under the lease, Cardinal pays nominal rent. The lease extends to 2016 and expires concurrently with the energy savings agreement between Ingredion 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 payments above a minimum level with respect to these agreements vary based on actual power production. The terms of the lease agreements extend to 2025, with a 20-year renewal option.

The Corporation has an operating lease for premises, 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 principally 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 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 Ingredion, Cardinal is required to sell up to 723 million pounds of steam per year to Ingredion 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 Amherstburg, 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, 2012 of which $33,300 were contracted for but not accrued.

Guarantees

Capstone also provides three guarantees relating to Clean Power Income Fund's legacy obligations. As at December 31, 2012, 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 30 of this MD&A for a detailed discussion on Capstone's equity accounted investment in Värmevärden.

For Capstone's equity interest in Chapais, 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. Additionally, Capstone's investment in MLTCLP had no significant activity during the year ended December 31, 2012.

Capital Expenditure Program

Capstone incurred $146,073 in capital expenditures during the year. Below is the breakdown of the investment by operating segment:

	For the year ended	
	Dec 31, 2012	Dec 31, 2011
Power	**5,432**	87,451
Utilities – water	**140,555**	22,962
Corporate	**86**	638
	146,073	111,051

Capital expenditures for the power segment in 2012 were in the normal course of operations and primarily related to the Cardinal, Whitecourt, Erie Shores and the hydro facilities as they completed scheduled outages in the second and third quarters of 2012. In 2011, the capital expenditures primarily related to the construction of the Amherstburg facility. For the utilities – water segment, expenditures included 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 AMP5 period. Overall, Bristol Water's expenditures to date are behind the five-year plan but are expected to catch up before the end of AMP5 in March 2015.

Retirement Benefit Plans

Bristol Water has a defined benefit plan and there are defined contribution plans for the employees of Bristol Water and Cardinal.

Bristol Water's defined benefit plan is for current and former employees. The defined benefit plan is closed to new employees, who are allowed to join Bristol Water's defined contribution plan.

As at	**Dec 31, 2012**	Dec 31, 2011
Fair value of assets	**271,650**	267,114
Present value of defined benefit obligation	**(234,075)**	(207,010)
	37,575	60,104

As at December 31, 2012, the defined benefit plan was in a $37,575 surplus position for accounting purposes. The surplus is subject to a number of critical accounting estimates which can materially impact the balances. 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.

For 2013, Bristol Water expects to make employer contributions of $3,348 compared with actual contributions of $3,725 for the year ended December 31, 2012. The expense is incurred entirely at Bristol Water.

The total defined contribution pension expense recorded in the consolidated statement of income for the year ended December 31, 2012 was $1,319. The expense comprised $1,135 for Bristol Water and $184 for Cardinal.

Income Taxes

Current income tax recovery was $239 for 2012. This was primarily attributable to Bristol Water resolving prior year tax recoveries.

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.

As at	**Dec 31, 2012**	Dec 31, 2011
Deferred income tax assets	**28,719**	32,897
Deferred income tax liabilities	**(181,176)**	(178,201)
	(152,457)	(145,304)

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

	Recognized	Unrecognized	Total
Canadian – capital losses	—	84,610	84,610
Canadian – non-capital losses	13,572	59,908	73,480
US – non-capital losses	—	14,385	14,385
UK – capital losses	—	4,633	4,633
UK – advanced corporation tax	—	6,345	6,345
	13,572	169,881	183,453

Capstone's total deferred income tax assets include $14,517 ($16,924 at December 31, 2011) attributable to the Canadian entities and $14,202 ($15,973 at December 31, 2011) for Bristol Water. Deferred income tax assets primarily relate to financial instruments fair value adjustments and differences in the amortization of deferred financing costs for tax and accounting purposes.

Deferred income tax liabilities of $64,704 ($60,286 at December 31, 2011) were attributable to Capstone's Canadian entities while $116,472 ($117,915 at December 31, 2011) was attributable to Bristol Water. Deferred income tax liabilities primarily relate to the defined benefit pension plan and differences in the amortization of intangible and capital assets for tax and accounting purposes.

Capstone's net deferred income tax liability increased by $7,153 in 2012. The increase was primarily attributable to the difference between accounting and tax depreciation. In addition, a substantively enacted tax rate reduction in the United Kingdom from 25% to 24% effective March 1, 2012, with an additional rate reduction from 24% to 23%, effective July 1, 2012, resulted in a recovery of $7,021. The decrease in the deferred income tax liability not attributable to the deferred income tax expense relates to amounts recorded to other comprehensive income.

The income tax recovery of $35,945 for the year ended December 31, 2011 was primarily attributable to Capstone's conversion to a corporation. As a trust in 2010, IFRS required Capstone to use an "undistributed" tax rate to determine deferred taxes. Upon conversion to a corporation, Capstone recognized the recovery from changing tax rates from 46%, the trust rate, to 25%, the general corporate rate.

DERIVATIVE FINANCIAL INSTRUMENTS

Capstone has exposure to market, credit and liquidity risks from its use of financial instruments as described in notes 9 (Financial Instruments) and 10 (Financial Risk Management) in the consolidated financial statements for the year ended December 31, 2012. These notes contain further details on the implicit risks and valuation methodology employed for Capstone's financial instruments.

To manage the risks inherent in the business, Capstone enters into derivative contracts to mitigate the economic impact of the fluctuations in interest rates and foreign exchange rates. The fair values of these contracts, as reported in Capstone's consolidated statements of financial position, were:

As at	**Dec 31, 2012**	Dec 31, 2011
Derivative contract assets	**2,021**	3,144
Derivative contract liabilities	**(30,651)**	(34,143)
Net derivative contract liabilities	**(28,630)**	(30,999)

The composition of derivative contracts in 2012 is consistent with 2011, aside from the expiry of the gas swap and certain interest rate swaps during 2012. The $2,369 decrease in the net derivative contract liabilities is included in the $2,605 gain as a part of other gains and losses in the consolidated statement of income for the year ended December 31, 2012. The unrealized gain (loss) on derivatives on the consolidated statements of income and comprehensive income comprised:

	Year ended	
	Dec 31, 2012	Dec 31, 2011
Interest rate swap contracts	**(100)**	(8,128)
Gas swap contracts	**—**	(1,918)
Foreign currency option contracts	**(975)**	(644)
Embedded derivative	**3,680**	(11,052)
Unrealized gain (losses) on derivatives in net income	**2,605**	(21,742)
Interest rate swap contracts in OCI	**(642)**	(60)
Unrealized gain (losses) on derivatives in comprehensive income	**1,963**	(21,802)

Gains on derivatives for the year ended December 31, 2012 were primarily attributable to the change in value of the embedded derivative at Cardinal, partially offset by losses on the foreign currency contracts.

The embedded derivative gain was primarily due to a decrease in the forecasted Direct Customer Rate ("DCR") and the passage of time. The liability portion of the embedded derivative is calculated by discounting Capstone's expected cash flows from Cardinal's fuel supply agreement. Cardinal may swap gas mitigation payments at DCR for a fixed rate, which means that declines in forecasted DCR reduce the fair value of the liability. Additionally, as time passes, fewer net payments are included in the calculation and the liability declines.

The loss on foreign currency contracts was due to the net depreciation of the Swedish krona and UK pound sterling forward-looking rates relative to the fixed Canadian dollar conversion rate.

FOREIGN EXCHANGE

The foreign exchange gains (losses) were primarily due to translation of Capstone's SEK-denominated shareholder loan receivable with Värmevärden. Capstone recorded a $1,620 foreign exchange gain in 2012 compared with a $3,274 loss in 2011. In 2012, the Swedish krona appreciated against the Canadian dollar thereby increasing the carrying value of the loans in Canadian dollars, compared with a deprecation in 2011. The 2012 gain was also mitigated by the repayment of more than half of the shareholder loan, reducing the impact of Swedish krona appreciation.

Capstone hedges the interest payments from Värmevärden, but not the outstanding loan receivable.

RISKS AND UNCERTAINTIES

Introduction

Risk is an inevitable aspect of operating a business. Decisions that balance risk exposure with intended financial rewards within risk tolerances are the responsibility of the Corporation's management under the supervision of the Board of Directors. When a risk exposure exceeds the Corporation's risk tolerance, the Corporation will take steps to eliminate, avoid, reduce or transfer such risk.

The Corporation recognizes the importance and benefits of timely identification, assessment and management of risks that may impact the Corporation's ability to achieve its strategic objectives. In this respect, the Corporation is committed to prudent risk management practices within the context of an enterprise risk management ("ERM") framework. The Corporation undertakes an annual comprehensive review of its ERM framework and, in 2012, engaged external advisors to further refine and strengthen its risk management practices and implement an outsourced internal audit function.

What follows is a description of the Corporation's key risk governance and risk processes to support achievement of strategic performance objectives.

Risk Management Principles and Governance

The Corporation's ERM framework is based on five core principles which establish the culture and tone that guide risk management decisions:

- Risk management is everyone's responsibility
- Risk management is about decision making
- Risk management is embedded within existing management routines
- Risk management is about people and culture
- Risk management is specific to each business unit

The Corporation's implementation of the ERM framework includes the following hierarchy of responsibilities:

- **Board of Directors and Audit Committee** have overall governance responsibility for overseeing management's implementation of the risk management policy.
- **Internal Audit** is responsible for reviewing management's practices to manage risk and reporting to the Audit Committee.
- **Senior Management** is responsible for ensuring the implementation of the ERM framework to all applicable activities and reporting to the Audit Committee.
- **Business Units** are responsible for ensuring the application of a risk management framework to identify, monitor and report risk.
- **Risk Owners** are responsible for the identification and day-to-day management and oversight of risks in their assigned area.

Risk Management Processes

The Corporation's framework relies on the following six key ERM processes to integrate risk management activities with strategic and operational planning, decision-making and day-to-day oversight of business activities.

- **Risk identification** is the process of identifying and categorizing risks that could impact the Corporation's objectives.
- **Risk assessment** is the process of determining the likelihood and impact of the risk. The Corporation uses a five point rating scale for likelihood and impact.
- **Risk prioritization** is the process of ranking risks as high, medium or low based on the net risk rating as described in the diagram below.
- **Risk management** responses are measures taken to optimize the Corporation's net risk exposure within overall tolerance to achieve the desired risk reward balance.
- **Monitoring and reporting** are the processes of assessing the effectiveness of risk management responses.
- **Training and support** ensure that personnel tasked with risk management responsibilities have sufficient knowledge and experience to complete their risk management obligations.

The Corporation's risk management approach is comprehensive and proactive. It combines the experience and specialized knowledge of individual business segments and the corporate oversight functions as well as various analytic tools and methodologies, including a risk matrix (see chart to the right), to assist the Corporation in regularly assessing and updating the net exposure (including mitigants) of each known material risk facing the Corporation in the following four risk categories: operational, strategic, financial and legal and regulatory. The Corporation's assessment process results in prioritization of risks.

Likelihood of Risk Occurrence

Impact of Risk		Rare 5	Unlikely 4	Somewhat Likely 3	Likely 2	Almost Certain 1
Catastrophic	5					
Major	4					
Moderate	3					
Minor	2					
Insignificant	1					

Managing Risk

The Corporation requires that risk assessments (which encompass operational, strategic, financial and legal and regulatory risks) be performed at each business unit and at the corporate level (which takes into consideration the business unit risks that are significant to the consolidated organization). The Corporation has identified and defined the following four broad risk categories:

- Risks related to the Corporation on a consolidated basis include: risks related to the variability of dividends on the Corporation's common shares; risks related to the availability of debt and equity financing; risks arising from default under credit agreements and debt instruments;; risks related to geographic concentration; foreign currency exchange risk; risks related to acquisitions; risks related to derivatives; risks related to environmental, health and safety matters; risk of adverse changes in legislation and administrative policy; risks related to insurance; and risks arising from the reliance on key personnel;
- Risks related to the power infrastructure facilities include: operational performance risk; risks related to expiry of Power Purchase Agreements; risk related to fuel costs and supply; contract counterparty performance risk; risk related to land tenure and related rights; environmental risks; and risks related to the regulatory environment;
- Risks related to Bristol Water include: risks related to Ofwat price determinations; the risk of failure to deliver capital investment programs; the risk of failure to deliver water leakage target; risks related to Ofwat's service incentive mechanism and the serviceability assessment; risks related to economic conditions; risks related to pension plan obligations; risks related to the regulatory environment; operational performance risk; risk of competition; risks related to seasonality and climate change; and risks related to labour relations; and
- Risks related to Värmevärden include: general risks inherent in the district heating sector; risks related to fuel costs and availability; risks related to industrial and residential contracts; environmental risks; risks related to the regulatory environment; and risks related to labour relations.

In addition to the risks described in this "Managing Risk" section, there are numerous other risk factors, many of which are beyond the Corporation's control and the effects of which can be difficult to predict, that could be material to investors or cause our results to differ significantly from our plans, objectives and estimates. For a more comprehensive list and description of the risks affecting the Corporation, its power infrastructure facilities, Bristol Water and Värmevärden, 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 of the following documents filed by the Corporation with securities commissions or similar authorities in Canada after the date of this annual MD&A, which are available on SEDAR at www.sedar.com: material change reports; business acquisition reports; interim financial statements; interim management's discussion and analysis; and information circulars.

Risks Related to the Corporation's Securities

Dividends on Common Shares and Preferred Shares are not Guaranteed

Although the Board of Directors of the Corporation has adopted a policy of paying a quarterly dividend on its common shares, and holders of preferred shares are entitled to receive annual fixed, cumulative, preferential dividends of $1.25 per share, payable quarterly, the declaration of common and preferred share dividends is at the discretion of the Board of Directors and may vary in the future based upon numerous factors.

Volatile Market Price for the Corporation's Securities

A publicly-traded company will not necessarily trade at values determined by reference to the underlying value of its business or its results of operations or financial performance. The prices at which the Corporation's securities will trade cannot be predicted. The market price for the Corporation's securities may be subject to significant fluctuations in response to numerous factors, many of which are beyond the Corporation's control.

Shareholder Dilution

The Corporation's constating documents permit the issuance of an unlimited number of common shares and a limited number of preferred shares issuable in series on such terms as the Directors determine without the approval of shareholders, who have no pre-emptive rights in connection with such issuances. In addition, the Corporation is required to issue common shares upon the conversion of its outstanding convertible debentures in accordance with their terms and the Corporation may, in certain circumstances, issue common shares to redeem or pay outstanding principal or interest amounts under the convertible debentures or issue common shares under the DRIP. Accordingly, holders of common shares may suffer dilution.

Convertible Debentures Credit Risk, Subordination and Absence of Covenant Protection

The likelihood that holders of the Corporation's convertible debentures will receive payments of interest and principal owing to them depends on the cash flows of the Corporation. In addition, the convertible debentures are unsecured obligations of the Corporation and are subordinate in right of payment to all the Corporation's existing and future senior indebtedness. The convertible debentures do not contain any covenants restricting future leveraged transactions involving the Corporation.

Risks Related to the Corporation and its Businesses

Availability of Debt and Equity Financing

There can be no assurance that debt or equity financing will be available or, together with internally-generated funds, will be sufficient to meet or satisfy the Corporation's objectives or requirements or be available on acceptable terms. In particular, Bristol Water is expected to continue to require access to the capital markets in connection with its capital investment program so the inability to raise debt or equity financing could have a material adverse effect on its business. The inability of the Corporation to access sufficient capital on acceptable terms could have a material adverse effect on the Corporation's ability to meet its other objectives or requirements.

Default under Credit Agreements and Debt Instruments

The Corporation and various of its subsidiaries and investees, as applicable, are parties to various credit agreements and debt instruments. A failure to comply with the obligations under the applicable credit agreement or debt instrument could result in a default, which, if not cured or waived, could result in the termination of distributions generated by the applicable entity and permit acceleration of the relevant indebtedness. Further, if the indebtedness under any of the credit agreements or debt instruments were to be accelerated, there could be no assurance that the assets of the applicable borrower, or the applicable guarantors, would be sufficient to repay that indebtedness in full. A portion of the cash flow of each applicable subsidiary or investee is devoted to servicing its debt and there can be no assurance that such entity will continue to generate sufficient cash flows from operations to meet the required interest and principal payments on its credit facility or debt instruments. If such an entity 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. Although many of the credit agreements related to the power infrastructure facilities are fully amortizing, there can also be no assurance that the Corporation, its subsidiaries or its investees could refinance these credit agreements or debt instruments or obtain additional financing on commercially reasonable terms, if at all. Borrowings under certain credit agreements and debt instruments may be at variable rates of interest, which, in the absence of effective hedges, expose the Corporation to the risk of increased interest rates. This factor may increase the sensitivity of the Corporation's cash flows to interest rate variations.

Geographic Concentration

Approximately 53.0% of the Corporation's Adjusted EBITDA is derived from those power infrastructure facilities that are located in Ontario. In addition, Bristol Water's operations are all located in the Bristol area of the UK and Värmevärden's heat production facilities and distribution networks are all located in certain municipalities in Sweden. Accordingly, the Corporation, its subsidiaries and investees, as applicable, are subject to risks associated with if any of Ontario, Bristol, UK or the applicable municipalities in Sweden were to experience adverse changes in local or regional economic conditions or adverse changes to the regulatory environment in Ontario, Bristol, UK or certain municipalities in Sweden, as applicable.

Foreign Currency Exchange

Through its investments in Bristol Water and Värmevärden, the Corporation is exposed to foreign currency exchange risk through exchange rate movements as the revenue generated by and the assets of Bristol Water and Värmevärden are denominated in UK pound sterling and Swedish krona, respectively. The Corporation's foreign currency exchange hedging strategy focus on reducing foreign currency exchange risk primarily in relation to expected future dividends from and interest paid by Bristol Water and Värmevärden, as applicable. However, the Corporation could be exposed to losses by undertaking hedging activities.

Acquisitions and Development

The Corporation's strategy includes growth through identifying suitable acquisition and development opportunities, pursuing such opportunities, consummating acquisitions, constructing development projects and effectively integrating and operating (or contracting for the operation of) such businesses. The Corporation competes for acquisitions and development opportunities and so there is a risk that the Corporation may not be successful in acquiring or developing such opportunities. Further, if the Corporation is unable to identify, pursue, integrate or manage acquisition or development projects, this could have an adverse impact upon its strategy. As well, in pursuing development opportunities, the Corporation may be required to make material capital expenditures with no guarantee that the development project will achieve commercial operation.

Environmental, Health and Safety

The power infrastructure facilities, Bristol Water and Värmevärden are each subject to a complex and stringent environmental, health and safety regulatory regime. As such, the operation of these businesses carries an inherent risk of environmental, health and safety liabilities (including potential civil actions, compliance or remediation orders, fines and other penalties) and may result in the applicable business being involved from time to time in administrative and judicial proceedings related to such matters. Changes in regulations, or more aggressive enforcement of existing regulations, could lead to material increases in unanticipated liabilities or expenditures for investigation, assessment, remediation or prevention, capital expenditures, restrictions or delays in the business' activities, the extent of which cannot be predicted. To mitigate the risk of administrative sanctions and to minimize safety risks to employees and contractors, the Corporation works continuously with all employees and contractors to

ensure the development and implementation of a progressive, proactive safety culture within all operations. The Corporation has safety committees operating within each operating unit to ensure existing safety programs are continuously improved.

Changes in Legislation and Administrative Policy

There can be no assurance that certain laws applicable to the Corporation, its subsidiaries and its investees, including tax laws, will not be changed in a manner which could adversely affect the value of the Corporation. In addition, there can be no assurance that the administrative policies and assessing practices of the Canada Revenue Agency will not be changed in a manner which adversely affects the holders of the Corporation's securities.

Reliance on Key Personnel

The Corporation's success depends heavily on its ability to attract, retain and motivate key employees, including its senior management, individuals with operational experience in industries related to the power infrastructure facilities and the management of Bristol Water and Värmevärden. If the Corporation loses the services of any of these key personnel and cannot replace them in a timely manner, its business and prospects may be adversely affected.

Risks Related to the Power Infrastructure Facilities

Power Purchase Agreements

Most of the electricity that is generated by the power infrastructure facilities is sold to large utilities or creditworthy customers under fixed-term PPAs. In particular, the first automatic one-year renewal following the initial 20-year term of the Cardinal PPA ends on December 31, 2014. As PPAs expire or are terminated, there can be no assurance that the applicable facility will be able to renegotiate or enter into a power supply contract on terms that are commercially reasonable, if at all, and it is possible that the price received for power under subsequent arrangements may be reduced significantly. It is also possible that subsequent PPAs may not be available at prices that permit the operation of a facility on a profitable basis. With respect to the Cardinal facility, which contributed approximately 22.3% of the Corporation's Adjusted EBITDA and approximately 65.8% of its AFFO in 2012, the Corporation expects that the price that the OPA will be willing to pay for electricity under any new PPA for the Cardinal facility will be less than the price paid under its current PPA. In addition, excess power currently generated by certain of the facilities may be sold in the open market and, upon expiry or termination of its PPA, a facility may choose to sell all of the power it produces on the open market. In such circumstances, the price received for power sold will depend on market conditions at the time and there can be no assurance that the market price received for the electricity so offered will exceed the facility's marginal cost of operation.

Operational Performance

The operational performance of Erie Shores, the hydro power facilities and Amherstburg Solar Park are dependent upon wind speed and density, water flows and the availability and constancy of solar insolation, respectively. The weather-related risk at the hydro power facilities is partially offset by their geographic diversification in the three different watersheds. All of the power infrastructure facilities are subject to risks related to premature wear or failure, defects in design, material or workmanship and longer than anticipated down times for maintenance and repair, including grid outages and curtailment. These risks are partially mitigated by the proven nature of the technologies employed at each facility, regular maintenance and the design of each facility. While much of the technology utilized at the power infrastructure facilities has a history of reliable performance at similar facilities throughout Canada, some of the components of Amherstburg Solar Park have not previously been used in operations in Canada for extended periods of time. The Corporation has attempted to mitigate some of these risks by obtaining manufacturers' warranties and a weather-adjusted performance guarantee and having all operations and maintenance services required for the facility provided by SunPower Corporation, which built the facility.

Fuel Costs and Supply

The supply of natural gas required by the Cardinal facility is contracted under a gas purchase agreement, which expires on May 1, 2015. The Whitecourt facility has a contract with a substantial forest products company to supply a majority of its wood waste fuel requirements. Upon the expiry of each of these supply agreements, the Corporation will have to renegotiate the agreement or enter into a new supply agreement or buy fuel in the open market, where available. There can be no assurance that such agreements will be able to be renegotiated, or new supply agreements be entered into, on terms that are similar to the existing agreements, if at all. Furthermore, there can be no assurance as to the supply or price of natural gas or wood waste available on the open market or at the time of the expiry of the supply agreements. Accordingly, there is the risk that, at the time of the expiry of a particular supply agreement, the price of natural gas or wood waste, as applicable, available to the relevant facility may be in excess of the price available under the current supply arrangements or such fuel may not be available in the quantities required. Furthermore, each of these facilities is also dependent on the supply of fuel to it. There is the risk that there could be an interruption in the supply of fuel (as a result of transportation or otherwise) or increases in fuel transportation costs. In particular, the natural gas used at the Cardinal facility is transported to the

facility through a number of pipelines, including the TCPL Canadian Mainline pipeline. The tolls on the TCPL Canadian Mainline pipeline are regulated by the National Energy Board and have increased significantly in the past few years.

Contract Performance

To a large extent, the Corporation's cash flows are dependent upon the parties to the various material supply, purchase and operations and management agreements relating to the power infrastructure facilities fulfilling their contractual obligations, As such, there is the risk of the inability or failure by any such party to meet its contractual commitments.

Land Tenure and Related Rights

The power infrastructure facilities have various land tenure and resource access rights upon which they depend for their operations. There can be no assurance that these rights will not be challenged, and, if challenged, whether such challenge will be successful. Furthermore, there can be no assurance that such rights will be able to be renegotiated or extended on commercially reasonable terms, if at all. At such time as any of these rights are successfully challenged or expire and cannot be renewed or renegotiated upon acceptable terms, the affected power infrastructure facility will likely be unable to continue to operate. In addition, in these circumstances, there can be no assurance that the Corporation or its subsidiaries will have the necessary financial resources or will be able to obtain the necessary financial resources to fund or cause to be funded any required restoration and remediation works.

Environmental

The primary environmental risks associated with the operation of the Cardinal facility and the Whitecourt facility include potential air quality and emissions issues, soil and water contamination resulting from oil spills, issues around the storage and handling of chemicals used in normal operations and, in the case of the Whitecourt facility, storage of wood waste fuel on site. The Corporation has procedures in place to prevent and minimize any impact of the foregoing, which procedures meet generally acceptable industry practices. The primary environmental risks associated with the operation of the hydro power facilities include possible dam failure which results in upstream or downstream flooding, and equipment failure which results in oil or other lubricants being spilled into the waterway. In addition, the operation of a hydro power facility may cause the water in the associated waterway to flow faster, or slower, which could result in water flow issues which could impact fish population, water quality and potential increases in soil erosion around a dam facility. In order to monitor and mitigate these risks, the Corporation completes facility inspections and ensures each of its facilities are in compliance with the appropriate regulatory requirements. The primary environmental risks associated with the operation of the Erie Shores Wind Farm include potential harm to the local migratory bird population, harm to the local bat population as well as concerns over sound levels and visual "harm" to the scenic environment around the facility. In order to monitor and mitigate these risks, the Corporation completes facility inspections and ensures its facilities are in compliance with the appropriate regulatory requirements. However, in the event of sound complaints or impacts, the Corporation could be subject to claims, costs and/or enforcement actions.

Regulatory Environment

The Corporation's power infrastructure 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 these facilities depends in part on a favourable regulatory climate and on the ability to obtain, maintain, comply with or renew all material licences, permits or government approvals. While these facilities are currently compliant with all material regulatory requirements, the Corporation could incur significant expense to achieve or maintain compliance with any new laws, rules or regulations that are introduced or with any modifications to their necessary licences, permits or government approvals. If the Corporation is unable to comply with applicable regulations and standards, or material licences, permits or government approvals, it could become subject to claims, costs or enforcement actions.

Risks Related to Bristol Water

Ofwat Price Determinations

The price determinations periodically made by Ofwat limit the prices Bristol Water can charge its customers. The conditions of Bristol Water's Instrument of Appointment, including any condition relating to the prices Bristol Water can charge its customers, can be modified by Ofwat either with Bristol Water's agreement or, following reference to the UK Competition Commission, on public interest grounds. Implicit within the most recent price limits set by Ofwat) are assumptions concerning Bristol Water's future operating expenditures and the achievement of operating cost savings. If these efficiencies are not achieved, this may be reflected in less favourable outcomes in future profitability and cash flows or in Ofwat's future price determinations. During 2013, Ofwat obtained the consent of all UK water companies (including Bristol Water) to certain amendments to their Instruments of Appointment which will enable Ofwat to set different price limits for different parts of each water company's business. While these changes do not impact the RPI+/-K formula for price controls on a water company's "wholesale" activities, there is no certainty that Ofwat will retain in future price reviews the RPI+/-K form of price control for "retail" activities related to the provision of goods or services directly to non-domestic customers.

Failure to Deliver Capital Investment Programs

Bristol Water is expected to continue to be required to undertake significant capital expenditures in its business, particularly in relation to new and replacement plant and equipment for water distribution networks and treatment facilities. There can be no assurance that operating cash flows will not decline or that external debt financing and other sources of capital will be available or at similar cost to that assumed by Ofwat in order to meet future capital expenditure requirements. Delivery of capital investment programs could also be affected by a number of factors and may affect Bristol Water's ability to meet regulatory and other environmental performance standards, which may result in sanctions being imposed against Bristol Water. In addition, the failure by Bristol Water to successfully complete its capital investment programs could adversely impact future calculations of Bristol Water's RCV, which could adversely impact Ofwat's determination of future price limits for Bristol Water.

Economic Conditions

Bristol Water's RCV is adjusted annually for inflation so, if RPI decreases, the RCV would be adjusted downward to reflect this decrease. Further, generally unfavourable economic conditions may also adversely influence Ofwat's determination of future price limits. Given the significant investments Bristol Water is set to undertake over the remainder of AMP5, it faces risks arising from any adverse changes in RPI.

Operational Performance

Bristol Water controls and operates a large water network and maintains the associated assets with the objective of providing high quality drinking water on a continuous basis. However, its facilities are subject to risks related to premature wear or failure, defects in design, material or workmanship, longer than anticipated down times for maintenance and repair, energy shortages, malicious intervention, failure by a supplier, pollution or contamination, human error, unavailability of access to critical sites or key staff, labour disputes, pollution or contamination and other events. These risks are partially mitigated by the proven nature of the technologies employed at each facility, regular maintenance and the design of each facility. Management also has limited control over future energy or chemical costs, abstraction charges, levels of customer bad debt or taxes. In particular, since 2000, domestic customers cannot be disconnected from their water supply for failure to pay their bill, although. an allowance for bad debts is included when Ofwat sets price limits, which partially mitigates the risk of such bad debts.

Failure to Deliver Water Leakage Target

Bristol Water is required to meet an annual target for water leakage. If Bristol Water fails to achieve the leakage target by a significant margin in any one year or by a small margin over a number of years, Ofwat may impose various sanctions, including a reduced revenue allowance at the next review of price limits. In addition, if performance were to decline, Bristol Water may incur additional operating or capital expenditure to restore performance.

SIM and the Serviceability Assessment

For the 2010-2015 period, Ofwat introduced the service incentive mechanism (the "SIM",) which compares water companies' performance in terms of the quality of service that is delivered to customers. 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. 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 2014. In addition, 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 review. In addition, if performance were to decline, Bristol Water may incur additional operating or capital expenditure to restore performance.

Pension Plan Obligations

Bristol Water operates both defined benefit and defined contribution pension arrangements. Since 2002, all new employees have been offered membership only in the defined contribution pension plan. Estimates of the amount and timing of future funding for Bristol Water's defined benefit plan are based on various actuarial assumptions and other factors, which may require Bristol Water to make additional contributions to its pension plan which may not be recoverable under the regulatory price determination process.

Regulatory Environment

Bristol Water is subject to and must ensure its compliance with various laws and regulations of the UK and the EU. Failure to comply with these laws and regulations could expose Bristol Water to regulatory and other proceedings and, in the most extreme case, lead to revocation of Bristol Water's Instrument of Appointment or the appointment of an administrator to manage the affairs, business and property of the company. Furthermore, the impact of future changes in laws or regulations or the introduction of new laws or regulations that affect the business cannot always be predicted and, from time to time, interpretation of existing laws or regulations may also change or the approach to their enforcement may become more rigorous.

Competition

Recently, legislation has been proposed in the UK that could eventually expand the competitive market allowing retail competition for all non-household customers as an initial step in opening markets to competition. Ofwat and the UK Environment Agency are also considering the introduction of reforms to the regulation of water abstraction licences that would allow the trading of licences. Ofwat is also examining the scope for upstream competition in treated water supply and has recently commenced consultations on future price limits. Ofwat has taken steps to introduce competition into the water supply market through inset appointments and the water supply licensing regime. One inset appointment is pending and further inset appointments may be made in the future, resulting in increased competition. In addition, Ofwat or the UK government may take steps that lead to other changes in the structure of the water industry with potentially adverse consequences to Bristol Water.

Seasonality and Climate Change

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, and 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 the demand by customers. As with other UK water companies, Bristol Water is dependent upon suitable weather conditions supplying raw water as inflow for its abstraction points and it has a drought contingency plan in place should there be a lack of such rainfall.

Labour Relations

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.

Risks Related to Värmevärden

Operational Performance

Värmevärden controls and operates several district heating networks and maintains the associated assets with the objective of providing heat to its customers on a continuous basis. However, its facilities are subject to risks related to premature wear or failure, defects in design, material or workmanship, longer than anticipated down times for maintenance and repair, energy shortages, malicious intervention, failure by a supplier, pollution or contamination, human error, unavailability of access to critical sites or key staff, labour disputes, pollution or contamination and other events. These risks are partially mitigated by the proven nature of the technologies employed at each facility, regular maintenance and the design of each facility. In addition, Värmevärden's revenue and costs are also affected by the demand for heat, which varies with weather conditions. Unusually cold weather may result in Värmevärden's marginal cost of production exceeding its marginal revenue. Warmer weather may also lead to a decrease in demand for heat which could result in lower revenue.

Fuel Costs and Availability

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. Further, 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. As a result, Värmevärden is subject to the risk of significant increases in fuel costs or unavailability of fuel.

Industrial and Residential Contracts

Värmevärden has entered into a number of contracts with large industrial consumers for the supply of heat and/or steam which account for a material amount of Värmevärden's total revenue. Värmevärden is subject to counterparty credit risk and risk of reduction in demand from such industrial customers. 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 which, in some cases, could adversely impact upon the business, operating results and financial condition of Värmevärden and could, in turn, adversely affect the Corporation's cash flows and the likelihood that holders of securities of the Corporation will receive payments, whether of interest or dividends or upon redemption or maturity, as applicable.

Environmental

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.

Regulatory Environment

Värmevärden is subject to regulation under legislation governing the district heating industry 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") regulations. However, there is the risk that price regulation or TPA could occur in the future. 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 with all material regulations and standards, Värmevärden could incur significant expenses to achieve or maintain compliance with any new laws or regulations that are introduced. If Värmevärden is unable to comply with applicable regulations and standards, it could become subject to claims, costs and enforcement actions.

Labour Relations

Approximately 80% 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. Such risks may be partially mitigated by Swedish legislation that prohibits labour disruptions in the provision of essential services, such as district heating.

ENVIRONMENTAL, HEALTH AND SAFETY REGULATION

Capstone's Canadian power facilities and the water distribution and district heating businesses, respectively, operated by Bristol Water and Värmevärden (collectively the "Facilities") hold all material permits and approvals required for their operations and are managed to comply with environmental, health and safety laws.

The Facilities are subject to complex and stringent environmental, health and safety regulatory regimes, which primarily focus on:

- air emissions;
- taking of water, and discharges into water;
- the storage, handling, use, transportation and distribution of dangerous goods and hazardous materials;
- the prevention of releases of hazardous materials into the environment;
- the prevention, presence and remediation of hazardous materials in soil and ground water, both on and off site;
- workers' health and safety; and
- sound regulation.

Due to the nature of their operations, the Facilities are not subject to any material contingent environment liabilities or environmental remediation costs upon the retirement of assets.

Greenhouse Gases and other Air Pollutants

Certain of the Facilities have an impact on the environment, particularly the Cardinal and Whitecourt facilities, which both emit greenhouse gases ("GHGs"), such as carbon dioxide ("CO_2") and nitrous oxides ("NOx"). All Facilities comply in all material respects, with the applicable Canadian, UK, Swedish and European Union legislation and guidelines regarding GHGs and other emissions. There are a number of draft proposals in respect of changes to such legislation and guidelines (including proposed limits on GHG emissions) – in various stages of development. However, it is difficult to predict how these changes may apply to the Facilities.

Capstone mitigates the potential impact of future changes to environmental legislation and guidelines by remaining diligent in the operation of the Facilities, including stringent policies and procedures to prevent the improper discharge of emissions or other pollutants. Capstone's environmental footprint is also mitigated by the renewable profile of its wind, hydro, biomass and solar power facilities, which could generate GHG offset credits, where eligible.

Cardinal

There is currently no limit on the amount of CO_2 that the Cardinal facility may emit, although the facility is required to report its CO_2 emissions under various federal and provincial regulations. Environmental regulations in Ontario also provide for, among other things, the reporting, allocation and retirement of NOx emissions. Under this system, applicable facilities receive a maximum yearly emission compliance limit, which may be achieved by controlling or reducing source emissions, or by trading NOx allowances. For 2012, Cardinal received 1,094 tonnes of NOx allowances based on actual generation in 2010. Cardinal expects to retire 375 tonnes of NOx allowances for 2012, leaving a cumulative allowance balance of 7,678 tonnes. NOx emissions from Cardinal's generating equipment are lower than the levels mandated by legislation.

Whitecourt

The Whitecourt Facility uses biomass combustion technology to convert the energy content in wood waste into electricity. Biomass is generally considered to be "carbon-neutral" as the amount of CO_2 arising from combustion is equal to what would be emitted if the biomass were to decompose naturally. As a result, electricity generated from biomass is regarded as an environmentally-friendly form of power generation. The Whitecourt facility is subject to limits governing the emissions of carbon monoxide, NOx and particulates in accordance with the facility's Environmental Approval. Average annual emission levels at the Whitecourt facility are below the levels of permitted emissions for the facility. The Whitecourt Facility is also subject to certain federal and provincial GHG reporting requirements and is in compliance with these requirements.

Hydro Facilities

Capstone's hydro facilities do not produce GHGs. However, their operations are governed by water management plans, which specify the hydrological conditions during which production may occur.

Erie Shores Wind Farm

Erie Shores does not produce GHGs, but is subject to regulations and/or approvals relating to birds, mammals, other animals, and to sound.

Amherstburg Solar Park

The operation of the Amherstburg does not generate GHGs and the primary environmental regulation relates to potential sound emissions issues.

Värmevärden

In 2007, the European Union adopted a long-term climate change target, commonly referred to as 20-20-20. The goal of the target is for member states (including Sweden) to reduce energy use by 20%, reduce CO_2 emissions by 20%, and increase their proportion of renewable energy by 20%, all by 2020. The government of Sweden has subscribed to the 20-20-20 targets and has made biomass-fired and waste-fired heating facilities an important component in its overall plan to meet its CO_2 reduction commitments.

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, although the forecast cost for 2012-2013 is an immaterial amount due to credits arising from Bristol Water's purchase of green energy. Bristol Water is also subject to the CRC Energy Efficiency Scheme, a mandatory UK carbon emissions reduction plan for significant consumers of energy; costs for 2012-2013 are projected to be an immaterial amount.

Further information regarding Environmental, Safety and Health Regulations matters is contained in the Corporation's Annual Information Form (which is available under the Corporation's profile on www.sedar.com).

RELATED PARTY TRANSACTIONS

Capstone's related party transactions in 2012 comprise compensation to key management, which commenced after the internalization of management on April 15, 2011.

In 2011, Capstone terminated its management and administration agreements with MGL, which established the related party relationship between Capstone and MGL. The 2011 transactions with MGL and MPML are described in note 26 (Related Party Transactions) in the consolidated financial statements for the year ended December 31, 2012.

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. Key management compensation is described in note 26 (Related Party Transactions) in the consolidated financial statements for the year ended December 31, 2012.

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

Linking Management Compensation to Performance

Compensation plays an important role in achieving short- and long-term business objectives that ultimately drive the Corporation's business success in alignment with long-term shareholder goals. The objectives of the Corporation's compensation program are to:

- attract and retain highly qualified employees with a history of proven success;
- align the interests of employees with shareholders' interests and with the execution of the Corporation's business strategy;
- establish performance goals that, if met, are expected to improve long-term shareholder value; and
- tie compensation to those goals and provide meaningful rewards for achieving them.

Financial performance targets are set each year to provide management with an incentivize to improve upon yearly budgeted financial results and are therefore aligned with shareholder interests.

The following table summarizes the link between the Corporation's executive and senior officer forms of compensation and performance:

	Salary	Short-term incentive plan ("STIP")	Long-term incentive plan ("LTIP")
Description	Salary is a fixed component of compensation that provides income certainty by establishing a base level of compensation for executives fulfilling their roles and responsibilities.	The STIP provides the possibility of an additional annual cash award based on the achievement of corporate and individual goals.	The LTIP provides the possibility of an additional award linked to the Corporation's common shares. This award is paid in cash or common shares purchased on the open market after meeting certain vesting conditions.
Purpose	To attract and retain qualified executives.	To motivate, attract and retain qualified executives.	To reward long-term performance and align interests of executives with security holders.
Link to performance	No direct link.	A significant portion of this award is based on actual business performance against Capstone's non-GAAP performance measures, Adjusted EBITDA and AFFO.	A significant portion of this award is directly linked to the performance of the Corporation's shares over the vesting period, as well as the total shareholder return relative to a comparator group.

For a comprehensive understanding of Capstone's compensation program please refer to the "Compensation Discussion and Analysis" section of the Corporation's most recently filed information circular.

SUMMARY OF QUARTERLY RESULTS

The following table provides a summary of the previous eight quarters of Capstone's financial performance.

	2012				2011			
($000s, except for per share amounts)	Q4	Q3	Q2	Q1	Q4 [1]	Q3	Q2 [2, 3]	Q1
Revenue	**94,654**	**84,951**	**85,849**	**92,156**	91,663	40,361	37,028	46,915
Net income (loss)[4]	**12,612**	**5,553**	**(4,568)**	**13,381**	(4,891)	(11,783)	(30,370)	41,332
Adjusted EBITDA	**31,139**	**24,618**	**27,605**	**37,295**	31,120	13,253	(6,569)	17,869
AFFO	**13,560**	**3,381**	**3,707**	**14,915**	9,722	5,891	(13,888)	13,484
Common dividends[5]	**5,579**	**5,655**	**10,231**	**12,299**	11,569	10,225	10,217	10,015
Preferred dividends	**938**	**938**	**938**	**938**	1,264	—	—	—
Earnings Per Share – Basic	**0.144**	**0.061**	**(0.073)**	**0.167**	(0.086)	(0.190)	(0.492)	0.685
Earnings Per Share – Diluted	**0.139** [6]	**0.061**	**(0.073)**	**0.161** [6]	(0.086)	(0.190)	(0.492)	0.625 [6]
AFFO per share	**0.179**	**0.045**	**0.049**	**0.200**	0.136	0.096	(0.225)	0.223
Dividends declared per common share	**0.075**	**0.075**	**0.135**	**0.165**	0.165	0.165	0.165	0.165

(1) AFFO and AFFO per share have been adjusted to conform to the Corporation's revised definition of AFFO; refer to page 20 of this MD&A.

(2) Net loss, Adjusted EBITDA, AFFO, Earnings Per Share, and AFFO per share were significantly impacted by $18,611 of internalization costs incurred during the second quarter.

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

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

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

(6) Convertible debentures were dilutive during the period.

FOURTH QUARTER 2012 HIGHLIGHTS

	Three months ended	
	Dec 31, 2012	Dec 31, 2011
Revenue	**94,654**	91,663
Operating expenses	**(51,533)**	(48,598)
Administrative expenses	**(3,037)**	(3,074)
Project development costs	**(279)**	(4,309)
Equity accounted income (loss)	**3,596**	320
Interest income	**893**	2,123
Other gains and (losses), net	**(378)**	(7,918)
Foreign exchange gain (loss)	**676**	(2,735)
Earnings before, interest, taxes, depreciation and amortization	**44,592**	27,472
Interest expense	**(11,184)**	(15,377)
Depreciation of capital assets	**(12,194)**	(11,912)
Amortization of intangible assets	**(2,582)**	(2,478)
Income (loss) before income taxes	**18,632**	(2,295)
Income tax recovery (expense)		
Current	**1,237**	(179)
Deferred	**(3,533)**	32
Total income tax recovery (expense)	**(2,296)**	(147)
Net income	**16,336**	(2,442)
Net income attributable to:		
Shareholders of Capstone	**12,612**	(4,891)
Non-controlling interest	**3,724**	2,449
	16,336	(2,442)

Capstone's EBITDA was $17,120, or 62.3%, higher compared with the fourth quarter of 2011.

Revenue was $2,991, or 3.3%, higher compared with 2011, primarily due to increases of $2,035 from Bristol Water and $956 from the power segment. Bristol Water's revenue increased primarily due to regulated increases in the water tariff charged to customers, which adjusts annually on April 1. The power segment increase was primarily due to increased power generation of 9.9 GwH, or 34.3%, at the hydro facilities, contributing $1,373. In addition, Cardinal contributed $773 due to higher power rates and increased production. Lower power generation at Erie Shores partially offset revenues by $1,165 due to poor wind conditions.

Expenses were $1,132, or 2.0%, lower compared with 2011.

- **Operating expenses** increased $2,935, primarily related to Bristol Water. Bristol Water's operating expenses increased primarily due to $1,080 of increased repairs and maintenance expenditures coinciding with the capital program, $670 of higher consultancy fees for the capital program and $350 of higher bad debts, as a result of collection experience.
- **Administrative expenses** were consistent with the fourth quarter of 2011.
- **Project development costs** declined by $4,030 as Capstone incurred costs in 2011 for the acquisition of Bristol Water.

Equity accounted income (loss) was $3,276, or 1,024%, higher than in 2011, due to higher earnings reported by Värmevärden.

Interest income was $1,230, or 57.9%, lower than in 2011, due to lower interest on the loan receivable with Värmevärden as a result of the partial repayment in the first quarter of 2011.

Other losses were $7,540, or 95%, lower compared with 2011. The change was primarily attributable to $7,931 greater reduction in the 2011 fair value of Capstone's financial instruments, primarily for interest rate swap contracts which expired in 2011.

Foreign exchange gain (loss) in 2012 was $3,411 favourable to 2011. The favourable change was attributable to the loan receivable with Värmevärden in Sweden. During the fourth quarter of 2012, the Swedish krona appreciated marginally against the Canadian dollar.

Interest expense was $4,193, or 27.3%, higher in 2011, due to additional interest on the senior debt facility used to acquire Bristol Water in 2011. The senior debt facility was repaid in the second quarter of 2012.

Income tax provision was a net **expense** in both years. The current portion income tax provision was a $1,237 recovery in 2012 due to Bristol Water which achieved recoveries from prior year tax return refilings. The deferred portion of the income tax provision was an expense in 2012 primarily attributable to fair value adjustment and the difference between accounting and income tax depreciation for financial instruments.

ACCOUNTING POLICIES AND INTERNAL CONTROL

Significant Changes in Accounting Standards

The consolidated financial statements have been prepared in accordance with IFRS.

Future Accounting Changes

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after January 1, 2013 and 2015, and have not been applied in preparing these consolidated financial statements. Those which may be relevant to Capstone are set out below. Capstone does not plan to adopt these standards early.

Title of the New IFRS [1]	Impact to Capstone
IFRS 9, Jan 1, 2015 Financial Instruments	Capstone's assessment of the impact of this standard is ongoing.
IFRS 10, 11 and 12, Jan 1, 2013 Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities	Capstone will adopt IFRS 10, 11 and 12 for the annual period beginning on January 1, 2013. Implementation of these standards will have no material impact on Capstone's consolidated financial statements, but will increase disclosure of interests in other entities.
IFRS 13, Jan 1, 2013 Fair Value Measurement	Capstone will adopt IFRS 13 prospectively beginning on January 1, 2013. Implementation of this standard will have no material impact on Capstone's consolidated financial statements.
IAS 19, Jan 1, 2013 Employee Benefits	Capstone will adopt the amendment to IAS 19 retrospectively as a change in accounting policy for the annual period beginning on January 1, 2013. Implementation of this amendment is limited to Bristol Water which has a defined benefit pension plan. The impact on Capstone's consolidated financial statements is: i) The expected return on plan assets must be calculated using the same discount rate as the pension obligation, which will affect interest expense and net income, and is then offset in comprehensive income. ii) Certain costs will be required to be recognized as period costs and will be reclassified from net interest in the statement of income to current service costs which are included in operating expenses.
IAS 27, Jan 1, 2013 Separate Financial Statements	Capstone will adopt the amendment to IAS 27 for the annual period beginning on January 1, 2013. Implementation will have no material impact on Capstone's consolidated financial statements.
IAS 28, Jan 1, 2013 Investments in Associates and Joint Ventures	Capstone will adopt the amendment to IAS 28 for the annual period beginning on January 1, 2013. Implementation will have no material impact on Capstone's consolidated financial statements.

(1) See the note 2 to the consolidated financial statement for the year ended December 31, 2012 for further detail about the nature of these future accounting changes.

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 judgements
• 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, amount and discount rate
• Impairment of trade receivables	• Probability of failing 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, tax rates and current and future taxable income
• Impairment assessments of capital, assets, intangibles and goodwill	• Future cash flows and discount rate

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 over Financial Reporting and Disclosure Controls and Procedures

Capstone's CEO and CFO 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' National Instrument 52-109 ("NI 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 NI 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.

During 2012, Capstone continued to improve internal control over financial reporting by adding a third-party internal audit function to objectively evaluate and advise management and the Board of Directors.

The CEO and CFO have concluded that Capstone's disclosure controls and procedures were effective as at December 31, 2012 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, 2012, 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, 2012.

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 auditors 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, 2013

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, 2012 and 2011 and the consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, 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 audit 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, 2012 and 2011 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Accountants, Licenced Public Accountants
Toronto, Canada
March 7, 2013

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

As at	Notes	**Dec 31, 2012**	Dec 31, 2011
Current assets			
Cash and cash equivalents	4	**49,599**	57,587
Restricted cash	4	**19,229**	14,947
Short-term deposits	5	**6,471**	82,202
Accounts receivable	6	**75,386**	70,854
Other assets	7	**7,218**	7,448
Current portion of loans receivable	8	**1,096**	984
Current portion of derivative contract assets	9a	**174**	261
		159,173	234,283
Non-current assets			
Loans receivable	8	**37,909**	85,824
Derivative contract assets	9a	**1,847**	2,883
Equity accounted investments	11	**16,990**	15,993
Capital assets	12	**1,086,407**	977,456
Intangible assets	13	**283,919**	288,304
Retirement benefit surplus	14	**37,575**	60,104
Deferred income tax assets	15a	**28,719**	32,897
Total assets		**1,652,539**	1,697,744
Current liabilities			
Accounts payable and other liabilities	16a	**106,767**	81,734
Current portion of derivative contract liabilities	9a	**3,106**	3,088
Current portion of finance lease obligations	17	**3,502**	5,256
Current portion of long-term debt	18	**14,977**	230,899
		128,352	320,977
Long-term liabilities			
Derivative contract liabilities	9a	**27,545**	31,055
Electricity supply and gas purchase contracts	13	**3,260**	4,894
Deferred income tax liabilities	15a	**181,176**	178,201
Deferred revenue	16b	**6,298**	1,363
Finance lease obligations	17	**3,699**	6,727
Long-term debt	18	**789,655**	704,145
Liability for asset retirement obligation	19	**2,096**	2,412
Total liabilities		**1,142,081**	1,249,774
Equity attributable to shareholders of Capstone	20e	**418,848**	413,520
Non-controlling interest		**91,610**	34,450
Total liabilities and shareholders' equity		**1,652,539**	1,697,744
Commitments and contingencies	25		

See accompanying notes to these consolidated financial statements

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

		Equity attributable to shareholders of Capstone					
	Notes	Share Capital [1]	Convertible Debentures	AOCI [2]	Retained Earnings	NCI [3]	Total Equity
Balance, Dec 31, 2010		536,278	—	—	(272,183)	—	264,095
Common shares issued	20a	77,526	—	—	—	—	77,526
Preferred shares issued	20c	72,020	—	—	—	—	72,020
Reclassification of debt instruments to equity on conversion to a corporation		26,710	11,554	—	—	—	38,264
Debenture conversions, net of costs	20a	11,819	(2,270)	—	—	—	9,549
Other comprehensive income (loss)		—	—	(6,729)	6,559	1,866	1,696
Non-controlling interest in net assets acquired of Bristol Water	3	—	—	—	—	31,810	31,810
Net income for the period		—	—	—	(5,712)	2,449	(3,263)
Dividends declared to common shareholders of Capstone	20a,d	1,238	—	—	(42,026)	—	(40,788)
Dividends declared to preferred shareholders of Capstone	20d	—	—	—	(1,264)	—	(1,264)
Dividends declared by Bristol Water		—	—	—	—	(1,675)	(1,675)
Balance, Dec 31, 2011		725,591	9,284	(6,729)	(314,626)	34,450	447,970
Common shares issued [4]	20a	(89)	—	—	—	—	(89)
Other comprehensive income (loss)		—	—	5,171	(10,538)	(5,933)	(11,300)
Net income for the period		—	—	—	26,978	16,746	43,724
Dividends declared to common shareholders of Capstone	20a,d	5,702	—	—	(33,764)	—	(28,062)
Dividends declared to preferred shareholders of Capstone [5]	20d	—	—	—	(4,575)	—	(4,575)
Dividends declared by Bristol Water		—	—	—	—	(5,312)	(5,312)
Partial sale of interest in Bristol Water	3	—	—	749	15,694	51,659	68,102
Balance, Dec 31, 2012		731,204	9,284	(809)	(320,831)	91,610	510,458

(1) Share capital includes common and preferred shares and Class B exchangeable units.

(2) Accumulated other comprehensive income (loss) ("AOCI").

(3) Non-controlling interest ("NCI").

(4) During 2012, additional transaction costs of $89 were included in relation to the common share offering on November 10, 2011.

(5) Dividends declared to preferred shareholders of Capstone include $200 of deferred income taxes.

See accompanying notes to these consolidated financial statements

CONSOLIDATED STATEMENTS OF INCOME

($000s, except per share amounts)	Notes	For the year ended Dec 31, 2012	Dec 31, 2011
Revenue		**357,610**	215,967
Operating expenses	23	**(195,178)**	(122,086)
Administrative expenses	23	**(11,070)**	(29,677)
Project development costs	23	**(365)**	(8,289)
Equity accounted income (loss)	11a	**2,294**	(5,276)
Interest income	9b	**4,886**	6,443
Other gains and (losses), net	24	**1,294**	(21,742)
Foreign exchange gain (loss)		**1,620**	(3,274)
Earnings before interest expense, taxes, depreciation and amortization		**161,091**	32,066
Interest expense	9b	**(49,707)**	(31,668)
Depreciation of capital assets	12	**(47,432)**	(31,006)
Amortization of intangible assets	13	**(10,120)**	(8,413)
Earnings before income taxes		**53,832**	(39,021)
Income tax recovery (expense)			
Current		**239**	(187)
Deferred		**(10,347)**	35,945
Total income tax recovery (expense)	15d	**(10,108)**	35,758
Net income (loss)		**43,724**	(3,263)
Net income (loss) attributable to:			
Shareholders of Capstone		**26,978**	(5,712)
Non-controlling interest		**16,746**	2,449
		43,724	(3,263)
Earnings per share			
Basic and diluted	21	**0.298**	(0.108)

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Notes	For the year ended Dec 31, 2012	Dec 31, 2011
Cumulative differences on translation of foreign operations		**6,478**	(6,890)
Other comprehensive income (loss) on equity accounted investments	11a	**702**	(724)
Losses on financial instruments designated as cash flow hedges (net of tax in 2012 – $13, 2011 – $20)		**(642)**	(60)
Actuarial gains (losses) recognized in respect of retirement benefit obligations (net of tax in 2012 – $6,826, 2011 – $3,123, respectively)	14	**(17,838)**	9,370
Other comprehensive income (loss)		**(11,300)**	1,696
Net income (loss)		**43,724**	(3,263)
Total comprehensive income (loss)		**32,424**	(1,567)
Comprehensive income (loss) attributable to:			
Shareholders of Capstone		**21,611**	(5,882)
Non-controlling interest		**10,813**	4,315
		32,424	(1,567)

See accompanying notes to these consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Notes	For the year ended Dec 31, 2012	Dec 31, 2011
Operating activities:			
Net income		**43,724**	(3,263)
Deferred income tax expense (recovery)		**10,347**	(35,945)
Depreciation and amortization		**57,552**	39,419
Other gains and losses (net)	24	**(1,294)**	21,742
Amortization of deferred financing costs and non-cash financing costs		**12,812**	7,599
Equity accounted (income) loss	11a	**(2,294)**	5,276
Unrealized foreign exchange (gain) loss		**(1,206)**	3,241
Change in non-cash working capital	28	**(4,963)**	12,812
Total cash flows from operating activities		**114,678**	50,881
Investing activities:			
Change in restricted cash and short-term deposits		**72,010**	3,324
Receipt of loans receivable		**48,943**	884
Return of capital from equity accounted investments	11a	**2,001**	—
Proceeds from sale (purchase) of foreign currency contracts		**38**	(2,468)
Investment in capital assets and computer software	12	**(127,941)**	(122,385)
Business acquisitions (net of cash acquired of $39,487)		**—**	(173,989)
Loan to equity accounted investments	8	**—**	(84,828)
Investment in equity accounted investments	11a	**—**	(21,882)
Total cash flows used in investing activities		**(4,949)**	(401,344)
Financing activities:			
Proceeds from issuance of long-term debt		**100,621**	249,200
Proceeds from partial sale of Bristol Water	3	**68,952**	—
Repayment of long-term debt and finance lease obligations		**(253,311)**	(76,872)
Dividends paid to common and preferred shareholders		**(26,131)**	(42,051)
Dividends paid to non-controlling interests		**(5,312)**	(1,675)
Transaction costs on debt issuance		**(3,364)**	(3,512)
Proceeds from issuance of common and preferred shares, net of costs		**(89)**	150,175
Proceeds from loans payable		**—**	5,466
Total cash flows from (used in) financing activities		**(118,634)**	280,731
Effect of exchange rate changes on cash and cash equivalents		**917**	(1,094)
Decrease in cash and cash equivalents		**(7,988)**	(70,826)
Cash and cash equivalents, beginning of year		**57,587**	128,413
Cash and cash equivalents, end of year		**49,599**	57,587
Supplemental information:			
Interest paid		**40,670**	20,128
Taxes paid (recovery)		**929**	(538)

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 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, and a 50% interest in a regulated water utility in the United Kingdom.

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Basis of Preparation

Statement of compliance

The consolidated financial statements of Capstone have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The consolidated financial statements were authorized for issue by the Board of Directors on March 7, 2013.

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 on a going concern basis of accounting (see note 10). Historical cost is generally based on the fair value of the consideration given in exchange for assets.

Consolidation

These audited consolidated financial statements are primarily made up of the assets, liabilities and results of operations of the following entities: Capstone Power Corp. ("CPC"), Cardinal Power of Canada, L.P. ("Cardinal"), Erie Shores Wind Farm Limited Partnership ("Erie Shores"),

CONTENTS

Corporate Information 59
Summary of Significant Accounting Policies 59
Acquisition and Disposition 68
Cash and Cash Equivalents and Restricted Cash 69
Short-Term Deposits 69
Trade and Other Receivables 69
Other Assets 70
Loans Receivable 70
Financial Instruments 71
Financial Risk Management 74
Equity Accounted Investments 77
Capital Assets 77
Intangibles 79
Retirement Benefit Plans 79
Income Taxes 82
Accounts Payable and Other Liabilities 83
Finance Lease Obligations 83
Long-Term Debt 84
Liability for Asset Retirement 89
Shareholders' Equity 89
Earnings Per Share 91
Share-Based Compensation 91
Expenses - Analysis by Nature 92
Other Gains and Losses 92
Commitments and Contingencies 92
Related Party Transactions 94
Segmented Information 95
Non-Cash Working Capital 95
Comparative Figures 95

MPT Hydro L.P. ("Hydro"), Whitecourt Power Limited Partnership (Whitecourt), Helios Solar A-1 Partnership ("Amherstburg Solar Park") and MPT Utilities Corp. all of which are 100% owned subsidiaries controlled by the Corporation. In addition, Capstone includes its controlling interest in Bristol Water plc and group companies (collectively "Bristol Water"), acquired on October 5, 2011. On May 10, 2012 Capstone sold a portion of its 70% indirect interest in Bristol Water and retains a 50% indirect interest in Bristol Water and continues to consolidate based on retention of control.

The Corporation accounts for its controlled 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 reporting periods and for its interest in Värmevärden AB ("Värmevärden") from March 31, 2011, the date of acquisition.

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:

	Swedish krona (SEK)		Pound sterling (£)	
As at and for the year ended	Average	Spot	Average	Spot
Dec 31, 2011	0.1525 (1)	0.1479	1.6076 (2)	1.5799
Dec 31, 2012	**0.1476**	**0.1528**	**1.5840**	**1.6178**

(1) Nine-month period from acquisition on March 31, 2011 to December 31, 2011.
(2) Period from acquisition on October 5, 2011 to December 31, 2011.

The financial statements of entities that have a functional currency different from that of the Corporation 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 for all reporting periods, 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 related to charges in 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 repairs and maintenance costs are charged to the statement of income during the period incurred.

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

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	**Utilities – water**
Equipment and vehicles:		
Computer hardware, communications, meters and telemetry equipment	3 to 25 years	3 to 15 years
Vehicles and mobile plant	3 to 15 years	5 to 7 years
Property and plant:		
Operational properties and structures	20 to 40 years	15 to 100 years
Treatment, pumping and general plant	n/a	20 to 24 years
Infrastructure assets (water network)	n/a	70 to 213 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.

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:

	Power	**Utilities – water**
Computer software	3 to 7 years	3 to 7 years
Electricity supply and gas purchase contracts	8 to 20 years	n/a
Water rights	10 to 35 years	n/a
Licences	n/a	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. For 2012, all such assets were included in the utilities – water segment.

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.

Retirement Benefit Plans

The Corporation operates both defined contribution and defined benefit pension plans, through its subsidiaries. The employees of Bristol Water and Cardinal participate in a defined contribution plan. The defined benefit plan is provided through Bristol Water's membership in the Water Companies' Pension Scheme ("WCPS") via a separate section.

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

Defined benefit plan 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 plan expected to arise from employee service in the period is charged to operating profit. The expected return on the plan's assets and the increase during the period in the present value of the plan'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 charged to 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 plan 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 reduction in equity.

Exchangeable Securities

The Class B exchangeable units issued by MPT LTC Holding LP meet the criteria to be presented as equity, as set out in IAS 32.

Preferred Shares

The Corporation classifies its series A preferred shares as equity for reporting purposes given that the preferred shares may be converted 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 reduction in 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

Revenue derived from the sale of electricity and steam is recognized upon delivery to the customer and priced in accordance with the provisions of the applicable electricity 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 Whitecourt electricity sales to the Alberta power pool 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.

Revenue from the sale of water is recognized upon delivery to the customer and priced in accordance with regulatory pricing. Revenue from metered supplies is based upon actual volumes of water invoiced plus estimated volumes of water not invoiced but delivered to customers during the year.

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

Project development costs are recorded as incurred. These costs include the activities to pursue and develop greenfield projects in the power segment and acquisition related business development expenses incurred at corporate.

Deferred Share Unit Plan

The Corporation has a Deferred Share Unit ("DSU") plan for eligible directors of Capstone as described in note 22 (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") for members of senior management as described in note 22 (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 amount recoverable or expensed based on the current year's taxable income 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 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 calculated 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 MPT LTC Holding LP.

Diluted earnings per share is computed in a similar manner as the basic earnings per share but reflects any dilutive effect from the conversion of debentures into shares. Debenture conversions 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 including 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 statement 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 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	• 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, 2012, the Corporation's derivatives include interest rate swaps and 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, 2012, except for cash flow hedges that meet the conditions for hedge accounting. The portion of the gain or loss on the hedging instruments which are determined to be an effective hedge are recognized directly in other comprehensive income, and the ineffective portion in the income statement. Gains or losses recognized in other comprehensive income are subsequently recognized in the consolidated 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 9).

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 Expense, Taxes, Depreciation and Amortization ("EBITDA")

EBITDA is calculated from the Corporation's earnings excluding interest expense, income taxes, depreciation and amortization. EBITDA includes the Corporation's 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 2012, 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 to Capstone	Impact to Capstone
IFRS 9, Jan 1, 2015 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's assessment of the impact of this standard is ongoing.
IFRS 10, 11 and 12, Jan 1, 2013 Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities	Establishes disclosure requirements for interests in other entities.	Capstone will adopt IFRS 10, 11 and 12 for the annual period beginning on January 1, 2013. Implementation of these standards will have no material impact on Capstone's consolidated financial statements, but will increase disclosure of interests in other entities.
IFRS 13, Jan 1, 2013 Fair Value Measurement	A comprehensive standard for fair value measurement and disclosure across all IFRS.	Capstone will adopt IFRS 13 prospectively beginning on January 1, 2013. Implementation of this standard will have no material impact on Capstone's consolidated financial statements.
IAS 19, Jan 1, 2013 Employee Benefits	Standard has been amended for 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. Various other amendments have been made to recognition, measurement, classification and expanded disclosures.	Capstone will adopt the amendment to IAS 19 retrospectively as a change in accounting policy for the annual period beginning on January 1, 2013. Implementation of this amendment is limited to Bristol Water which has a defined benefit pension plan. The impact on Capstone's consolidated financial statements is: i) The expected return on plan assets must be calculated using the same discount rate as the pension obligation, which will affect interest expense and net income, and is then offset in comprehensive income. ii) Certain costs will be required to be recognized as period costs and will be reclassified from net interest in the statement of income to current service costs which are included in operating expenses.
IAS 27, Jan 1, 2013 Separate Financial Statements	Amendments are to be consistent with changes to IFRS 10 to 13.	Capstone will adopt the amendment to IAS 27 for the annual period beginning on January 1, 2013. Implementation will have no material impact on Capstone's consolidated financial statements.
IAS 28, Jan 1, 2013 Investments in Associates and Joint Ventures	Amendments are to be consistency with changes to IFRS 10 to 13.	Capstone will adopt the amendment to IAS 28 for the annual period beginning on January 1, 2013. Implementation will have no material impact on Capstone's consolidated financial statements.

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 expected cash flows. 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 $809.	• 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 for our capital assets and the assignment of amounts to the asset retirement obligations.	• 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 estimate fair value based on future cash flows, discount rates 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 defined benefit pension obligations is dependent on actuarial calculations, which include a number of assumptions.	• 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 UK 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 determination of deferred income taxes affect asset 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 • Tax rates • Current and future taxable income

NOTE 3. ACQUISITION AND DISPOSITION

Acquisition of 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. Transaction costs on acquisition of $5,997 were expensed in the consolidated statement of income as part of administrative expenses for the year ended December 31, 2011.

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. On acquisition, the non-controlling interest has only been calculated on the fair value of the net identifiable assets.

The preliminary allocation of total consideration was allocated to net assets acquired and adjusted to the final allocation as follows:

As at October 5, 2011	Original	Adjustment	Revised
Working capital	804	849	1,653
Tangible assets	506,792	—	506,792
Intangible assets – licence	21,591	—	21,591
Intangible assets – goodwill	139,255	953	140,208
Incremental deferred income tax asset on acquisition	15,285	—	15,285
Less: net financial liabilities (net of cash received £24,324, $39,487)	(375,310)	—	(375,310)
Other	(51,392)	—	(51,392)
Incremental deferred income tax liability on acquisition	(11,739)	(1,802)	(13,541)
Non-controlling interest	(31,810)	—	(31,810)
Total cash consideration	213,476	—	213,476

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

Partial Sale of Interest in Bristol Water

On May 10, 2012, Capstone sold to I-Environment Investments Ltd, a subsidiary of ITOCHU Corporation, a 20% indirect interest in Bristol Water plc. I-Environment Investments Ltd acquired a 2/7ths ownership interest in CSE Water UK Limited, which indirectly owns a 70% interest in Bristol Water plc. Capstone received $68,952 of net proceeds on sale and used the funds to repay the remaining $28,975 on the senior debt facility and $39,000 on the CPC-Cardinal credit facility, retaining cash of $977.

Following this sale, Capstone retained a 50% beneficial interest in Bristol Water and continues to consolidate based on retention of control. Capstone recorded the transaction as a transfer of equity to non-controlling interest holders as follows:

As at May 10, 2012	$
Proceeds on sale (£43,500)	70,274
Transaction costs	(1,322)
Net proceeds on sale	68,952
Taxes payable for gain on sale	(850)
Adjustment to total equity	68,102
Non-controlling interest adjustment	(52,408)
Retained earnings adjustment	15,694

In addition, the portion of cumulative differences on translation related to Bristol Water has been adjusted to the non-controlling interest acquired by ITOCHU Corporation as follow:

	AOCI	NCI
Non-controlling interest adjustment for partial sale of interest in Bristol Water	—	52,408
Transfer of cumulative differences on translation of foreign operations	749	(749)
Non-controlling interest adjustment, net	749	51,659

NOTE 4. CASH AND CASH EQUIVALENTS AND RESTRICTED CASH

	Dec 31, 2012	Dec 31, 2011
Bristol Water debt service reserve – one year of Artesian loans	**8,898**	8,689
Erie Shores debt service reserve – six months	**5,662**	5,648
Hydro facilities debt service and maintenance reserves	**4,484**	—
Debt service and maintenance reserves	**19,044**	14,337
Cash on deposit	**73**	572
Construction holdbacks	**112**	38
Restricted cash	**19,229**	14,947
Unrestricted cash and cash equivalents	**49,599**	57,587
	68,828	72,534

NOTE 5. SHORT-TERM DEPOSITS

	Dec 31, 2012	Dec 31, 2011
Short-term cash deposits	**6,471**	82,202

The effective interest rate on short-term cash deposits was 0.45% and these deposits have an average maturity date of 54 days for the year ended December 31, 2012 (December 31, 2011 – 1.1% and 164 days).

NOTE 6. TRADE AND OTHER RECEIVABLES

	Dec 31, 2012	Dec 31, 2011
Power	**31,618**	30,485
Utilities – water	**43,480**	39,252
Corporate	**288**	1,117
Total trade and other receivables	**75,386**	70,854

Substantially all of the accounts receivable for the power segment are with government authorities. Refer to note 10 (b) and 10 (c) for further detail of credit risk and economic dependence.

The utilities – water segment accounts receivable are composed of:

	Dec 31, 2012	Dec 31, 2011
Trade receivables	**39,181**	39,105
Less: provision for impairment of receivables	**(21,907)**	(21,438)
Net trade receivables	**17,274**	17,667
Other receivables	**6,044**	3,674
Accrued income	**20,162**	17,911
	43,480	39,252

The aging of net trade receivables at Bristol Water was:

	Dec 31, 2012	Dec 31, 2011
Past due 0-30 days	**3,255**	6,424
Past due 31-120 days	**4,744**	1,660
Past due more than 120 days	**9,275**	9,583
	17,274	17,667

As at December 31, 2012, based on a review of collection rates $21,907 of trade receivables in the utilities – water segment were considered impaired and have been provided for (December 31, 2011 – $21,438).

The increase in the provision for impairment of trade receivables at Bristol Water comprised:

	2012	2011
As at January 1	**(21,438)**	—
As at business acquisition	**—**	(21,262)
Charge to statement of income	**(6,181)**	(1,206)
Amounts written off during the year as uncollectable	**6,225**	447
Net foreign exchange difference	**(513)**	583
As at December 31	**(21,907)**	(21,438)

Charges 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 an IAS 39 portfolio provision, but cannot identify which receivables are specifically impaired. Bristol Water policy is to consider a receivables impairment to be allocated on a collective basis and only impaired for the purposes of IFRS 7 disclosures when the loss can be specifically identified with the receivable.

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

NOTE 7. OTHER ASSETS

	Dec 31, 2012	Dec 31, 2011
Prepaid expenses	3,665	4,140
Inventory of spare parts and consumable supplies	3,553	3,308
	7,218	7,448

The cost of inventories recognized in operating expenses for the year ended December 31, 2012 was$1,232 (December 31, 2011 – $1,289).

NOTE 8. LOANS RECEIVABLE

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

	Maturity	Interest Rate	**Dec 31, 2012**	Dec 31, 2011
Värmevärden	2021	7.944%	**34,768**	81,587
Chapais:				
Tranche A (original principal $ 9,391)	2015	10.8%	**3,675**	4,659
Tranche B (original principal $ 3,624)	2019	4.9%	**562**	562
Tranche C (original principal $ 2,558)	2016	—%	**—**	—
			39,005	86,808
Less: current portion			**(1,096)**	(984)
Total long-term loans receivable			**37,909**	85,824

Accrued interest on the loans receivable in the amount of$63 for the year ended December 31, 2012 is included in accounts receivable (December 31, 2011 – $42).

The estimated fair value of the loans receivable as at December 31, 2012 and 2011 approximates their carrying values.

The following table summarizes the change in the loan receivable from Värmevärden during the years ended:

For the year ended	**Dec 31, 2012**		Dec 31, 2011	
	SEK	**$**	SEK	$
Opening balance	**551,808**	**81,587**	—	—
Balance on origination as at March 31, 2011	**—**	**—**	551,808	84,828
Principal repayment	**(324,267)**	**(47,959)**	—	—
Unrealized foreign exchange gain (loss)		**1,140**	—	(3,241)
Ending balance	**227,541**	**34,768**	551,808	81,587

During the first quarter of 2012, Värmevärden's parent company, Sefyr Värme AB, in which Capstone holds a 33.3% indirect investment, completed an approximately $150,000 (1,000,000 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%.

Proceeds from the bond issuance were distributed to the owners of Sefyr Värme AB, with Capstone receiving approximately $49,400, which was used to repay a portion of the senior credit facility. The distribution of $49,400 was comprised of a $48,100 shareholder loan repayment and a payment of $1,300 of accrued interest. Refer to note 18 (Long-term debt).

In March 2012, the shareholder loan receivable from Värmevärden was amended. The annual interest rate is 7.944%, effective January 1, 2012 (2011 – 7.965%).

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

Year	Amount
2013	1,096
2014	1,220
2015	1,359
2016	—
2017	—
Thereafter	562
Total	4,237

NOTE 9. 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, 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, 2012, 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, which is consistent with the prior year.

Derivative financial instruments and hedging instruments

Gas swap

In 2011, the Corporation held a gas swap contract that effectively fixed 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 Corporation no longer holds any gas swap contracts due to the current market conditions for gas.

Interest rate swap

The Corporation has several interest rate swap contracts to effectively fix the interest cost on its long-term debt with variable rates, summarized in the following list:

- CPC-Cardinal facility swap had a notional amount of $85,000 which expired in June 2012.
- Erie Shores project debt had 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 on April 1, 2011.

  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.

- Amherstburg project debt swap has a notional amount of $90,560.
  The Corporation pays a fixed rate of 4.1925% in return for a floating rate equal to 1.2943%.
- Bristol Water has a swap with a notional amount of £10,000 for a bank loan drawn in October 2008 by Bristol Water.
  The swap exchanges LIBOR rates on a six monthly 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, 2012.

Embedded derivative

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.

Foreign currency contracts

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 (December 31, 2011 - 65,800 SEK) to Canadian dollars expiring in January 2016 are at a fixed exchange rate of 6.5165 SEK. The options to sell £14,900 (December 31, 2011 - £14,900) to Canadian dollars expiring May 2015 are at a fixed exchange rate of £1.623.

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 8 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, 2012.

The Corporation's long-term debt and finance lease obligations are recorded at amortized cost using the effective interest rate 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 fair value of the Corporation's long-term debt is determined as follows:

- Floating rate debt and loans payable approximate their carrying value.
- Fixed-rate debt is determined through the use of a discounted cash flow analysis using relevant risk-free bond rates plus an estimated margin.
- 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 18 for further details.
- 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 carrying value of the Corporation's finance leases approximates fair value.

The following table illustrates the classification of the Corporation's financial instruments that have been recorded at fair value as at December 31, 2012, within the fair value hierarchy:

	Level 1	Level 2	Level 3	**Dec 31, 2012**	Dec 31, 2011
Cash and cash equivalents	49,599	—	—	**49,599**	57,587
Restricted cash	19,229	—	—	**19,229**	14,947
Short-term deposits	6,471	—	—	**6,471**	82,202
Derivative contract assets:					
Foreign currency contracts	—	849	—	**849**	1,820
Interest rate swap contracts	—	—	—	**—**	—
Embedded derivative asset	—	—	1,172	**1,172**	1,324
Less: Current portion	—	(174)	—	**(174)**	(261)
	—	675	1,172	**1,847**	2,883
Derivative contract liabilities:					
Interest rate swap contracts	—	15,337	—	**15,337**	15,237
Interest rate swap contracts for hedging	—	3,156	—	**3,156**	2,916
Embedded derivative liability	—	—	12,158	**12,158**	15,990
Less: Current portion	—	(3,106)	—	**(3,106)**	(3,088)
	—	15,387	12,158	**27,545**	31,055

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 interest rates, 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, 2012	Dec 31, 2011
Financial instruments designated as held-for-trading:		
Interest income on cash and cash equivalents, restricted cash and short-term deposits [1]	**962**	872
Financial instruments classified as held-for-trading:		
Unrealized loss on foreign currency contracts	**(975)**	(644)
Unrealized loss on gas swap contracts	**—**	(1,918)
Unrealized loss on interest rate swap contracts	**(100)**	(8,128)
	(1,075)	(10,690)
Unrealized loss on embedded derivative asset	**(152)**	(3,963)
Unrealized gain (loss) on embedded derivative liability	**3,832**	(7,089)
	3,680	(11,052)
Loans and receivables[1]:		
Interest income from loans receivable [2]	**3,924**	5,571
Other liabilities:		
Interest expense on finance lease obligations	**226**	(108)
Interest expense on pension obligation (net expected return on assets)	**(538)**	(75)
Interest expense on long-term debt with maturities under 12 months	**(4,978)**	(9,826)
Interest expense on long-term debt[3]	**(44,417)**	(21,659)
	(49,707)	(31,668)

(1) Foreign exchange gains and losses on loans receivable are also recognized in the statement of income as disclosed in note 8.
(2) Interest income for 2012 of $4,886 (2011 – $6,443) includes interest income from loans receivable and cash balances.
(3) Interest expense on the long-term debt for 2012 includes amortization of deferred financing fees of$1,965 (2011 – $3,485).

NOTE 10. 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 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 may choose 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.

In 2011, Cardinal used 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. These contracts were not renewed in 2012 given the outlook for gas prices.

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 Corporation's 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
Erie Shores project debt	December 1, 2016	20,000	5.63%	—	5.63%
Amherstburg debt swap	June 30, 2028	90,560	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 18 (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 dollar 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 dollar 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, 2012, the maximum exposure with respect to receivables from the OEFC and OPA was $23,948 or 31.8% and $3,975 or 5.3%, respectively (2011 – $22,558 or 31.8% and $4,184 or 5.9%, respectively) 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 water 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 2012, approximately 31.8% and 10.3% (2011 – 53.0% and 13.0%) 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.

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 16 (Accounts payable and other liabilities), 17 (Finance lease obligations) and 18 (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, 2012 were as follows:

Financial Liabilities	Within one year	One year to five years	Beyond five years	Total
Accounts payable and accrued liabilities	106,767	—	—	106,767
Derivative financial instruments				
Embedded derivatives	—	12,158	—	12,158
Interest rate swaps	3,106	8,615	6,772	18,493
	3,106	20,773	6,772	30,651
Finance lease obligations	3,528	2,689	2,572	8,789
Long-term debt	14,977	212,443	522,273	749,693

(E) Sensitivity Analysis

The sensitivity analysis provided below discloses the effect on net income for the year ended December 31, 2012, 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, 2012 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, 2012 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.

	Carrying	Natural Gas Price Risk		DCR Risk	
For year ended Dec 31, 2012	Amount	(10)%	10%	(1)%	1%
Financial assets:					
Embedded derivative asset	1,172	(266)	366	38	(30)
Financial liabilities:					
Embedded derivative liability	12,158	—	—	1,659	(1,675)

	Carrying	Interest Rate Risk		Canadian $ to SEK Foreign Exchange Rate Risk	
For year ended Dec 31, 2012	Amount	(0.5)%	0.5%	(10)%	10%
Financial assets:					
Cash and cash equivalents (1)	49,599	(248)	248	—	—
Restricted cash	19,229	(96)	96	—	—
Short-term deposits	6,471	(32)	32	—	—
Loans receivable (2)	34,768	—	—	(3,477)	3,477
SEK – foreign exchange contracts	250	—	—	(353)	177
Financial liabilities:					
Finance lease obligations	7,201	81	(81)	—	—
Long-term debt (3)	52,495	262	(262)	—	—
Interest rate swap contracts, net (4)	15,337	3,932	(3,932)	—	—

(1) Cash and cash equivalents include deposits at call, which are at floating interest rates.
(2) Loans receivable exclude loans related to Chapais of $4,237.
(3) Long-term debt excludes all fixed-rate debt totaling $668,905 and variable rate debt that is covered by a swap instrument for fixed-rate debt totaling $90,560.
(4) Interest rate swaps exclude Bristol Water's cash flow hedge of $3,156 as changes flow through OCI.

Pound 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's sensitivity to changes in inflation and foreign exchange on its long-term debt were as follows:

	Inflation Rate Risk (RPI)		Canadian $ to £ Foreign Exchange Rate Risk	
For year ended Dec 31, 2012	(1)%	1%	(1)%	1%
Impact on net income before taxes	2,610	(2,610)	—	—
Impact on equity	2,054	(2,054)	3,702	(3,702)

NOTE 11. EQUITY ACCOUNTED INVESTMENTS

(A) Equity Accounted Investments

As at	Dec 31, 2012 Ownership %	Dec 31, 2012 Carrying Value	Dec 31, 2011 Ownership %	Dec 31, 2011 Carrying Value
Macquarie Long Term Care L.P. ("MLTCLP")	**45.0%**	**87**	45.0%	106
Värmevärden	**33.3%**	**16,903**	33.3%	15,887
Chapais	**31.3%**	**—**	31.3%	—
		16,990		15,993

See note 8 for detail on loans receivable with Värmevärden and Chapais.

The changes in the Corporation's total equity accounted investments for the years ended were as follows:

For the year ended	Opening Balance	Acquisition, Plus Costs, Less Return of Capital	Equity Accounted Income (Loss)	Equity Share of OCI	Distributions Received	Other	Ending Balance
Dec 31, 2012	**15,993**	**—**	**2,294**	**702**	**(2,001)**	**2**	**16,990**
Dec 31, 2011	54,789	21,882	(5,276)	(724)	(54,666) [1]	(12)	15,993

(1) 2011 were apart of a non-cash distribution.

(B) Summarized Information for Equity Accounted Investments

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

As at	Dec 31, 2012 Assets	Dec 31, 2012 Liabilities	Dec 31, 2011 Assets	Dec 31, 2011 Liabilities
MLTCLP	**212**	**—**	227	—
Värmevärden [1]	**391,208**	**336,586**	383,367	332,344
Chapais	**26,744**	**42,285**	27,963	45,757

For the year ended	Dec 31, 2012 Revenue	Dec 31, 2012 Income	Dec 31, 2012 Capstone's Income	Dec 31, 2011 Revenue	Dec 31, 2011 Income	Dec 31, 2011 Capstone's Income
MLTCLP	**—**	**(15)**	**(21)**	—	(46)	(6)
Värmevärden [1]	**97,182**	**6,947**	**2,315**	65,875	(15,776)	(5,270)
Chapais	**19,390**	**2,252**	**—**	18,730	2,933	—
	116,572	**9,184**	**2,294**	84,605	(12,889)	(5,276)

(1) Includes purchase accounting adjustments.

NOTE 12. CAPITAL ASSETS

(A) Continuity

	Jan 1, 2012	Additions	Disposals	Foreign Exchange	Transfers	Dec 31, 2012
Cost						
Land	2,707	—	—	59	—	2,766
Equipment and vehicles	8,389	1,001	(637)	534	6,363	15,650
Property and plant	790,178	4,517	(4,729)	9,906	51,854	851,726
Water network	271,485	59,571	—	9,542	5,932	346,530
Construction in progress	35,750	80,984	—	1,162	(66,687)	51,209
	1,108,509	146,073	(5,366)	21,203	(2,538)	1,267,881
Accumulated depreciation						
Equipment and vehicles	(3,568)	(1,847)	608	(353)	—	(5,160)
Property and plant	(126,465)	(40,516)	2,978	(4,413)	—	(168,416)
Water network	(1,020)	(5,069)	—	(1,809)	—	(7,898)
Net carrying value	977,456	98,641	(1,780)	14,628	(2,538)	1,086,407

	Jan 1, 2011	Business Acquisition	Additions	Disposals	Foreign Exchange	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
Water network	—	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)
Water network	—	—	(1,052)	—	32	—	(1,020)
Net carrying value	408,623	502,818	80,045	—	(13,783)	(247)	977,456

(B) Reconciliation to Cash Additions

Year ended	**Dec 31, 2012**	Dec 31, 2011
Additions	**146,073**	111,051
Adjustment for change in capital amounts included in accounts payable and accrued liabilities	**(18,919)**	10,298
Net foreign exchange difference	**787**	1,036
Cash additions	**127,941**	122,385

(C) Construction in Progress

The net book value of property, plant and equipment includes $2,292 (£1,417) of capitalized borrowing costs at Bristol Water in accordance with IAS 23. Capstone has used 5.8% 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 became available for use at which time amortization over the asset useful life began. Until such time, assets within construction in progress were not amortized.

(D) Capital Assets Under Finance Leases

As at	Land	Equipment and Vehicles	Property and Plant	Water Network	Total
Dec 31, 2012	**—**	**4**	**16,924**	**1,315**	**18,243**
Dec 31, 2011	—	29	18,242	1,820	20,091

(E) Impairments

At the end of each reporting period, Capstone reviews its capital assets and amortizing intangible assets to determine if any indicators of impairment exist. As at December 31, 2012, Capstone identified the deficit of market capitalization to the carrying amount of owners' equity as an indicator of impairment. Consequently, Capstone performed a comprehensive analysis, which confirmed that the fair value of its assets was greater than the carrying amounts included in these financial statements. As a result, no impairments were recognized at December 31, 2012.

Capstone's determination of fair value was based on a discounted cash flow analysis of the expected future cash flows for each cash generating unit ("CGU"). The analysis then compared the recoverable amount of each CGU with the carrying amount included in the consolidated statement of financial position. For the purposes of this analysis, the recoverable amount was based on the present value of cash flows, which relies on management's current best estimate of the underlying cash flows and discount rate.

NOTE 13. INTANGIBLES

	Jan 1, 2012	Additions	Foreign Exchange	Transfers	Dec 31, 2012
Assets					
Computer software	4,220	28	758	2,538	7,544
Electricity supply and gas purchase contracts	108,048	—	—	—	108,048
Water rights	73,018	—	—	—	73,018
Licence	21,012	—	504	—	21,516
Goodwill	135,512	—	4,200	—	139,712
Accumulated amortization					
Computer software	(550)	(2,060)	(659)	—	(3,269)
Electricity supply and gas purchase contracts	(43,395)	(7,572)	—	—	(50,967)
Water rights	(9,561)	(2,122)	—	—	(11,683)
	288,304	(11,726)	4,803	2,538	283,919
Provisions					
Electricity supply and gas purchase contracts	12,257	—	—	—	12,257
Utilization	(7,363)	(1,634)	—	—	(8,997)
	4,894	(1,634)	—	—	3,260

	Jan 1, 2011	Business Acquisition	Additions	Foreign Exchange	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
Accumulated 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

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 CGU. The calculation of goodwill for Bristol Water is described in Note 3.

NOTE 14. RETIREMENT BENEFIT PLANS

Defined Contribution Plan

Bristol Water and Cardinal operate defined contribution retirement plans for certain employees. The total cost recorded in the statement of income for the year ended December 31, 2012 was $1,319 (December 31, 2011 – $431).

Defined Benefit Plan

Defined benefit pension arrangements for Bristol Water's employees are provided through Bristol Water's membership in the 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 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 Bristol Water's Section of the WCPS as at March 31, 2011 was updated to December 31, 2012, by Lane, Clark & Peacock LLP, using the following significant assumptions in accordance with IAS19:

Assumptions	**2012**	2011
Inflation – Retail Price Index	**3.1%**	3.2%
Inflation – Consumer Price Index	**2.6%**	2.5%
Pension increases uncapped	**2.6%**	2.5%
Pension increases capped at 5%	**2.6%**	2.5%
Salary increases	**4.1%**	4.2%
Discount rate	**4.3%**	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 the 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.

As at	**Dec 31, 2012**			Dec 31, 2011		
	Amount	**Expected Long-term Rate of Return**	**Current Allocation**	Amount	Expected Long-term Rate of Return	Current Allocation
Equities	**22,788**	**7.0%**	**8%**	32,260	7.5%	12%
Diversified growth funds	**8,526**	**6.3%**	**3%**	10,574	6.8%	4%
Bonds	**229,192**	**3.0%**	**85%**	223,362	3.5%	84%
Emerging markets multi-asset funds	**5,366**	**7.1%**	**2%**	—	—	—%
High yield bonds	**5,216**	**5.8%**	**2%**	—	—	—%
Other	**562**	**3.0%**	**—%**	918	3.5%	—%
Market value of assets	**271,650**	**3.6%**	**100%**	267,114	4.2%	100%
Present value of liabilities	**(234,075)**			(207,010)		
Surplus	**37,575**			60,104		

The overall expected rate of return on assets of 3.6% per annum was derived by taking the weighted average of the long term expected rate of return on each of the above asset classes (December 31, 2011 – 4.2%).

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. Per the mortality assumptions used the average life expectancy for a male pensioner currently aged 60 is 26.9 years and for a female pensioner currently aged 60 is 29.2 years (December 31, 2011 – 26.5 male, 29.1 female).

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 28.9 years, and for a female retiring at age 60 in 2036 is assumed to have increased to 30.8 years (December 31, 2011 – 29.1 male, 31.5 female).

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 bonds.

As an indication of sensitivity to changes in assumptions for the year ended December 31, 2012, 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 $3,721 (£2,300) (December 31, 2011 – $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 $2,103 (£1,300) (December 31, 2011 – $2,124 (£1,322)).

Contributions

Contributions paid in the year to the Section were $4,400 (£2,778) (December 31, 2011 – $659 (£410)). For normal employer contributions after April 1, 2012 Bristol Water was required to contribute at the rates of 29% for the main sub Section and 17% for the alternative benefits sub Section of the relevant payroll costs. Prior to April 1, 2012, Bristol Water contributed 21% and 10%, respectively.

The estimated amount of the total employer contribution expected to be paid to the Section for the year ending December 31, 2013 is $3,348 (£2,070) (December 31, 2012 – $3,729 (£2,320)).

Changes in Comprehensive Income

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

	For the year ended	
	Dec 31, 2012	Dec 31, 2011
Current service cost	**2,626**	654
Total operating expense	**2,626**	654
Expected return on Section assets	**(9,056)**	(2,455)
Interest expense on pension obligation	**9,594**	2,530
Interest expense	**538**	75
Gain/(loss) on pension Section assets	**(5,685)**	19,182
Experience gains/(losses) arising on Section liabilities	**(1,830)**	—
Gain/(loss) due to changes in assumptions	**(17,149)**	(6,689)
Actuarial gain/(loss) recognized in Statement of Comprehensive Income ("SCI")	**(24,664)**	12,493

The cumulative actuarial gains and losses recognized in the SCI as at December 31, 2012 was a gain of $12,171 (£7,799) (2011 – gain of $12,493 (£7,772)).

Changes in Financial Position

The following table summarizes the movement in Section pre-tax financial position and defined benefit obligation:

For the year ended	**December 31, 2012**			December 31, 2011		
	Asset	**Liability**	**Total**	Asset	Liability	Total
Opening Surplus in Section	**267,114**	**(207,010)**	**60,104**	—	—	—
Movement in year:						
Business acquisition	**—**	**—**	**—**	254,164	(204,951)	49,213
Current service cost: employee	**—**	**(633)**	**(633)**	—	(177)	(177)
Current service cost: employer	**—**	**(1,993)**	**(1,993)**	—	(477)	(477)
Aggregate contributions: employees	**675**	**—**	**675**	186	—	186
Aggregate contributions: employer	**3,725**	**—**	**3,725**	473	—	473
Benefits paid	**(9,604)**	**9,604**	**—**	(2,190)	2,190	—
Charge to interest expense	**9,056**	**(9,594)**	**(538)**	2,455	(2,530)	(75)
Actuarial gain/(loss) recognized in SCI	**(5,685)**	**(18,979)**	**(24,664)**	19,182	(6,689)	12,493
Foreign exchange	**6,369**	**(5,470)**	**899**	(7,156)	5,624	(1,532)
Ending surplus in Section	**271,650**	**(234,075)**	**37,575**	267,114	(207,010)	60,104

The actual return on the Section's assets for the year ended as at December 31, 2012 was a gain of $3,371 (£2,128) (2011 – gain of $21,634 (£13,460)).

For the year ended	**Dec 31, 2012**		Dec 31, 2011	
	Actuarial Adjustments	**As a % of Balance**	Actuarial Adjustments	As a % of Balance
Asset	**(5,685)**	**2%**	19,182	7%
Liability	**(18,979)**	**8%**	(6,689)	3%
	(24,664)	**66%**	12,493	21%

NOTE 15. INCOME TAXES

(A) Deferred Income Tax Continuity

The changes in the deferred income tax assets and liabilities are as follows:

As at	Dec 31, 2011	Recorded in Earnings	Recognized in OCI (excluding foreign exchange)	Foreign Exchange Recorded in OCI [1]	Other	Dec 31, 2012
Non-capital loss carry-forwards	1,523	1,908	—	—	—	**3,431**
Levelization amounts	4,760	(1,644)	—	—	—	**3,116**
Financial instruments	8,460	(928)	13	17	—	**7,562**
Asset retirement obligations	601	(73)	—	—	—	**528**
Capital and Intangible assets	1,162	(1,162)	—	—	—	**—**
Loan premium and deferred financing costs	15,701	(2,731)	—	316	—	**13,286**
Other	690	(549)	—	50	605 (2)	**796**
Deferred income tax assets	32,897	(5,179)	13	383	605	**28,719**
Capital assets	125,888	8,723	—	2,611	1,802 (3)	**139,024**
Intangible assets	36,113	(3,746)	—	—	—	**32,367**
Equity investment in Chapais	301	(301)	—	—	—	**—**
Loan premium and deferred financing costs	93	254	—	—	—	**347**
Pension surplus	15,129	189	(6,828)	222	—	**8,712**
Convertible debentures	677	(123)	—	—	—	**554**
Financial instruments	—	172	—	—	—	**172**
Deferred income tax liabilities	178,201	5,168	(6,828)	2,833	1,802	**181,176**
Net, deferred income tax liability	145,304	10,347	(6,841)	2,450	1,197	**152,457**

(1) Cumulative differences on translation of foreign operations.
(2) Recorded $805 to current income taxes payable, partially offset by $200 recorded in equity, with respect to the taxes on the dividends of the preferred shares. See note 20 (d).
(3) Recorded as purchase equation adjustment through working capital and goodwill. See note 3.

(B) Timing of Deferred Income Tax Recovery

The timing of deferred income tax recovery is summarized as follows:

As at	Dec 31, 2012	Dec 31, 2011
Within 12 months	**17,983**	12,596
After more than 12 months	**(170,440)**	(157,900)
Net, deferred tax liability	**(152,457)**	(145,304)

The aggregate amount of temporary differences associated with investments in subsidiaries and equity-accounted investees, for which deferred tax liabilities have not been recognized, as at December 31, 2012 was $12,612 (December 31, 2011 – nil). These liabilities have not been recorded as the reversal of such differences are not expected to create a tax liability.

(C) Tax Loss Carry-forwards

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

	Expiry	Recognized	Unrecognized	Dec 31, 2012	Dec 31, 2011
Canadian – capital losses	No expiry	—	84,610	**84,610**	70,557
Canadian – non-capital losses	2025 – 2032	13,572	59,908	**73,480**	38,052
US – non-capital losses	2023 – 2027	—	14,385	**14,385**	17,942
UK – capital losses (£2,864)	No expiry	—	4,633	**4,633**	4,681
UK – advanced corporation tax (£3,922)	No expiry	—	6,345	**6,345**	6,196

The Corporation additionally has $14,659 of unused tax credits, which have not been recognized as a tax asset as at December 31, 2012 (December 31, 2011 – $5,587).

(D) Rate Reconciliation

The following table reconciles the expected income tax expense using the statutory tax rate to the expense:

	For the year ended	
	Dec 31, 2012	Dec 31, 2011
Income (loss) before income taxes	**53,832**	(39,021)
Statutory income tax rate	**25.47%**	28.17%
Income tax expense based on statutory income tax rate	**13,711**	(10,992)
Permanent differences	**(1,461)**	4,950
Tax rate differentials	**(7,076)**	764
Change in tax status	**—**	(34,808)
Unrecognized losses arising in the year	**4,075**	5,186
Other	**859**	(858)
Total income tax recovery	**10,108**	(35,758)

The weighted average applicable tax rate was 25.47% (2011 – 28.17%). The decrease in the weighted average rate is attributed to a change in the Federal and Ontario rates.

NOTE 16. ACCOUNTS PAYABLE AND OTHER LIABILITIES

(A) Current Accounts Payable and Accrued Liabilities

	Dec 31, 2012	Dec 31, 2011
Accounts payable and accrued liabilities	**100,465**	77,233
Dividends payable	**6,302**	4,501
	106,767	81,734

(B) Deferred Revenue

Deferred revenue represents grants and contributions received by the utilities – water segment in respect of assets that are not related to the water network less amounts amortized to the statement of income:

	2012	2011
As at January 1	**1,363**	—
Contributions received	**4,856**	1,396
Amortized to statement of income	**(55)**	—
Net foreign exchange difference	**134**	(33)
As at December 31	**6,298**	1,363

NOTE 17. FINANCE LEASE OBLIGATIONS

	Interest Rate	Maturity	**Dec 31, 2012**	Dec 31, 2011
Power: equipment lease	7%	2012	**—**	129
Utilities – water: equipment leases	3.71 – 4.23%	2012 – 2020	**7,201**	11,854
			7,201	11,983
Less: current portion			**(3,502)**	(5,256)
Non-current portion			**3,699**	6,727

For the year ended December 31, 2012, the Corporation repaid $5,172 (December 31, 2011 - $133) on finance leases, including interest of $221 (December 31, 2011 – $108).

The minimum lease payments in the next five years and thereafter are reconciled to the finance lease obligation as follow:

	Within one year	One year to five years	Beyond five years	Less: future finance charges	Total
Utilities – water	3,528	2,689	2,572	(1,588)	7,201

NOTE 18. LONG-TERM DEBT

(A) Components of Long-term Debt

As at	Dec 31, 2012		Dec 31, 2011	
	Fair Value	**Carrying Value**	Fair Value	Carrying Value
Power	**305,497**	**297,792**	314,196	308,513
Utilities – water	**519,660**	**473,537**	504,479	480,339
Corporate	**44,416**	**40,631**	155,124	152,613
	869,573	**811,960**	973,799	941,465
Less: deferred financing costs	**—**	**(7,328)**	—	(6,421)
Long-term debt	**869,573**	**804,632**	973,799	935,044
Less: current portion	**(21,258)**	**(14,977)**	(235,209)	(230,899)
	848,315	**789,655**	738,590	704,145

(B) Power

As at	Dec 31, 2012		Dec 31, 2011	
	Fair Value	**Carrying Value**	Fair Value	Carrying Value
CPC-Cardinal credit facility	**12,050**	**12,050**	85,000	85,000
Erie Shores project debt	**106,538**	**97,703**	108,616	102,933
Amherstburg Solar Park project debt	**90,560**	**90,560**	94,267	94,267
Hydro facilities senior secured and subordinated bonds	**96,349**	**97,479**	—	—
Wawatay facility's levelization liability	**—**	**—**	26,313	26,313
	305,497	**297,792**	314,196	308,513
Less: deferred financing costs	**—**	**(5,080)**	—	(3,248)
Long-term debt	**305,497**	**292,712**	314,196	305,265
Less: current portion	**(21,258)**	**(14,977)**	(99,136)	(94,826)
	284,239	**277,735**	215,060	210,439

(i) CPC-Cardinal credit facility

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

	Interest Rate	Maturity	**Dec 31, 2012**	Dec 31, 2011
Total available credit				
Term facility			**12,050**	125,625
Revolving facility			**15,000**	40,625
			27,050	166,250
Amounts drawn – Term facility				
Cardinal – Power portion	4.53%	Jun 30, 2014	**(12,050)**	(17,000)
CPC – Power portion			**—**	(68,000)
CPC – Corporate portion			**—**	(34,000)
Letters of credit for the benefit of Erie Shores			**(2,533)**	(2,533)
Letter of credit for the benefit of Amherstburg			**(5,330)**	(5,330)
Letter of credit for the benefit of Hydros			**(250)**	—
Letter of credit for the benefit of Capstone Power Corp			**(397)**	—
Guarantee for Erie Shores project debt			**—**	(5,000)
Remaining available credit			**6,490**	34,387

As at December 31, 2012, Capstone had six letters of credit authorized under the revolving facility (December 31, 2011 – four under the revolving facility).

Capstone's $5,000 guarantee of Erie Shores project debt is authorized against the new CPC-Cardinal revolving facility and does not reduce the remaining available credit. The terms of the old CPC-Cardinal credit facility required the available credit to be reduced for this guarantee.

During 2012, Capstone repaid $106,700 of the CPC-Cardinal credit facility. Capstone repaid $39,000 with proceeds from the partial sale of Bristol Water (refer to note 3 Acquisition and Disposal) and $67,700 with proceeds from the financing of the hydro power facility. On September 17, 2012, Capstone refinanced the CPC-Cardinal credit facility in the aggregate amount of up to $27,300, comprised of a $12,300 term loan used to repay the outstanding balance and a $15,000 revolving facility.

Advances under the credit facility are made in the form of a series of bankers' acceptances ("BAs") and prime rate loans. Interest paid on BAs is based on the then current BA rate plus an applicable margin ("stamping fee"). The weighted average contractual rate of interest at December 31, 2012 is included in the preceding table and the maturity date of the facility was June 30, 2014. The collateral for the facility is provided by a 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.

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, 2012, the carrying value of the assets of the restricted group exceeded total amounts drawn on the facility.

The CPC-Cardinal credit facility had various interest rate swap contracts to convert the floating rate obligations to a fixed rate obligation, which all expired during 2012 (see note 10(a)).

(ii) Erie Shores Wind Farm

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

	Interest Rate	Maturity	**Dec 31, 2012**	Dec 31, 2011
Tranche A	5.96%	Apr 1, 2026	**57,041**	59,721
Tranche B	5.28%	Apr 1, 2016	**3,223**	4,040
Tranche C	6.15%	Apr 1, 2026	**37,439**	39,172
			97,703	102,933

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 a debt service reserve account. As a result, $5,662 was included in restricted cash on the consolidated statement of financial position (December 31, 2011 – $5,648).

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, 2012, the carrying value of the assets of Erie Shores exceeded the total amount of project debt outstanding.

As at December 31, 2012, the Erie Shores project debt had an interest rate swap contract to convert the Erie Shores obligation to a fixed rate (see note 10(a)).

(iii) Amherstburg Solar Park project debt

The Amherstburg Solar Park has non-recourse project debt composed as follows:

	Interest Rate	Maturity	**Dec 31, 2012**	Dec 31, 2011
Project debt	7.32%	Jun 30, 2016	**90,560**	94,267

In July 2011, the outstanding balance of the construction facility was converted to a 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, 2012, the carrying value of the assets of the Amherstburg Solar Park exceeded the total amount of project debt outstanding.

As at December 31, 2012, the Amherstburg Solar Park project debt had an interest rate swap contract to mitigate interest rate risk (see note 10(a)).

(iv) Hydro facilities senior secured and subordinated secured bonds

The Corporation has non-recourse amortizing bonds for the hydro facilities summarized in the following table:

As at	Interest Rate	Maturity	**Dec 31, 2012**	Dec 31, 2011
Senior secured bonds	4.56%	Jun 30, 2040	**77,237**	—
Subordinated secured bonds	7.00%	Jun 30, 2041	**20,242**	—
			97,479	—

On June 6, 2012, MPT Hydro LP completed a $100,621 debt offering to recapitalize the Dryden, Hluey Lakes, Sechelt and Wawatay facilities (the "hydro facilities"). The debt offering comprising $80,379 of senior secured bonds and $20,242 of subordinated secured bonds. The senior secured and subordinated secured bonds are fully amortizing over their respective terms.

The bonds are secured by the hydro facilities alone and are non-recourse to the Corporation's other businesses. As at December 31, 2012, the carrying value of the assets of the hydro facilities exceeded the total amount of bonds outstanding.

Proceeds of the bond offerings were first used to repay the $27,239 balance of the levelization debt at the Wawatay hydro facility, along with $1,785 of transaction costs, which were capitalized to the debt. In addition, Capstone cash funded $3,846 to the debt service and maintenance reserve accounts in accordance with the bond indenture which is presented as restricted cash. The remaining $67,700 of net proceeds was used to repay a portion of the CPC-Cardinal credit facility.

(v) Levelization amounts

The carrying value of the levelization amounts was as follows:

As at	Interest Rate	Maturity	**Dec 31, 2012**	Dec 31, 2011
Principal	6.87%	Settled	**—**	13,902
Accrued Interest			**—**	12,411
			—	26,313

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. This liability was settled on June 6, 2012, with the proceeds from the hydro facilities bond offering.

The interest on the levelization liability was accrued at the prescribed variable rate of 6.87% per annum (December 31, 2011 – 6.87%).

(C) Utilities – water

	Dec 31, 2012		Dec 31, 2011	
As at	**Fair Value**	**Carrying Value**	Fair Value	Carrying Value
Bank loans	**31,540**	**31,430**	55,625	54,213
Term loans	**457,563**	**413,746**	420,242	398,445
Debentures	**2,346**	**2,072**	2,125	2,008
Irredeemable cumulative preferred shares	**28,211**	**26,289**	26,487	25,673
	519,660	**473,537**	504,479	480,339
Less: deferred financing costs	**—**	**—**	—	—
Long-term debt	**519,660**	**473,537**	504,479	480,339
Less: current portion	**—**	**—**	(23,698)	(23,698)
	519,660	**473,537**	480,781	456,641

(i) Bank loans

As at	Interest Rate	Maturity	**Dec 31, 2012 [£]**	**Dec 31, 2012 [$]**	Dec 31, 2011 [$]
Secured, variable interest at one month Libor plus a margin (principal £10,000[(1)])	1.18%	Dec 17, 2017	**9,714**	**15,715**	15,257
Secured, variable interest at six month Libor plus a margin (principal £10,000[(1 and 2)])	5.73%	Dec 17, 2017	**9,714**	**15,715**	15,257
Secured, variable interest at one month Libor plus a margin (principal £30,000)	1.04%	May 31, 2013	**—**	**—**	—
Secured, variable interest at one month Libor plus a margin (principal £20,000)	1.79%	Aug 17, 2015	**—**	**—**	—
Secured, variable interest at one month Libor plus a margin (principal £50,000)	2.04%	Aug 17, 2017	**—**	**—**	—
Secured, variable interest at one month Libor plus a margin (principal £15,000)	1.52%	Settled	**—**	**—**	23,699
				31,430	54,213

(1) The principal due on maturity is different from the balance as at December 31, 2012 in pounds sterling due to the fair value adjustment required on acquisition and deferred financing costs.

(2) The variable rate bank 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 10(a)). The loan has a bullet repayment on maturity.

The bank loans are fully repayable on maturity and incur non-utilization fees on the undrawn portion of the total available credit.

(ii) Term loans

As at	Interest Rate	Maturity	**Dec 31, 2012 [£]**	**Dec 31, 2012 [$]**	Dec 31, 2011 [$]
Secured, principal index-linked to RPI, fixed interest at 3.635%[2] on the indexed principal (principal £118,664[1])	6.79%	Sep 30, 2032	**146,781**	**237,462**	227,752
Secured, fixed interest at 6.01%[2] (principal £57,500[1])	6.01%	Sep 30, 2033	**63,265**	**102,350**	100,388
Secured, principal index-linked to RPI, fixed interest at 2.701% on the indexed principal (principal £42,588[1])	5.77%	Mar 24, 2041	**45,700**	**73,934**	70,305
				413,746	398,445

(1) The principal due on maturity is different from the balance as at December 31, 2012 in pounds sterling due to the fair value adjustment made to the long-term debt on acquisition and deferred financing costs.
(2) Coupons as specified in loan documentation.

The interest rate on the £118,664 indexed linked loan is adjusted in March and September, by reference to the Retail Price Index ("RPI"), with an eight month lag.

The interest rate on the £42,588 indexed linked loan is adjusted in March and September, by reference to the RPI, with a two month lag.

(iii) Debentures

As at	Interest Rate	Maturity	**Dec 31, 2012 [£]**	**Dec 31, 2012 [$]**	Dec 31, 2011 [$]
Consolidated (principal £1,405[1])	4.00%	Irredeemable	**1,116**	**1,806**	1,748
Perpetual (principal £37[1])	4.25%	Irredeemable	**37**	**59**	58
Perpetual (principal £55[1])	4.00%	Irredeemable	**55**	**89**	87
Perpetual (principal £73[1])	3.50%	irredeemable	**73**	**118**	115
				2,072	2,008

(1) The principal due on maturity is different from the balance as at December 31, 2012 in pounds sterling as due to the fair value adjustment made to the long-term debt on acquisition.

The rate of interest is fixed and payable every six months.

(iv) Irredeemable cumulative preferred shares

As at	Interest Rate	Maturity	**Dec 31, 2012 [£]**	**Dec 31, 2012 [$]**	Dec 31, 2011 [$]
Preferred shares, cumulative (principal £12,500[1])	8.75%	irredeemable	**16,250**	**26,289**	25,673

(1) The principal due on maturity is different from the balance as at December 31, 2012 in pounds sterling 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, 2012.

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, 2012		Dec 31, 2011	
As at	Fair Value	Carrying Value	Fair Value	Carrying Value
Senior debt facility	—	—	78,375	78,375
CPC-Cardinal credit facility	—	—	34,000	34,000
Convertible debentures	44,416	40,631	42,749	40,238
	44,416	40,631	155,124	152,613
Less: deferred financing costs	—	(2,248)	—	(3,173)
Long-term debt	44,416	38,383	155,124	149,440
Less: current portion	—	—	(112,375)	(112,375)
	44,416	38,383	42,749	37,065

(i) Senior debt facility

The senior debt facility is composed as follows:

As at	Interest Rate	Maturity	Dec 31, 2012	Dec 31, 2011
Senior debt facility	6.73%	Settled	—	78,375

The Corporation settled the remaining balance during 2012, with $49,400 from the proceeds of the Värmevärden bond issue (refer to note 8 Loan Receivable) and $28,975 with proceeds from the partial sale of Bristol Water.

(ii) Convertible debentures

The carrying values of the liability and the equity components of the debentures were as follows:

As at	Dec 31, 2012	Dec 31, 2011
Liability component	40,238	49,067
Conversion to shares, net of costs (1)	—	(9,547)
Amortization and accretion	393	718
	40,631	40,238
Deferred financing costs	(2,248)	(2,710)
	38,383	37,528
Convertible debentures – conversion option	—	—
	38,383	37,528
Equity component (2)	9,284	11,554
Conversion to shares (1), net of costs	—	(2,270)
	9,284	9,284
	47,667	46,812

(1) No conversions occurred during the year ended December 31, 2012 (note 20) (December 31, 2011 – $11,819). Conversion transfer the carrying amount in debt and equity to share capital, net of transaction costs incurred in connection with the issuance of the convertible debentures.
(2) On January 1, 2011, the amount was 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 incurring 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, 2012 was $42,749 (December 31, 2011 – $42,749).

(E) Long-term Debt Covenants

For the year ended and as at December 31, 2012, the Corporation and its subsidiaries were in compliance with all financial and non-financial debt covenants.

(F) 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	Within one year	One year to five years	Beyond five years	Total
Power	14,977	137,338	145,477	297,792
Utilities – water	—	32,356	376,796	409,152
Corporate	—	42,749	—	42,749
	14,977	212,443	522,273	749,693

NOTE 19. 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:

	Dec 31, 2012	Dec 31, 2011
Assumptions:		
Expected settlement date	**2014 – 2062**	2014 – 2042
Estimated settlement amount	**Nil – $2,965**	Nil – $2,965
Inflation rate	**2.0%**	2.0% – 2.1%
Credit-adjusted risk-free rate	**8.0% – 12.5%**	8.0% – 9.5%
Balance, beginning of year	**2,412**	3,167
Revision of estimates	**(533)**	(962)
Accretion expense	**217**	207
Balance, end of year	**2,096**	2,412

NOTE 20. SHAREHOLDERS' EQUITY

The share capital of the Corporation was as follows:

As at	**Dec 31, 2012**	Dec 31, 2011
Common shares	**632,474**	626,861
Class B exchangeable units	**26,710**	26,710
Preferred shares	**72,020**	72,020
	731,204	725,591

(A) Common Shares

Capstone is authorized to issue an unlimited number of common shares.

Continuity for the year ended	**Dec 31, 2012**		Dec 31, 2011	
($000s and 000s shares)	**Shares**	**Carrying Value**	Shares	Carrying Value
Opening balance	**70,957**	**626,861**	56,352	536,278
Common shares issued (1) to (3)	**—**	**(89)**	12,856	77,526
Dividend reinvestment plan (4)	**1,488**	**5,702**	253	1,238
Conversion of convertible debentures, net of cost (5)	**—**	**—**	1,496	11,819
Ending balance	**72,445**	**632,474**	70,957	626,861

(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.
(3) On November 10, 2011, the Corporation issued 12,000 common shares for gross proceeds of $75,000 before issues costs of $4,526. Additional transaction costs of $89 were included in share capital in 2012 in relation to this common share offering.
(4) Shares issued by the Corporation under the Dividend Re-Investment Plan (DRIP).
(5) No convertible debentures were converted to shares of the Corporation during 2012 (note 18(d)(ii)) (December 31, 2011 – $11,819). Amounts transferred from debt and equity are net of original issuance transaction costs.

(B) Class B Exchangeable Units

MPT LTC Holding LP had 3,249 Class B exchangeable units outstanding as at December 31, 2012 and 2011. 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 atDecember 31, 2012 and 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 5-year anniversary, the next anniversary date is July 31, 2016. The shares are non-voting and redeemable at the Corporation's discretion. Subsequent to the initial 5-year fixed rate period, the issuer will determine the annual dividend for the next 5-year period based on the 5-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 holders option. The series B preferred shares are redeemable at the Corporation's discretion after June 20, 2021 and every 5 years thereafter at 25 dollars per share plus accrued and unpaid dividends.

(D) Dividends

Dividends to common shareholders and distributions to Class B exchangeable unitholders were paid on a monthly basis up to June 1, 2012, when Capstone's Board of Directors established a new dividend policy to pay dividends on a quarterly basis. The series A preferred shares are also paid on a quarterly basis. The dividends declared were as follows:

	For the year ended	
	Dec 31, 2012	Dec 31, 2011
Common shares	**32,302**	39,882
Class B exchangeable units	**1,462**	2,144
	33,764	42,026
Preferred shares (includes $200 of deferred income taxes)	**4,575**	1,264

Capstone has included $5,677 of accrued common dividends and $625 of accrued preferred dividends based on the declaration on November 13, 2012, which were paid to shareholders on January 31, 2013 (December 31, 2011 – $4,501 was accrued for common shares).

Capstone paid $0.450 per common share and $1.250 per preferred share during the year ended December 31, 2012 (December 31, 2011 – $0.660 per common share and $0.421 per preferred share).

(E) Capital Management

The Corporation defines its capital as its long-term debt and shareholders' equity as follows:

As at	**Dec 31, 2012**	Dec 31, 2011
Long-term debt	**811,960**	941,465
Shareholders' equity (1)	**418,848**	413,520
Total capitalization	**1,230,808**	1,354,985

(1) Capstone does not include the non-controlling interest of $91,610 in shareholders equity (December 31, 2011 – $34,450).

The Corporation manages its capital to achieve the following objectives:

(i) maintain a capital structure that provides financial flexibility to the Corporation to ensure access to either debt or equity 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 18.

NOTE 21. EARNINGS PER SHARE ("EPS")

	For the year ended	
	Dec 31, 2012	Dec 31, 2011
Net income (loss)	**43,724**	(3,263)
Non-controlling interest	**(16,746)**	(2,449)
Dividends declared on preferred shares	**(4,575)**	(1,264)
Net income (loss) available to common shareholders	**22,403**	(6,976)
Weighted average number of common shares (including Class B exchangeable units) outstanding	**75,116**	64,465
Basic and Diluted EPS	**0.298**	(0.108)

The convertible debentures are anti-dilutive for the years ended December 31, 2012 and 2011.

NOTE 22. SHARE-BASED COMPENSATION

(A) Deferred Share Units

The Deferred Share Units ("DSUs") are granted to eligible directors on the first day of each quarter at the five-day volume weighted average price ("VWAP") prior to the grant date. Grants vest immediately upon the last trading day of each quarter. In addition, directors may elect to receive their quarterly director fees in the form of DSUs, which vest at the time of granting. Dividend equivalents are granted as of each payment 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.

For the year ended	**Dec 31, 2012**		Dec 31, 2011	
($000s, except unit amounts)	**Number of Units**	**Fair Value**	Number of Units	Fair Value
Outstanding at January 1	**8,407**	**32**	—	—
Fixed quarterly grants during the period	**20,102**	**75**	7,896	60
Dividend equivalents	**1,689**	**7**	511	3
	30,198	**114**	8,407	63
Unrealized gain (loss) on revaluation	**—**	**8**	—	(31)
Outstanding at December 31	**30,198**	**122**	8,407	32

The average VWAP per DSU granted during 2012 was 4.10 dollars (2011 – 7.60 dollars). As at December 31 2012, the carrying value of the DSUs, based on a market price of 4.03 dollars, was $122 and is included in accounts payable and other liabilities in the consolidated statement of financial position (December 31, 2011 – 3.81 dollars and $32). The resulting DSU expense for 2012 was $90 and is recorded as compensation expense in the consolidated statement of income (2011 – $32).

(B) Long-term Incentive Plan

During 2012, Capstone granted to the senior management of the Corporation 253,959 Restricted Stock Units ("RSUs") and 141,431 Performance Share Units ("PSUs"). The five-day VWAP per RSU and PSU granted January 3, 2012 was 3.78 dollars and 4.23 dollars per RSU granted March 23, 2012 and all RSUs and PSUs granted vest on December 31, 2014. In 2011, 67,058 RSUs and 67,058 PSUs were granted and they 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.

	Dec 31, 2012		Dec 31, 2011	
($000s, except unit amounts)	**Notional number of Units**	**Fair Value**	Notional number of Units	Fair Value
Outstanding at January 1	**141,892**	**541**	—	—
Grants during the period	**395,390**	**1,546**	134,116	1,062
Dividend equivalents	**50,878**	**205**	7,776	45
	588,160	**2,292**	141,892	1,107
Unrealized loss on revaluation	**—**	**(81)**	—	(566)
Outstanding at December 31	**588,160**	**2,211**	141,892	541

The average VWAP per RSU and PSU granted on during 2012 was 4.01 dollars (2011 – 7.87 dollars). As at December 31, 2012, the carrying value of the RSUs and PSUs, based on a market price of 4.03 dollars, was $836 and is included in accounts payable and other liabilities in the consolidated statement of financial position (December 31, 2011 – 3.81 dollars and $115). The RSU and PSU compensation expense of $721 is recorded as compensation expense in the consolidated statement of income for 2012 (2011 – $115).

(C) Employee Share Purchase Plan

All Canadian employees of Capstone are entitled to participate in the employee share purchase plan where employees can direct up to 15% of their salary to purchase Capstone shares. The Corporation will match 50% of the employee's contribution to maximum of $3 per year, except for employees included in the LTIP program, who are ineligible for matching. Shares acquired as a matching contribution (including any dividends on those shares) vest after one year of match.

NOTE 23. EXPENSES – ANALYSIS BY NATURE

For the year ended	**Dec 31, 2012**				Dec 31, 2011			
	Operating	**Admin.**	**Project Development Costs**	**Total**	Operating	Admin.	Project Development Costs	Total
Fuel	**77,678**	**—**	**—**	**77,678**	77,838	—	—	77,838
Raw materials, chemicals and supplies	**57,663**	**—**	**—**	**57,663**	16,438	—	—	16,438
Wages and benefits	**41,148**	**6,749**	**20**	**47,917**	11,911	4,126	—	16,037
Maintenance	**4,370**	**—**	**—**	**4,370**	5,053	—	—	5,053
Insurance	**1,654**	**—**	**—**	**1,654**	1,610	—	—	1,610
Manager fees	**1,914**	**—**	**—**	**1,914**	1,806	1,825	—	3,631
Professional fees for legal, audit, tax and other advisory	**2,470**	**1,780**	**345**	**4,595**	894	2,195	8,289	11,378
Leases	**1,334**	**—**	**—**	**1,334**	1,114	—	—	1,114
Property taxes	**1,125**	**—**	**—**	**1,125**	1,383	—	—	1,383
Internalization	**—**	**—**	**—**	**—**	—	19,675	—	19,675
Other	**5,822**	**2,541**	**—**	**8,363**	4,039	1,856	—	5,895
Total	**195,178**	**11,070**	**365**	**206,613**	122,086	29,677	8,289	160,052

NOTE 24. OTHER GAINS AND LOSSES

	For the year ended	
	Dec 31, 2012	Dec 31, 2011
Unrealized gain (loss) on derivative financial instruments	**2,605**	(21,742)
Loss on disposal of capital assets	**(1,311)**	—
Other net gains and (losses)	**1,294**	(21,742)

NOTE 25. COMMITMENTS AND CONTINGENCIES

The Corporation, either directly or indirectly through its subsidiaries, has entered into various contracts and commitments as at December 31, 2012 as described below:

(A) Swap Contracts

The Corporation has various swap contracts for gas and interest, which have been further disclosed in notes 9 and 10.

(B) Leases

The following table summarizes the minimum operating lease payments:

	Within one year	One year to five years	Beyond five years	Total
Operating leases	939	3,765	8,443	13,147

Cardinal leases the site on which it is located from Ingredion Canada Incorporated ("Ingredion"), formerly Casco Inc. Under the lease, Cardinal pays nominal rent. The lease extends to 2016 and expires concurrently with the energy savings agreement between Ingredion 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 payments above a minimum level with respect to these agreements vary based on actual power production. 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 has 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 Ingredion, Cardinal is required to sell up to 723 million pounds of steam per year to Ingredion 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 five-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, 2012 of which $33,300 were contracted for but not accrued (December 31, 2011 – $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, 2012, no claims had been made on these guarantees.

NOTE 26. RELATED PARTY TRANSACTIONS

In the second quarter of 2011, 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	
	Dec 31, 2012	Dec 31, 2011
Management fees (1)	—	13,821
Administrative fees (2)	—	1,053
Cost reimbursement	—	1,881
	—	16,755

(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 22.

The following table summarizes key management compensation:

	For the year ended	
	Dec 31, 2012	Dec 31, 2011
Salaries, directors' fees and short-term employee benefits (1)	**1,272**	2,973
Share based compensation	**573**	102
	1,845	3,075

(1) The short-term incentive plan component of this balance in based on amounts paid during the period.

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 27. SEGMENTED INFORMATION

The Corporation has three reportable segments based on how management has organized the business to assess performance and for operating and capital allocation. Cash generating units included within each reportable segment have 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
Power	Canada
The Corporation's investments in gas cogeneration, wind, hydro, biomass power and solar power assets.	
Utilities – water	United Kingdom
The regulated water services business (Bristol Water), in which the Corporation holds a 50% indirect interest (70% October 5, 2011 – May 10, 2012)	
Utilities – district heating ("DH")	Sweden
The district heating business (Värmevärden), in which the Corporation holds a 33.3% indirect interest.	

	Year ended Dec 31, 2012					Year ended Dec 31, 2011				
		Utilities					Utilities			
	Power	**Water**	**DH**	**Corporate**	**Total**	Power	Water	DH	Corporate	Total
Revenue	**179,218**	**178,392**	**—**	**—**	**357,610**	172,407	43,560	—	—	215,967
Depreciation of capital assets	**(26,753)**	**(20,297)**	**—**	**(382)**	**(47,432)**	(26,428)	(4,611)	—	33	(31,006)
Amortization of intangible assets	**(8,031)**	**(2,028)**	**—**	**(61)**	**(10,120)**	(7,882)	(440)	—	(91)	(8,413)
Interest income	**761**	**751**	**3,356**	**18**	**4,886**	787	291	5,024	341	6,443
Interest expense	**(18,450)**	**(22,007)**	**—**	**(9,250)**	**(49,707)**	(20,534)	(6,417)	—	(4,717)	(31,668)
Income tax recovery (expense)	**(6,589)**	**(2,654)**	**—**	**(865)**	**(10,108)**	41,073	(2,665)	—	(2,650)	35,758
Net income (loss)	**19,788**	**38,805**	**7,936**	**(22,805)**	**43,724**	27,757	5,002	(3,541)	(32,481)	(3,263)
Cash flow from operations	**56,173**	**76,474**	**3,356**	**(21,325)**	**114,678**	66,769	22,192	5,024	(43,104)	50,881
Additions to capital assets	**5,432**	**140,555**	**—**	**86**	**146,073**	87,451	22,962	—	638	111,051

	As at Dec 31, 2012					As at Dec 31, 2011				
		Utilities					Utilities			
	Power	**Water**	**DH**	**Corporate**	**Total**	Power	Water	DH	Corporate	Total
Total assets	**634,403**	**946,510**	**51,923**	**19,703**	**1,652,539**	656,871	913,811	97,458	29,604	1,697,744
Total liabilities	**309,004**	**682,740**	**2,245**	**148,092**	**1,142,081**	287,780	663,454	—	298,540	1,249,774

NOTE 28. NON-CASH WORKING CAPITAL

The change in non-cash working capital was composed of the following:

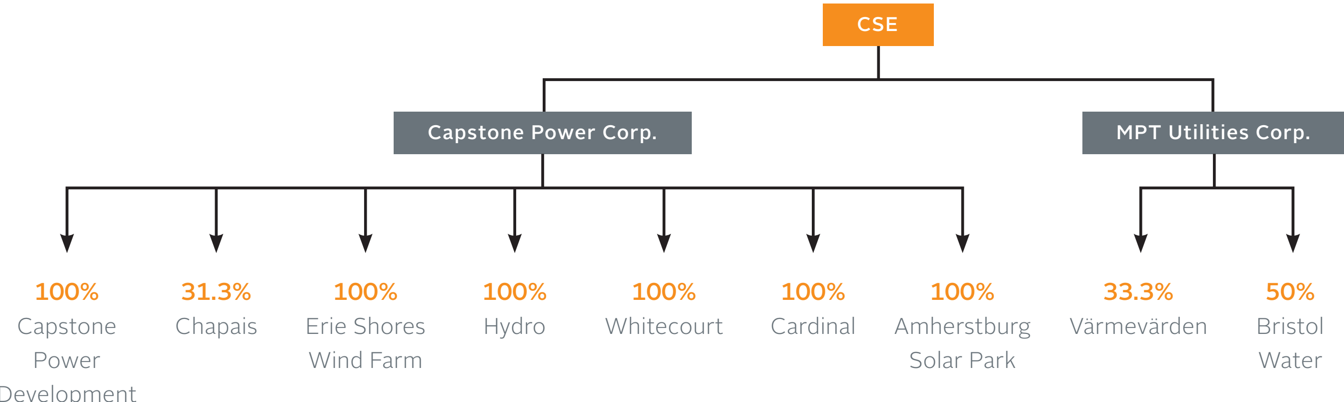
	For the year ended	
	Dec 31, 2012	Dec 31, 2011
Accounts receivable	**(3,603)**	(20,014)
Other assets	**1,188**	864
Accounts payable and other liabilities	**(2,548)**	31,962
	(4,963)	12,812

NOTE 29. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the current period's presentation.

SUPPLEMENTARY INFORMATION

ORGANIZATIONAL STRUCTURE



PORTFOLIO

Hydro
- Sechelt
- Wawatay
- Dryden
- Hluey Lakes

Biomass
- Whitecourt
- Chapais

Solar
- Amherstburg Solar Park

Wind
- Erie Shores Wind Farm

Gas Cogeneration
- Cardinal

Water Utility
- Bristol Water

District Energy
- Värmevärden

Power

Business	Year Built	Ownership 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	10
Whitecourt	1994	100%	25	TransAlta	2014	Millar Western	2016	34
Amherstburg	2011	100%	20	OPA	2031	n/a	n/a	n/a
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
Chapais[3]	1995	31.3%	28	Hydro-Québec	2015	Barrette/Chantiers/ Société en commandite Scierie Opitciwan	2015	n/a

Utilities

Business	Ownership Interest	Capacity	Counterparties	Length of Network	Approximate Population Served	Regulated	Employees
Värmevärden	33.3%	Heat production capacity of 786 MWth	Mix of industrial and retail customers, with industrial counterparties representing approximately one-third of revenue	317 kilometres	163,000	No	89
Bristol Water	50%	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	528

(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.

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 to 2012.

Earnings Measures ($000s)	**2012**	2011	2010	2009	2008	2007	2006	2005	2004
Revenue	**357,610**	215,967	158,512	148,384	153,186	122,811	89,940	90,235	55,848
Net income (loss)	**43,724**	(3,263)	15,901	11,259	(26,534)	5,426	8,411	8,372	7,236
Basic earnings per share	**0.298**	(0.108)	0.339	0.226	(0.531)	0.135	0.280	0.364	0.342

Cash Flow Measures ($000s)	**2012**	2011	2010	2009	2008	2007	2006	2005	2004
Cash flows from operating activities	**114,678**	50,881	29,011	38,040	50,516	29,663	21,044	20,230	14,729
Adjusted EBITDA (1)	**120,657**	55,673	55,818	61,244	67,324	61,250	34,104	27,912	16,304
Adjusted funds from operations ("AFFO") (1)	**35,563**	34,884	34,774	42,989	50,626	72,835	33,267	27,708	15,821
AFFO per share (1)	**0.473**	0.541	0.693	0.861	1.013	1.806	1.107	1.191	0.747

(1) These performance measures are not defined by International Financial Reporting Standards ("IFRS"). Please see page 20 for a definition of each measure.

Capital Structure – At Fair Value ($000s)	**2012**	2011	2010	2009	2008	2007	2006	2005	2004
Long-term debt – power	**305,497**	314,196	245,911	214,107	246,960	219,162	35,000	35,000	35,000
Long-term debt – utilities – water (1)	**259,830**	353,135	—	—	—	—	—	—	—
Long-term debt – corporate	**44,416**	155,124	61,311	89,437	35,026	38,918	—	—	—
Common shares	**291,955**	270,348	463,217	273,161	310,066	376,275	214,231	235,382	188,680
Class B exchangeable units	**13,093**	12,380	26,710	19,854	15,565	30,642	32,656	33,501	—
Preferred shares	**58,200**	52,500	—	—	—	—	—	—	—
Debt to capitalization	**62.7%**	71.0%	38.5%	50.9%	46.4%	38.8%	12.4%	11.5%	15.6%

(1) Calculated as 50% proportionate share based on ownership interest (December 31, 2011 – 70%).

INVESTOR INFORMATION

Quick Facts	
Common shares outstanding	72,445,509
Preferred shares outstanding	3,000,000
Convertible debentures outstanding	42,749
Class B exchangeable units	3,249,390
Securities exchange and symbols	Toronto Stock Exchange: CSE, CSE.PR.A, CSE.DB.A

QUARTERLY TRADING INFORMATION

	2012				2011			
	Q4	**Q3**	**Q2**	**Q1**	Q4	Q3	Q2	Q1
Common shares								
High share price (intraday)	**4.49**	**4.69**	**4.15**	**4.35**	6.60	7.85	8.29	8.80
Low share price (intraday)	**3.91**	**4.01**	**3.72**	**3.82**	3.26	6.12	7.60	7.50
Closing share price	**4.03**	**4.43**	**4.01**	**4.15**	3.81	6.33	7.82	7.94
Average daily trading volume	**206,000**	**186,000**	**272,000**	**410,675**	678,233	154,499	126,407	125,861
Dividend declared	**0.075**	**0.075**	**0.135**	**0.165**	0.165	0.165	0.165	0.165
Preferred shares								
High share price (intraday)	**20.67**	**21.50**	**19.24**	**18.84**	21.14	24.20	24.75	—
Low share price (intraday)	**18.65**	**18.40**	**16.66**	**17.00**	15.83	18.76	24.00	—
Closing share price	**19.40**	**20.80**	**19.00**	**17.60**	17.50	20.10	24.19	—
Average daily trading volume	**2,971**	**2,070**	**3,054**	**4,385**	9,583	8,136	13,150	—
Dividend declared	**0.3125**	**0.3125**	**0.3125**	**0.3125**	0.4212	—	—	—
Convertible debentures								
High share price (intraday)	**104.50**	**107.20**	**108.49**	**104.49**	102.00	112.00	117.40	123.00
Low share price (intraday)	**102.50**	**102.02**	**99.51**	**99.50**	90.25	99.05	110.00	108.50
Closing debenture price	**103.90**	**104.15**	**103.00**	**101.50**	100.00	103.00	112.90	114.00
Average daily trading volume	**300**	**200**	**492**	**933**	3,074	5,687	837	1,960

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

Michael Chapin
Senior Vice President

BOARD OF DIRECTORS

V. James Sardo
Chairman of the Board

Patrick J. Lavelle

Goran Mornhed

Jerry Patava

François R. Roy

HEAD OFFICE

155 Wellington Street West
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.
100 University Avenue, 9th Floor
Toronto, Ontario M5J 2Y1

North America toll-free: 1-800-564-6253
International: 1-514-982-7555
Website: www.computershare.com/investorcentrecanada

AUDITORS

PricewaterhouseCoopers LLP
Toronto, Ontario

INVESTOR RELATIONS CONTACT

Sarah Borg-Olivier
Senior Vice President, Communications

Tel: 416-649-1325
Toll-free: 1-855-649-1300
Email: info@capstoneinfrastructure.com

ANNUAL GENERAL MEETING OF SHAREHOLDERS

Tuesday, June 18, 2013
10 a.m. EDT
TMX Broadcast Centre Gallery
130 King Street West
Toronto, Ontario

Visit our website at www.capstoneinfrastructure.com for information about Capstone's business and to access investor materials, including annual and quarterly financial reports, recent news and investor presentations, including a webcast of the annual general meeting.

Readers are advised that this annual report may contain forward-looking information and a financial outlook as described on page 18 of this document.

This document contains statistical data, market research and industry forecasts that were obtained from government and industry publications and reports or are based on estimates derived from same and management's knowledge of, and experience in, the markets in which the Corporation operates. Market and industry data is subject to variations and cannot be verified due to limits on the availability and reliability of data inputs and other limitations and uncertainties inherent in any statistical survey. While management believes this data to be reliable, the Corporation has not independently verified the accuracy or completeness of any of the data from third party sources or ascertained the underlying assumptions relied upon by such sources. Accordingly, the accuracy, currency and completeness of this information cannot be guaranteed. Actual outcomes may vary materially from those forecast in such publications or reports, and the prospect for material variation can be expected to increase as the length of the forecast period increases.

This document is not an offer or invitation for the subscription or purchase of or a recommendation of securities. It does not take into account the investment objectives, financial situation and particular needs of any investors. Before making an investment in the Corporation, an investor or prospective investor should consider whether such an investment is appropriate to their particular investment needs, objectives and financial circumstances and consult an investment adviser if necessary.

DESIGN: Craib Design & Communications www.craib.com

WHY INVEST IN INFRASTRUCTURE?

- **ESSENTIAL SERVICE**
  Core infrastructure businesses provide an essential service, which translates into steady, long-term cash flow for investors that is largely resistant to economic or market fluctuations.
- **STRATEGIC COMPETITIVE ADVANTAGE**
  Capstone's core infrastructure businesses are physical, long-life assets that are regulated or contractually defined, which creates a competitive advantage that cannot easily be replicated.
- **PREDICTABLE, GROWING CASH FLOW**
  Capstone's infrastructure portfolio generates reliable cash flow that is largely linked to measures of economic growth such as inflation.
- **ATTRACTIVE RISK-ADJUSTED RETURN**
  Infrastructure represents a distinct asset class that has historically exhibited a low correlation to other asset classes, making it an excellent portfolio diversification tool.

VISIT US ONLINE:
www.capstoneinfrastructure.com