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"),

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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.