## 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.