MANAGEMENT'S DISCUSSION AND ANALYSIS

Financial Highlights

	As at and for the year ended December 31		
	2016	2015	2014
Revenue [(1)]	**172,940**	117,956	203,308
Net income (loss) [(2)]	**(15,541)**	26,192	33,547
Adjusted EBITDA [(2), (3)]	**125,862**	115,301	160,359
AFFO [(2), (3)]	**23,476**	11,233	56,412
Total assets [(4)]	**1,148,404**	2,522,089	2,299,980
Total long-term liabilities [(4)]	**786,474**	1,493,836	1,428,293

(1) Comparative figures for revenue have been adjusted to remove amounts from discontinued operations. Including discontinued operations, total revenue is $364,255, $344,983 and $441,578 in 2016, 2015 and 2014, respectively.
(2) Results include continuing operations and discontinued operations for all periods.
(3) Non-GAAP performance measures are defined on page 6.
(4) Comparative figures include balances relating to discontinued operations.

INSIDE THIS SECTION

LEGAL NOTICE

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

Caution Regarding Forward-Looking Statements

Certain of the statements contained within this document are forward-looking and reflect management's expectations regarding the future growth, results of operations, performance and business of Capstone Infrastructure Corporation (the "Corporation") based on information currently available to the Corporation. Forward-looking statements are provided for the purpose of presenting information about management's current expectations and plans relating to the future and readers are cautioned that such statements may not be appropriate for other purposes. These statements use forward-looking words, such as "anticipate", "continue", "could", "expect", "may", "will", "intend", "estimate", "plan", "believe" or other similar words, and include, among other things, statements found in "Results of Operations" and "Financial Position Review". These statements are subject to known and unknown risks and uncertainties that may cause actual results or events to differ materially from those expressed or implied by such statements and, accordingly, should not be read as guarantees of future performance or results. The forward-looking statements within this document are based on information currently available and what the Corporation currently believes are reasonable assumptions, including the material assumptions set out in the management's discussion and analysis of the results of operations and the financial condition of the Corporation ("MD&A") for the year endedDecember 31, 2016 under the headings "Changes in the Business", "Results of Operations" and "Financial Position Review", as updated in subsequently filed MD&A of the Corporation (such documents are available under the Corporation's SEDAR profile at www.sedar.com).

Other potential material factors or assumptions that were applied in formulating the forward-looking statements contained herein include or relate to the following: that the business and economic conditions affecting the Corporation's operations will continue substantially in their current state, including, with respect to industry conditions, general levels of economic activity, regulations, weather, taxes and interest rates; that the preferred shares will remain outstanding and that dividends will continue to be paid on the preferred shares; that there will be no further material delays in the Corporation's wind development projects achieving commercial operation; that the Corporation's power infrastructure facilities will experience normal wind, hydrological and solar irradiation conditions, and ambient temperature and humidity levels; that there will be no material changes to the Corporation's facilities, equipment or contractual arrangements; that there will be no material changes in the legislative, regulatory and operating framework for the Corporation's businesses; that there will be no material delays in obtaining required approvals for the Corporation's power infrastructure facilities or Värmevärden; that there will be no material changes in environmental regulations for the power infrastructure facilities or Värmevärden; that there will be no significant event occurring outside the ordinary course of the Corporation's businesses; the refinancing on similar terms of the Corporation's and its subsidiaries' various outstanding credit facilities and debt instruments which mature during the period in which the forward-looking statements relate; market prices for electricity in Ontario and the amount of hours that Cardinal is dispatched; the price that Whitecourt will receive for its electricity production considering the market price for electricity in Alberta, the impact of renewable energy credits, and Whitecourt's agreement with Millar Western, which includes sharing mechanisms regarding the price received for electricity sold by the facility; the re-contracting of the power purchase agreement ("PPA") for Sechelt; and that there will be no material changes to the Swedish krona to Canadian dollar exchange rate.

Although the Corporation believes that it has a reasonable basis for the expectations reflected in these forward-looking statements, actual results may differ from those suggested by the forward-looking statements for various reasons, including: risks related to the Corporation's securities (dividends on preferred shares are not guaranteed; volatile market price for the Corporation's preferred shares; and subordination and absence of covenant protection); risks related to the Corporation and its businesses (availability of debt and equity financing; default under credit agreements and debt instruments; geographic concentration; foreign currency exchange rates; acquisitions, development and integration; environmental, health and safety; changes in legislation and administrative policy; and reliance on key personnel); risks related to the Corporation's power infrastructure facilities (market price for electricity; power purchase agreements; completion of the Corporation's wind development projects; operational performance; contract performance and reliance on suppliers; land tenure and related rights; environmental; and regulatory environment); and risks related to Värmevärden (operational performance; fuel costs and availability; industrial and residential contracts; environmental; regulatory environment; and labour relations);.

For a comprehensive description of these risk factors, please refer to the "Risk Factors" section of the Corporation's Annual Information Form dated March 29, 2016, as supplemented by disclosure of risk factors contained in any subsequent annual information form, material change reports (except confidential material change reports), business acquisition reports, interim financial statements, interim management's discussion and analysis and information circulars filed by the Corporation with the securities commissions or similar authorities in Canada (which are available under the Corporation's SEDAR profile at www.sedar.com).

The assumptions, risks and uncertainties described above are not exhaustive and other events and risk factors could cause actual results to differ materially from the results and events discussed in the forward-looking statements. The forward-looking statements within this document reflect current expectations of the Corporation as at the date of this document and speak only as at the date of this document. Except as may be required by applicable law, the Corporation does not undertake any obligation to publicly update or revise any forward-looking statements.

INTRODUCTION

Management's discussion and analysis ("MD&A") summarizes Capstone Infrastructure Corporation's (the "Corporation" or "Capstone") consolidated financial position, operating results and cash flows as at and for the years ended December 31, 2016 and 2015.

This MD&A should be read in conjunction with the accompanying audited consolidated financial statements of the Corporation and notes thereto as at and for the years ended December 31, 2016 and 2015. Additional information about the Corporation, including its Annual Information Form ("AIF") for the year ended December 31, 2015, quarterly financial reports of Capstone and other public filings of the Corporation are available under the Corporation's profile on the Canadian Securities Administrators' System for Electronic Document Analysis and Retrieval ("SEDAR") website at www.sedar.com.

This MD&A is dated February 28, 2017, the date on which this MD&A was approved by the Corporation's Board of Directors.

BASIS OF PRESENTATION

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

Discontinued Operations and Assets Held for Sale

On December 15, 2016, Capstone sold its 50% interest in Bristol Water resulting in the utilities - water segment being presented as a discontinued operation. This means Capstone's consolidated statement of financial position as at December 31, 2016 does not contain balances related to Bristol Water. In addition, the statements of income for the years ended December 31, 2016 and 2015 only include results for Bristol Water as a discontinued operation up until December 15, 2016.

As at December 31, 2016, Capstone's plan to sell its 33.3% investment in Värmevärden results in the utilities - district heating segment meeting the assets held for sale ("AHFS") criteria and consequently being presented as a discontinued operation. This means Capstone's consolidated statement of financial position as at December 31, 2016 classifies balances related to Värmevärden as AHFS within the current assets and liabilities. In addition, the statements of income for the years ended December 31, 2016 and 2015 include Värmevärden as a discontinued operation.

Foreign Currency Translation and Presentation

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

	Swedish Krona (SEK)		**UK Pound Sterling (£)**	
As at and for the year ended	**Average**	**Spot**	**Average**	**Spot**
December 31, 2015	0.1516	0.1638	1.9540	2.0407
December 31, 2016 (1)	**0.1550**	**0.1478**	**1.8014**	**1.6597**

(1) Bristol Water's spot rate and average rate were as at and for the period ended December 15, 2016, the date of sale.

CHANGES IN THE BUSINESS

In 2016, Capstone's power segment was able to conclude the legal proceedings and receive payment for retroactive amounts owing from the Ontario Electricity Financial Corporation ("OEFC"), as well as progress the wind development projects, and complete several financings. During the year, changes to Capstone's ownership and key management allowed for significant steps to be taken towards refocusing on the core power business, which include the decision to divest of the Corporation's utilities businesses, Bristol Water and Värmevärden. In addition, Capstone's preferred share dividend rate was reset.

Acquisition of Capstone by iCON III

On April 29, 2016, Capstone completed the previously announced arrangement under which Irving Infrastructure Corp. ("Irving"), a subsidiary of iCON Infrastructure Partners III, LP ("iCON III"), a fund managed by London, UK-based iCON Infrastructure LLP ("iCON"), acquired all the issued and outstanding common shares of Capstone and all the Class B exchangeable units of Capstone's subsidiary MPT LTC Holding LP ("Class B units") for $4.90 cash per share or unit, as applicable ("iCON III acquisition"). Pursuant to the arrangement agreement, the outstanding 2016 convertible debentures were redeemed and the 2017 convertible debentures were converted into common shares prior to being acquired by Irving. As part of the transaction, Capstone issued a demand interest-free promissory note to Irving for $316,225, which consisted of three multi-currency tranches: £106,000, 712,700 SEK, and $10,370, and Capstone Power Corp. ("CPC") entered into a credit agreement for $125,000 in part to fund the convertible debenture redemption. Upon completion, the common shares, Class B units, and 2016 and 2017 convertible debentures were delisted from the Toronto Stock Exchange and ceased trading. Capstone also settled all outstanding share-based compensation.

Key Management Changes

On closing of the iCON III acquisition, four of the independent directors of Capstone resigned and were replaced by one new independent director and three directors from iCON. In June 2016, the President and Chief Executive Officer and a director of Capstone, Michael Bernstein, left Capstone subsequent to the iCON III acquisition. Paul Malan, the chairman of Capstone's board of directors and Senior Partner of iCON, was appointed as interim Executive Chairman until December 31, 2016 and Michael Smerdon, Capstone's Executive Vice President and Chief Financial Officer, was appointed to the board of Capstone. On January 1, 2017, David Eva was appointed as Chief Executive Officer and as a member of the Board of Directors. Paul Malan stepped down as Executive Chair of Capstone, but remains as chairman of Capstone's Board of Directors.

Sale of Bristol Water

On December 15, 2016, Capstone sold its 50% ownership interest in Bristol Water to iCON III Bristol Limited, a subsidiary of Capstone's ultimate parent, iCON III. As part of the sale, Irving converted its £106,000 tranche of the promissory note into 123,905 Class A shares of the Corporation, which reduced the promissory note payable to Irving by $194,531. In return, Capstone distributed $192,011 to Irving as a return of capital. This results in a $2,520 increase in Capstone's Class A shares and a loss of $2,803 on the sale.

As a result of the sale, the utilities - water segment is presented as a discontinued operation (refer to page 3 "Basis of Presentation" in this MD&A).

Värmevärden Refinancing and Expected Sale

On May 26, 2016, Värmevärden made an in-kind distribution of 1,095,000 SEK to its shareholders, representing gains recognized from a restructuring, of which Capstone's portion was 365,000 SEK. Capstone subsequently reinvested these gains back in to Värmevärden in return for a new shareholder loan. On June 30, 2016, Värmevärden completed a third-party financing raising 1,425,000 SEK, which was used to repay the 1,000,000 SEK senior secured bonds. The excess proceeds were used to repay the early call premium, transaction costs, as well as a portion of the pre-existing shareholder loan. The net excess proceeds, including operating cash flows generated from the business, were used to repay 162,424 SEK to Capstone. In the third quarter, Capstone used 160,000 SEK of the refinancing proceeds to partially repay the SEK tranche of the promissory note to Irving.

During 2016, Capstone and its co-shareholder evaluated strategic options for Värmevärden, including a potential sale. As at December 31, 2016, management expects to sell its 33.3% ownership interest Värmevärden in 2017. As such, Capstone has classified Värmevärden's assets and liabilities as AHFS and the results of the utilities - district heating segment are presented as a discontinued operation (refer to page 3 "Basis of Presentation" in this MD&A).

OEFC Settlement

On March 12, 2015, the Ontario Superior Court of Justice determined that the OEFC had not properly calculated the price paid for electricity produced under its power purchase agreements with Cardinal, Wawatay and Dryden, as well as a number of other power producers in Ontario. This determination was upheld by the Ontario Court of Appeal in its April 19, 2016 decision. On January 19, 2017, the Supreme Court of Canada dismissed the OEFC's application for leave to appeal the April 19, 2016 decision.

On October 21, 2016, Capstone received $23,527 in net retroactive payments from the OEFC. This was recorded in the statement of income, with $33,288 in revenue and $2,288 in interest income. In addition, associated expenses of $12,049 were recorded in operating expenses.

Wind Development Projects Achieved Commercial Operations

In 2016, four of Capstone's Ontario wind development projects reached commercial operations ("COD") as follows:

- February 26, 2016 - Grey Highlands ZEP, a 10 MW facility with a PPA expiring in 2036;
- May 6, 2016 - Ganaraska, an 18 MW facility with a PPA expiring in 2036;
- September 21, 2016 - Grey Highlands Clean, an 18 MW facility with a PPA expiring in 2036; and
- October 5, 2016 - Snowy Ridge, a 10 MW facility with a PPA expiring in 2036.

In addition, on September 19, 2016, the Environmental Review Tribunal ("ERT") issued its decision accepting the Settlers Landing Ontario wind project's modification proposal, which included removal of one turbine, reducing the project nameplate capacity from 10 MW to 8 MW and enhancing the site restoration plan. Construction commenced in the fourth quarter of 2016 and COD is expected in 2017.

Financing Changes - CPC Acquisition and Project Financings

CPC Financing

On April 29, 2016, Capstone entered into credit facilities at CPC for an aggregate amount of$125,000, consisting of an $85,000 non-revolving facility, a $5,000 revolving facility, and a $35,000 revolving letter of credit facility ("the CPC Credit Agreement"). The proceeds drawn on the non-revolving facility were used to repay the outstanding convertible debentures and to replace the existing corporate credit facility. The CPC Credit Agreement matures on April 29, 2019 and bears interest at a variable rate plus an applicable margin. In addition, fixed annual minimum repayments are required, which are paid quarterly by excess cash as determined in accordance with the CPC Credit Agreement.

This replaced the corporate credit facility capacity which was reduced concurrent with the Cardinal financing on March 18, 2016, to $60,000 and repaid as part of the iCON III acquisition on April 29, 2016.

Project Financings

Capstone, through its subsidiaries, completed several project financings in 2016, which are non-recourse to Capstone. All of these financings amortize over the term of the PPA's with variable interest rates which are fixed using interest rate swap contracts until the end of the PPA (refer to page 19 "Derivative Financial Instruments" in this MD&A).

- On March 18, 2016, Cardinal gas cogeneration plant entered into a credit agreement, consisting of a term loan and a letter of credit facility;
- On March 24, 2016, the Grey Highlands Clean wind project entered into a credit agreement which funded construction of the project and was converted to a term facility on December 23, 2016;
- On July 8, 2016, the Snowy Ridge wind project entered into a credit agreement which funded the construction of the project and was converted to a term facility on December 23, 2016; and
- On December 2, 2016, the Settlers Landing wind project entered into a credit agreement to fund the construction of the project. The construction term of the facility is expected to mature in the third quarter of 2017 and convert into a term facility.

In addition, on August 26, 2016, the Grey Highlands ZEP and Ganaraska ("GHG") construction facility was converted to term facility.

Preferred Shares Dividend Rate Reset

On July 4, 2016, Capstone announced to preferred shareholders the applicable fixed and floating dividend rates for its cumulative five-year rate reset preferred shares, which is effective from July 31, 2016 to July 30, 2021. In accordance with the terms of the share agreement, all preferred shares accrue dividends at a fixed rate of 3.271% per annum and preferred dividends are paid quarterly.

SUBSEQUENT EVENTS

Whitecourt Bioenergy Producer Program

On February 8, 2017, Whitecourt, Capstone's biomass facility, was notified that the Government of Alberta approved its application to the Bioenergy Producer Program ("BPP"). Whitecourt expects to receive grants of up to $4,800 for contributing to Alberta's bioenergy production capacity over the 18 month program, ending September 30, 2017.

Värmevärden Sale

On February, 21 2017, Capstone announced that, alongside its co-shareholder Macquarie European Infrastructure Fund 2 ("MEIF 2"), it has agreed to sell 100% of Värmevärden. Capstone expects to receive approximately$140,000 in net proceeds for its 33.3% indirect interest in Värmevärden and the related outstanding loans receivable. The transaction is expected to close in March 2017. The net proceeds exceed the carrying value of$13,197 by $126,803. On completion, the excess will be included as a gain on sale, net of applicable taxes and foreign exchange translation. A portion of the proceeds from the sale will be used to eliminate the remaining outstanding balance of the promissory note to Irving.

Sechelt Creek Facility Electricity Purchase Agreement Extension

On February 28, 2017, Capstone's electricity purchase agreement for the Sechelt Creek facility with BC Hydro was extended from its original expiry on an interim basis. The interim arrangement, and any new or amended electricity purchase agreement that may be entered, is expected to provide a lower price for electricity supplied than was paid under the expiring contract and would generate lower revenues than in 2016.

ADDITIONAL GAAP AND NON-GAAP PERFORMANCE MEASURES DEFINITIONS

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

Additional GAAP Measure

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

EBITDA is an additional GAAP financial measure defined as earnings (loss) before financing costs, income tax expense, depreciation and amortization. EBITDA includes earnings (loss) related to the non-controlling interest ("NCI"), impairment charges, interest income and net pension interest. EBITDA from discontinued operations is consistent with the definition for continuing operations. EBITDA represents Capstone's 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.

Non-GAAP Measures

Adjusted EBITDA

Adjusted EBITDA is a non-GAAP financial measure that assists management, investors and other stakeholders in evaluating Capstone's operating performance. Adjusted EBITDA is an indicator of results generated by the business activities, prior to how these operations are financed or taxed and excludes capitalized expenditures and amortization.

Adjusted EBITDA is calculated as revenue less operating and administrative expenses and project development costs plus interest income, contractual settlements included in other gain and (losses) and dividends or distributions received from equity accounted investments. Adjusted EBITDA for investments in subsidiaries with non-controlling interests is included at Capstone's proportionate ownership interest by deducting amounts attributed to any non-controlling interest. Adjusted EBITDA from discontinued operations are added or subtracted as a single line consistent with the net result following the definition for continuing operations, up to the date of Capstone's disposal. The reconciliation of Adjusted EBITDA to EBITDA is provided on page 7.

Adjusted Funds from Operations ("AFFO")

AFFO is a non-GAAP financial measure that assists management, investors and other stakeholders in analyzing the cash flow available for future growth capital investments, acquisitions and dividends available to the preferred shareholders and Capstone's common shareholder.

AFFO is calculated from Adjusted EBITDA by:

Deducting:	Adding:	Deducting items for corporate and businesses without significant non-controlling interests:
• Adjusted EBITDA generated from businesses with significant non-controlling interests	• Distributions received from businesses with significant non-controlling interests • Scheduled repayments of principal on loans receivable from equity accounted investments	• Interest paid • Income taxes paid • Dividends paid on the preferred shares included in shareholders' equity • Maintenance capital expenditure payments • Scheduled repayments of principal on debt

AFFO from discontinued operations are added or subtracted as a single line consistent with the net result following the definition for continuing operations, up to the date of Capstone's disposal.

Reconciliation of GAAP and Non-GAAP Performance Measures

The following tables reconcile Adjusted EBITDA and AFFO to the nearest GAAP measures, Net Income and EBITDA:

For the year ended	**Dec 31, 2016**	Dec 31, 2015
Net Income (loss) from continuing operations	**18,830**	(28,680)
Interest expense	**34,476**	34,174
Depreciation and amortization	**58,802**	45,096
Income tax recovery (expense)	**(3,859)**	(1,453)
EBITDA from continuing operations	**108,249**	49,137
Foreign exchange (gain) loss	**(397)**	(193)
Other (gains) and losses, net	**(23,410)**	11,779
Contractual settlements in other gains and (losses)	**8,142**	3,774
Equity accounted (income) loss	**(958)**	(688)
Distributions from equity accounted investments	**1,886**	2,426
NCI portion of Adjusted EBITDA	**(14,947)**	(8,930)
Adjusted EBITDA from continuing operations	**78,565**	57,305
Continuing operations cash flow from operating activities (1)	**50,323**	22,922
Cash flow from operating activities of businesses with NCI	**5,759**	(12,673)
Distributions paid to Capstone from businesses with NCI	**7,322**	5,257
Distributions from equity accounted investments	**1,886**	2,426
Foreign exchange (gains) losses on loans receivable	**—**	(193)
Power and corporate working capital changes	**(18,945)**	10,340
Loans receivable principal repayments	**—**	1,442
Power and corporate maintenance capital expenditures	**(3,917)**	(3,518)
Power and corporate scheduled principal repayments	**(23,575)**	(19,047)
Dividends on redeemable preferred shares	**(3,426)**	(3,750)
AFFO from continuing operations	**15,427**	3,206

(1) Cash flow from operating activities for the period ended December 31, 2015 include $13,046 of one-time costs to terminate the Amherstburg interest rate swap.

For the year ended	**Dec 31, 2016**	Dec 31, 2015
Net Income (loss) from discontinued operations	**(34,371)**	54,872
Interest expense	**24,081**	23,767
Depreciation and amortization	**33,983**	38,885
Income tax recovery (expense)	**(1,752)**	(4,434)
EBITDA from discontinued operations	**21,941**	113,090
Asset impairment charges	**58,000**	—
Foreign exchange (gain) loss	**5,333**	(3,527)
Other (gains) and losses, net	**1,000**	(1,394)
Net pension interest income	**(3,169)**	(3,062)
Equity accounted (income) loss	**—**	1,504
Distributions from equity accounted investments	**4,167**	3,427
NCI portion of Adjusted EBITDA	**(39,975)**	(52,042)
Adjusted EBITDA from discontinued operations	**47,297**	57,996
Discontinued operations cash flow from operating activities	**70,866**	93,896
Cash flow from operating activities of businesses with NCI	**(70,019)**	(91,181)
Distributions paid to Capstone from businesses with NCI	**660**	1,992
Distributions from equity accounted investments	**4,167**	3,427
Utilities working capital changes	**2,375**	(107)
AFFO from discontinued operations	**8,049**	8,027

RESULTS OF OPERATIONS

Overview

Capstone's Adjusted EBITDA and AFFO were both higher than in 2015.

Higher Adjusted EBITDA from continuing operations primarily reflected:

- Higher power segment results, primarily attributable to net OEFC proceeds awarded for retroactive payments to Cardinal and the Ontario hydro facilities. The new wind facilities added since January 1, 2015, which consist of Goulais, GHG, Grey Highlands Clean and Snowy Ridge, also contributed to the increase. In addition, Capstone's hydro facilities generally experienced favourable hydrology conditions producing higher revenue; partially offset by
- Higher corporate expenses, relating to costs associated with the acquisition of Capstone by iCON III, including professional fees and staff costs.

Lower Adjusted EBITDA from discontinued operations consisted of:

- Lower results from Bristol Water, reflecting lower revenues, primarily attributable to a rate decrease in AMP 6 and unfavourable foreign currency translation, and lower expenses, mainly due to the favourable impact of a decrease the UK Pound Sterling on expenses, which was partially offset by fees accrued for the notice of termination of the operations and maintenance ("O&M") agreement, partially offset by
- Higher interest income and dividends from Värmevärden.

In addition to the factors affecting Adjusted EBITDA, Capstone's AFFO was affected by higher debt service payments at the power segment and corporate as well as lower dividends from Bristol Water.

	For the year ended		
	Dec 31, 2016	Dec 31, 2015	Change
Revenue	**172,940**	117,956	54,984
Expenses	**(92,078)**	(59,419)	(32,659)
Interest income	**2,622**	1,498	1,124
Contractual settlements in other gains and (losses)	**8,142**	3,774	4,368
Distributions from equity accounted investments	**1,886**	2,426	(540)
Less: NCI	**(14,947)**	(8,930)	(6,017)
Adjusted EBITDA from continuing operations	**78,565**	57,305	21,260
Adjusted EBITDA from discontinued operations	**47,297**	57,996	(10,699)
Adjusted EBITDA	**125,862**	115,301	10,561
Adjusted EBITDA of discontinued operations	**(47,297)**	(57,996)	10,699
Adjusted EBITDA of consolidated businesses with NCI	**(16,304)**	(9,337)	(6,967)
Distributions from businesses with NCI	**7,322**	5,257	2,065
Principal from loans receivable	**—**	1,442	(1,442)
Interest paid	**(21,891)**	(24,120)	2,229
Dividends paid on Capstone's preferred shares	**(3,426)**	(3,750)	324
Income taxes (paid) recovery	**(1,347)**	(1,026)	(321)
Maintenance capital expenditures	**(3,917)**	(3,518)	(399)
Scheduled repayment of debt principal	**(23,575)**	(19,047)	(4,528)
AFFO from continuing operations	**15,427**	3,206	12,221
AFFO from discontinued operations	**8,049**	8,027	22
AFFO	**23,476**	11,233	12,243

Revenue increased by $54,984, or 47%, due to higher power segment revenue, primarily due to proceeds awarded of $33,288 for retroactive revenue adjustments from the OEFC for Cardinal and the Ontario hydro facilities. New wind facilities also contributed $16,998. In addition, revenue increased by $6,492 due to higher production because of more favourable resource conditions from the hydro facilities. These were partially offset by $2,770 of lower revenue at Whitecourt due to lower merchant power rates in Alberta.

Expenses increased by $32,659, or 55%, because:

- **Operating expenses** increased by $16,432, or 41%, due to higher power segment expenses, mainly because of a one time increase in fuel expenses of $12,049, directly related to contractual obligations from the OEFC settlement. New wind facilities also contributed $2,750 of higher expenses. In addition, expenses increased by $1,316 for costs incurred for tower repairs at the Ferndale site, net of interim insurance recoveries as part of Capstone's claim.
- **Administrative expenses** increased by $8,225, or 71%, primarily due to higher non-recurring staff costs of $9,761 because of the iCON III acquisition, including long-term incentive plan payments and employee separation costs.
- **Project development costs** increased by $8,002, or 110%, of which $9,170 related to higher corporate development costs, partially offset by $1,168 of lower power segment costs. The corporate development costs increased due to $10,154 of non-recurring costs related to the iCON III acquisition, partially offset by $984 of lower acquisition due diligence costs. Power segment costs decreased by $1,168 due to the stage of progress on the wind development projects.

Interest income increased by $1,124, or 75%, primarily due to $2,288 of interest income related to the OEFC settlement, partially offset by $998 of lower interest income because the Goulais wind facility loan receivable matured in 2015.

Contractual settlements in other gains and (losses) relate to cash settlements included in other gains and losses under IFRS in the consolidated statement of income. The current amount is comprised of revenue sharing receipts in Whitecourt's fuel supply agreement with Millar Western and the payments are higher in response to lower merchant power rates in Alberta.

Distributions from equity accounted investments were $540, or 22%, lower in 2016 due to lower distributions from the Glen Dhu wind facility ("Glen Dhu").

Adjusted EBITDA from discontinued operations decreased by $10,699, or 18%, primarily due to lower Bristol Water contributions of $12,053, partially offset by higher Värmevärden contributions of $1,354, due to higher interest on the shareholder loans and higher dividends.

Bristol Water's revenue decreased by $35,712, primarily due to lower regulated water tariffs since April 1, 2015 and unfavourable foreign currency translation. These were partially offset by lower operating expenses of $11,860 primarily due to a recovery of past service costs on closing the defined benefit pension plan and non-recurring costs in 2015 related to the CMA process. In addition, operating expenses were lower due to favourable foreign currency translation. These decreases in operating expenses were partially offset by $13,940 of costs to terminate the O&M agreement with Agbar.

Distributions from businesses with NCI were $2,065, or 39%, higher in 2016 mainly due to distributions of $3,601 from the new wind facilities, partially offset by $1,791 of lower distributions from Saint-Philémon.

Interest paid decreased by $2,229, or 9%, primarily attributable to $4,189 of lower corporate interest, resulting from the settlement of the convertible debentures and corporate credit facility on April 29, 2016, and $1,501 of lower interest due to the Amherstburg refinancing, completed in the third quarter of 2015. In addition, $871 of lower interest on amortizing debt for the wind facilities contributed to the decrease. These decreases were partially offset by $2,883 of higher interest at CPC and $1,664 at Cardinal due to the new debt facilities put in place in 2016.

Interest paid by businesses with significant NCI are excluded from Capstone's definition of AFFO and represent the primary difference between interest expense included in consolidated net income and interest paid in AFFO. The remaining difference between interest expense and interest paid was attributable to the amortization of financing costs and accrued interest to December 31, 2016.

Scheduled debt principal repayments increased by $4,528, or 24%, primarily due to payments on new debt at Cardinal and Grey Highlands Clean which were completed in 2016, as well as higher debt amortization at Amherstburg, the hydro facilities, SkyGen and Glace Bay.

AFFO from discontinued operations increased by $22, or 0.3%, primarily due to $1,354 of higher interest and dividends from Värmevärden, offset by $1,332 of lower distributions from Bristol Water.

Results by Segment

Capstone's results are segmented into power in Canada and utilities in Europe. All remaining results relate to corporate activities. The power segment includes gas cogeneration, hydro, wind, biomass and solar power, as well as power development activities. The utilities segments comprise Capstone's 50% interest in Bristol Water, a regulated water utility in the United Kingdom, and a 33.3% interest in Värmevärden, a district heating business in Sweden. Both of the utilities segments are presented as discontinued operations resulting from Capstone's sale of its 50% ownership interest in Bristol Water on December 15, 2016 and Capstone's plan to sell its investment in Värmevärden in 2017.

Capstone's operating segments, including discontinued operations, by ownership interest are:

Accounting treatment	Control		Significant influence
Ownership	Wholly owned	Partially owned	Minority interest
Power (1)	Cardinal (gas cogeneration facility), Erie Shores, SkyGen, Glace Bay and Grey Highlands Clean (wind facilities), Whitecourt (biomass facility), Amherstburg (solar facility) and the hydro facilities.	Amherst, Saint-Philémon, Goulais, GHG and Snowy Ridge (wind facilities)	Glen Dhu and Fitzpatrick (wind facilities)
Discontinued Operations:			
Utilities - water (2)		Bristol Water	
Utilities - district heating (2)			Värmevärden

(1) The power segment includes investments in wind development projects in addition to the operating businesses disclosed above.
(2) Capstone's ownership interests in Bristol Water and Värmevärden are presented as discontinued operations (refer to page 3 "Basis of Presentation" in this MD&A).

Performance measures

Capstone's performance measures from continuing operations are shown before several large one-time transactions in 2016 and with discontinued operations. These one-time transactions include the net OEFC proceeds awarded for retroactive payments to Cardinal and the Ontario hydro facilities and corporate costs relating to the iCON III acquisition.

	Net Income			Adjusted EBITDA			AFFO		
	For the year ended		Change	For the year ended		Change	For the year ended		Change
	2016	2015	$	**2016**	2015	$	**2016**	2015	$
Power	**35,395**	(8,054)	43,449	**110,842**	72,130	38,712	**54,856**	29,195	25,661
Corporate	**(16,565)**	(20,626)	4,061	**(32,277)**	(14,825)	(17,452)	**(39,429)**	(25,989)	(13,440)
Total continuing operations	**18,830**	(28,680)	47,510	**78,565**	57,305	21,260	**15,427**	3,206	12,221
Add: Costs relating to the iCON III acquisition, including staff costs	**21,639**	—	21,639	**21,639**	—	21,639	**21,639**	—	21,639
Less: Net OEFC proceeds	**(23,527)**	—	(23,527)	**(23,527)**	—	(23,527)	**(23,527)**	—	(23,527)
Adjusted total continuing operations	**16,942**	(28,680)	45,622	**76,677**	57,305	19,372	**13,539**	3,206	10,333
Discontinued operations:									
Utilities – water	**(34,723)**	49,341	(84,064)	**39,908**	51,961	(12,053)	**660**	1,992	(1,332)
Utilities – district heating	**352**	5,531	(5,179)	**7,389**	6,035	1,354	**7,389**	6,035	1,354
Total discontinued operations	**(34,371)**	54,872	(89,243)	**47,297**	57,996	(10,699)	**8,049**	8,027	22
Total continuing operations	**18,830**	(28,680)	47,510	**78,565**	57,305	21,260	**15,427**	3,206	12,221
Total	**(15,541)**	26,192	(41,733)	**125,862**	115,301	10,561	**23,476**	11,233	12,243

(1) See page 7 for a reconciliation of Adjusted EBITDA and AFFO to GAAP measures.

Infrastructure: Power

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

For the year ended December 31, 2016	Gas	Wind (1)	Biomass (1)	Hydro (2)	Solar	Development & Corporate (3)	Total
Power generated (GWh)	**88.6**	**689.2**	**196.8**	**181.7**	**39.2**	**n/a**	**1,195.5**
Capacity factor	**6.8%**	**30.4%**	**92.6%**	**57.9%**	**22.3%**	**n/a**	**n.m.f**
Availability	**98.6%**	**96.2%**	**95.5%**	**99.1%**	**98.2%**	**n/a**	**n.m.f**
Revenue	54,293	76,935	4,683	20,551	16,478	—	172,940
Expenses	(24,873)	(15,221)	(10,911)	(4,803)	(1,139)	(2,763)	(59,710)
Interest income	2,143	171	6	187	8	16	2,531
Contractual settlements (4)	—	—	8,142	—	—	—	8,142
Distributions from equity accounted investments	—	1,886	—	—	—	—	1,886
Less: NCI	—	(15,020)	—	—	—	73	(14,947)
Adjusted EBITDA	31,563	48,751	1,920	15,935	15,347	(2,674)	110,842
Adjusted EBITDA of consolidated businesses with NCI	—	(16,380)	—	—	—	76	(16,304)
Distributions from businesses with NCI	—	7,192	—	—	—	130	7,322
Interest paid	(1,664)	(7,654)	—	(4,270)	(3,138)	(2,883)	(19,609)
Maintenance capital expenditures	(946)	(2,094)	(271)	(487)	(22)	—	(3,820)
Scheduled repayment of debt principal	(2,443)	(10,601)	—	(5,207)	(5,324)	—	(23,575)
AFFO	26,510	19,214	1,649	5,971	6,863	(5,351)	54,856

(1) For equity accounted investments, Adjusted EBITDA reflects management fees earned, interest income, as well as distributions paid to Capstone. Principal received on outstanding loans receivable is included in AFFO. The statistics for power generated, capacity factors and availability exclude those of Capstone's equity accounted investments.
(2) On August 23, 2016, BC Hydro exercised its right to terminate the existing electricity purchase agreement ("EPA") with Capstone's Sechelt hydro facility. The current Sechelt EPA will expire on February 28, 2017 and Capstone is in discussions for a new EPA with the relevant parties.
(3) Development & Corporate consists of costs related to Capstone's power development projects, as well as interest income and CPC's debt service costs.
(4) Contractual settlements are included in other gains and (losses) on the consolidated statement of income.

For the year ended December 31, 2015	Gas	Wind [1]	Biomass [1]	Hydro [2]	Solar	Development & Corporate [3]	Total
Power generated (GWh)	**66.5**	**554.4**	**183.1**	**142.1**	**38.1**	**n/a**	**984.2**
Capacity factor	**10.1%**	**28.1%**	**86.4%**	**45.4%**	**21.7%**	**n/a**	**n.m.f**
Availability	**85.6%**	**96.5%**	**95.5%**	**98.9%**	**97.7%**	**n/a**	**n.m.f**
Revenue	22,854	57,599	7,453	14,059	15,991	—	117,956
Expenses	(13,849)	(10,747)	(10,549)	(4,052)	(1,318)	(3,931)	(44,446)
Interest income	70	1,167	79	17	17	—	1,350
Contractual settlements [4]	(261)	—	4,035	—	—	—	3,774
Distributions from equity accounted investments	—	2,426	—	—	—	—	2,426
Less: NCI	—	(8,932)	—	—	—	2	(8,930)
Adjusted EBITDA	8,814	41,513	1,018	10,024	14,690	(3,929)	72,130
Adjusted EBITDA of consolidated businesses with NCI	—	(9,296)	—	—	—	(41)	(9,337)
Distributions from businesses with NCI	—	5,257	—	—	—	—	5,257
Principal from loans receivable	—	—	1,359	—	—	—	1,359
Interest paid	—	(8,525)	—	(4,485)	(4,639)	—	(17,649)
Maintenance capital expenditures	(670)	(1,298)	(652)	(898)	—	—	(3,518)
Scheduled repayment of debt principal	—	(9,563)	—	(4,705)	(4,779)	—	(19,047)
AFFO	8,144	18,088	1,725	(64)	5,272	(3,970)	29,195

(1) For equity accounted investments, Adjusted EBITDA reflects management fees earned, interest income, as well as distributions paid to Capstone. Principal received on outstanding loans receivable is included in AFFO. The statistics for power generated, capacity factors and availability exclude those of Capstone's equity accounted investments.
(2) On August 23, 2016, BC Hydro exercised its right to terminate the existing electricity purchase agreement ("EPA") with Capstone's Sechelt hydro facility. The current Sechelt EPA will expire on February 28, 2017 and Capstone is in discussions for a new EPA with the relevant parties.
(3) Development & Corporate consists of costs related to Capstone's power development projects, as well as interest income and CPC's debt service costs.
(4) Contractual settlements are included in other gains and (losses) on the consolidated statement of income.

The following table shows the significant changes in Adjusted EBITDA and AFFO from 2015:

Change	Explanations
23,527	Adjusted EBITDA contributions from OEFC proceeds awarded for retroactive payments to Cardinal and the Ontario hydro facilities.
8,156	Adjusted EBITDA contributions from the new wind facilities, consisting of Goulais which reached COD on May 21, 2015, and the GHG, Grey Highlands Clean and Snowy Ridge wind facilities, which reached COD in 2016.
2,891	Higher revenue from the hydro facilities (excluding the OEFC proceeds awarded) and Amherstburg due to higher production, resulting from strong hydrology and solar resources.
2,544	Lower operating expenses at Cardinal due to lower fuel and repair expenses (excluding payments to suppliers resulting from the OEFC proceeds awarded).
1,764	Higher revenue from the operating wind facilities (excluding new facilities) due to increased production and payments to curtail, reflecting stronger wind resource.
(1,316)	Higher operating expenses at SkyGen to repair a tower at Ferndale, net of $2,000 of interim insurance recoveries.
1,146	Various other changes.
38,712	Change in Adjusted EBITDA.
(6,967)	Change in Adjusted EBITDA attributable to non-controlling interests.
(6,990)	Higher debt service at Cardinal and CPC, due to the financings completed in 2016.
(1,000)	Higher maintenance capital expenditures on gearboxes at Erie Shores.
3,587	Higher distributions from Goulais, GHG and Snowy Ridge, which did not distribute in the prior periods.
(1,681)	Various other changes.
25,661	Change in AFFO.

Project development

The Grey Highlands ZEP[1], Ganaraska[1], Grey Highlands Clean and Snowy Ridge[1] wind development projects reached COD on schedule and within budget and began contributing to Capstone's operating results for a portion of 2016, since their respective COD's. As at December 31, 2016, Capstone's development pipeline included the rights to net 14 MW (gross 18 MW) summarized as follows:

Project	Expected COD	Expected Ownership Interest	Net Capacity	Counterparty	Expected PPA Expiry	Status
Settlers Landing [1]	2017	50%	4.0 MW	IESO	2037	Under construction
Riverhurst	2019	100%	10.0 MW	SaskPower	2039	Interconnection agreement [2]

(1) Capstone expects to share control of these projects.
(2) As at December 31, 2016, Capstone continues to progress the previously awarded PPA and interconnection agreement with SaskPower.

Seasonality

Overall, the results for Capstone's power segment fluctuate during the year because of seasonal factors that affect quarterly production of each facility. These factors include scheduled maintenance and environmental factors such as water flows, solar radiation, wind speeds and density, ambient temperature and humidity, which affect the amount of electricity generated. In aggregate, these factors have historically resulted in higher electricity production during the first and fourth quarters.

Corporate

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

	For the year ended		
	Dec 31, 2016	Dec 31, 2015	Change
Administrative expenses	**(19,876)**	(11,651)	(8,225)
Project development costs	**(12,492)**	(3,322)	(9,170)
Interest income	**91**	148	(57)
Adjusted EBITDA	**(32,277)**	(14,825)	(17,452)
Principal from loans receivable	**—**	83	(83)
Interest paid	**(2,282)**	(6,471)	4,189
Dividends paid on Capstone's preferred shares	**(3,426)**	(3,750)	324
Income taxes paid	**(1,347)**	(1,026)	(321)
Maintenance capital expenditures	**(97)**	—	(97)
AFFO	**(39,429)**	(25,989)	(13,440)

The following table shows the significant changes in Adjusted EBITDA and AFFO from 2015:

Change	Explanations
(10,154)	Higher professional fees attributable to the iCON III acquisition.
(9,761)	Higher staff costs related to the iCON III acquisition, including final long-term incentive plan payments and employee separation costs.
1,448	Lower professional fees attributable to 2015 acquisition due diligence costs.
1,015	Various other changes.
(17,452)	Change in Adjusted EBITDA.
3,095	Lower interest paid on convertible debentures following redemption on April 29, 2016.
1,094	Lower interest paid on the corporate facility following settlement on April 29, 2016.
(177)	Various other changes.
(13,440)	Change in AFFO.

Discontinued Operations:

For detail regarding the presentation and background of the utilities segments refer to page 3, "Basis of Presentation" and page 3, "Changes in the Business" in this MD&A.

Infrastructure: Utilities – Water

Bristol Water is a regulated water utility located in the UK and these non-GAAP results are included to December 15, 2016, when Capstone sold its 50% ownership interest.

	For the year ended		
	Dec 31, 2016	Dec 31, 2015	Change
Water supplied (megalitres)	**80,712**	83,151	(2,439)
Revenue	**191,315**	227,027	(35,712)
Operating expenses	**(111,664)**	(123,524)	11,860
Interest income	**232**	500	(268)
Adjusted EBITDA before NCI from discontinued operations	**79,883**	104,003	(24,120)
Less: NCI	**(39,975)**	(52,042)	12,067
Adjusted EBITDA from discontinued operations	**39,908**	51,961	(12,053)
Adjusted EBITDA of consolidated businesses with NCI	**(39,908)**	(51,961)	12,053
Dividends from businesses with NCI	**660**	1,992	(1,332)
AFFO from discontinued operations	**660**	1,992	(1,332)

The following table shows the significant changes in Adjusted EBITDA and AFFO from 2015:

Change	Explanations
(6,970)	Higher operating expenses reflecting accrued termination fees for the O&M agreement.
(5,586)	Lower revenue due to the decrease in regulated water tariffs.
(4,057)	Impact of foreign exchange.
(1,927)	Lower operating results due to the sale of Bristol Water on December 15, 2016.
3,025	Lower operating expenses for non-recurring recovery of past service costs on closing of the defined benefit pension plan in 2016.
2,905	Lower operating expenses due to 2015 non-recurring costs for restructuring and participating in the CMA process.
557	Various other changes.
(12,053)	Change in Adjusted EBITDA from discontinued operations.
(1,332)	Lower dividends received during 2016.
(1,332)	Change in AFFO from discontinued operations.

Infrastructure: Utilities – District Heating

Värmevärden is a district heating business located in Sweden. Capstone's investment includes shareholder loans receivable and a 33.3% ownership interest, which are presented as AHFS.

	For the year ended		
	Dec 31, 2016	Dec 31, 2015	Change
Heat and steam production (GWh)	**1,011**	985	26
Administrative expenses	**(588)**	(131)	(457)
Interest income	**3,810**	2,739	1,071
Dividends	**4,167**	3,427	740
Adjusted EBITDA and AFFO from discontinued operations	**7,389**	6,035	1,354

The following table shows the significant changes in Adjusted EBITDA and AFFO from 2015:

Change	Explanations
2,316	Higher interest income attributable to the new shareholder loan.
740	Higher dividends received.
(1,245)	Lower interest income on the pre-existing shareholder loan.
(457)	Higher professional fees attributable to Värmevärden's refinancing.
1,354	Change in Adjusted EBITDA and AFFO from discontinued operations.

FINANCIAL POSITION REVIEW

Overview

On April 29, 2016, Capstone was acquired by iCON III, refer to page 3 of "Changes in the Business" in this MD&A for details. Overall, iCON III's investment in Capstone consists of a combination of Class A shares and a multi-currency demand promissory note, which were issued in exchange for Class A shares of the Corporation. In addition, a new credit facility was put in place at CPC and the existing corporate credit facility was repaid.

The 2016 consolidated statement of financial position excludes balances relating to Capstone's 50% interest in Bristol Water as a result of the December 15, 2016 sale. In addition, Värmevärden's assets and liabilities are classified as held for sale because the Corporation expects to sell its ownership interest in 2017.

As at December 31, 2016, Capstone was in a $55,627 net current liabilities position, compared with $54,580 as at December 31, 2015. Excluding items that Capstone does not expect to fund from current assets, the working capital surplus of $41,075 sufficiently meets foreseeable current commitments.

As at December 31, 2016, Capstone and its subsidiaries complied with all debt covenants.

Liquidity

Working capital

As at	**Dec 31, 2016**	Dec 31, 2015
Power	**26,092**	(34,929)
Utilities – water (1)	**—**	26,239
Corporate	**(81,719)**	(45,890)
Net current assets (liabilities)	**(55,627)**	(54,580)
Corporate - promissory note payable (2), (4)	**96,702**	—
Corporate - 2016 convertible debentures (3), (4)	**—**	42,278
Working capital (4)	**41,075**	(12,302)

(1) 2015 balances include amounts relating to Bristol Water sold on December 15, 2016. Refer to page 3 "Changes in the Business" in this MD&A.
(2) The promissory note is held by Irving, the owner of the Corporation's Class A shares, and is classified as current due to the demand feature of the note. Capstone does not expect to settle the promissory note from the current liquidity. Refer to page 16 of "Financial position review" in this MD&A.
(3) The 2016 convertible debentures were redeemed as part of the iCON III acquisition.
(4) GAAP does not define working capital. To assist in understanding liquidity it is calculated as current assets less current liabilities adjusted for items Capstone does not expect to fund from current liquidity, including the promissory note payable in 2016 and the 2016 convertible debentures in 2015.

As at December 31, 2016, Capstone had a consolidated working capital surplus of $41,075 compared with a deficit of $12,302 at December 31, 2015. Capstone's working capital was $53,377 higher than December 31, 2015, due to increases of $61,021 for the power segment, and $18,595 for corporate, partially offset by a decrease of $26,239 due to the sale of Bristol Water on December 15, 2016.

The power segment working capital increase includes the $23,527 net increase in cash at Cardinal and the Ontario hydro facilities from the proceeds of the OEFC litigation, and a $21,127 reduction in accounts payable, as vendors were paid while construction of the wind projects progressed. In addition, there was higher restricted cash of $13,557 for new project debt reserves. These were offset by a $2,640 increase in the current portion of long-term debt. The long-term debt increase primarily includes $24,675 relating to the new CPC Credit Agreement and $9,953 for new credit facilities at Cardinal, GHG, Grey Highlands Clean and Snowy Ridge, partially offset by decreases from a $20,802 project debt extension and a $9,966 promissory note repayment at SkyGen, and scheduled repayments.

The corporate working capital increase primarily reflects the reclassification of Värmevärden's long term assets of $10,968 to current assets, as part of assets held for sale. The remaining difference relates to ongoing distributions from the power segment.

Cash and cash equivalents

As at	**Dec 31, 2016**	Dec 31, 2015
Power	**56,000**	43,705
Utilities – water [1]	**—**	25,495
Corporate [2]	**6,246**	5,192
Unrestricted cash and cash equivalents	**62,246**	74,392
Less: cash with access limitations		
Power	**(56,000)**	(22,056)
Utilities – water	**—**	(25,495)
Cash and cash equivalents available to corporate	**6,246**	26,841

(1) 2015 balances include amounts relating to Bristol Water sold on December 15, 2016. Refer to page 3 "Changes in the Business" in this MD&A .
(2) 2015 balances include amounts relating to Värmevärden, which was transferred to AHFS as at December 31, 2016. Refer to page 3 "Changes in the Business" in this MD&A.

Unrestricted cash represents funds available for operating activities, capital expenditures and future acquisitions. The unrestricted cash and cash equivalents decrease of $12,146, consists of a $25,495 reduction due to the sale of Bristol Water, partially offset by increases of $12,295 at the power segment and $1,054 at corporate.

Cash and cash equivalents available to corporate were net of power segment cash of $56,000, which is only periodically accessible by Capstone through distributions. The power segment's cash and cash equivalents are accessible to Capstone through distributions under the terms of the new CPC Credit Agreement, which allows for distributions to Capstone, subject to certain conditions. In turn, CPC receives distributions from its subsidiary power assets, which are subject to the terms of their project-specific credit agreements.

Restricted cash

Restricted cash decreased by $1,331 because of a $12,325 reduction due to the sale of Bristol Water and $2,563 of lower corporate restricted cash. These were partially offset by a $13,557 increase at the power segment. The power segment increase was primarily due to draws on the new construction facilities to develop the GHG, Grey Highlands Clean, Snowy Ridge and Settlers Landing wind projects and additional funds into the maintenance reserve for Cardinal's new debt facility, partially offset by releases of the remaining construction reserves at Goulais and Saint-Philémon.

Cash flow

Capstone's consolidated cash and cash equivalents decreased by $12,012 in 2016 compared with an increase of $15,550 in 2015. The components of the increase, as presented in the consolidated statement of cash flows, from both continuing and discontinued operations, are summarized as follows:

For the year ended	**Dec 31, 2016**	Dec 31, 2015
Operating activities	**121,189**	116,818
Investing activities	**(210,235)**	(137,445)
Financing activities (excluding dividends to shareholders)	**93,185**	64,438
Dividends paid to shareholders	**(9,887)**	(30,364)
Exchange difference on translation of discontinued operations	**(6,264)**	2,103
Change in cash and cash equivalents	**(12,012)**	15,550

Cash flow from operating activities were $4,371 higher in 2016 and $27,401 higher, excluding discontinued operations. The increase from continuing operations consists of $35,686 of higher cash flows from the power segment, partially offset by $8,285 of lower corporate cash flows. The increase in cash flows at the power segment primarily reflects the net OEFC proceeds awarded for retroactive payments to Cardinal and the Ontario hydro facilities, as well as contributions from the new wind facilities. Cash flows from corporate decreased primarily due to costs associated with iCON III's acquisition of Capstone. Cash flows from the discontinued operations decreased primarily due to lower revenue at Bristol Water, resulting from lower water tariffs, and unfavorable foreign currency translation.

Cash flow used in investing activities were $72,790 higher in 2016, and $119,706 higher, excluding discontinued operations. In 2016, cash used by the continuing operations primarily included power segment funding of $120,992 for the construction of projects under development (2015 - $93,973) and $15,536 (2015 - $24,511) to fund capital asset additions. Cash also decreased by $38,374 due to Capstone's sale of its 50% ownership interest in Bristol Water. In addition, restricted cash increased by $10,994 in 2016 (2015- $38,806 decrease in restricted cash) primarily due to debt draws on the construction facilities for the projects under development. The remaining significant 2015 cash flows include a $12,859 non-recurring loan settlement at Chapais and BFN.

For 2016, the significant cash flows from the discontinued operations included $49,624 (2015 - $75,911) used to fund capital asset additions at Bristol Water and $23,432 from Värmevärden as a partial settlement of the pre-existing shareholder loan receivable.

Cash flow from financing activities were $28,747 higher in 2016 and $27,438 higher, excluding discontinued operations. In 2016, cash from the continuing operations were higher primarily because of higher proceeds from debt draws of $122,488 due to the new debt raised for CPC, Cardinal, GHG, Grey Highlands Clean, Snowy Ridge and Settlers Landing. In addition, debt payments were $38,853 lower, primarily due to the repayment of Amherstburg's old project debt in 2015. These increases were partially offset by $53,836 paid to settle a portion of the promissory notes issued to Irving, $43,176 paid to redeem the 2016 convertible debentures and $35,089 lower convertible debenture advances for the GHG, Snowy Ridge and Settlers Landing wind projects in 2016.

Dividends paid to shareholders were $20,477 lower in 2016, due to the suspension of common share dividends because of the iCON III acquisition. Refer to page 3 of "Changes in the Business" in this MD&A.

Promissory Note Payable

On April 29, 2016, Capstone issued a $316,225 demand interest-free promissory note to Irving, the owner of the Corporation's Class A shares. Refer to page 3, "Changes in the Business" in this MD&A for details on the iCON III acquisition. IFRS requires the promissory note to be classified as a current liability because it is due on demand. On issuance, the promissory note consisted of three tranches: £106,000, 712,700 SEK, and $10,370 which are repayable at either the holder or borrower's option any time prior to the maturity date of December 31, 2021. On September 2, 2016, 160,000 SEK or $24,992 was repaid and on December 15, 2016, the £106,000 tranche was converted into $194,531 of Class A shares of the Corporation, decreasing the outstanding balance of the promissory note payable to $96,702 as at December 31, 2016.

Settlement of the remaining SEK tranche can occur in cash in the source currency or by transferring the equity securities of Värmevärden at an agreed upon fair market value. In addition, the promissory note is convertible at the holder's option into Class A shares of Capstone at fair value using the foreign exchange rate as at April 29, 2016.

Long-term Debt

Continuity of Capstone's long-term debt for the year ended was:

	Dec 31, 2015	Additions	Repayments & Redemptions	Foreign Exchange	Disposal of business (1)	Other	Dec 31, 2016
Long-term debt (2)							
Power (3), (4), (5), (6) and (7)	529,211	292,511	(39,262)	—	—	(240)	**782,220**
Utilities – water (1)	712,584	—	—	(132,379)	(580,205)	—	**—**
Corporate (5)	116,869	7,000	(126,804)	—	—	2,935	**—**
Deferred financing fees	(14,127)	(6,916)	1,259	758	1,603	1,194	**(16,229)**
	1,344,537	292,595	(164,807)	(131,621)	(578,602)	3,889	**765,991**
Less: current portion of long-term debt	(101,203)	(11,605)	50,751	—	—	(112)	**(62,169)**
	1,243,334	280,990	(114,056)	(131,621)	(578,602)	3,777	**703,822**

(1) 2015 balances include amounts relating to Bristol Water sold on December 15, 2016. Refer to page 3 "Changes in the Business" in this MD&A.
(2) Refer to page 3 "Changes in the Business" in this MD&A for details of Capstone's financing changes.
(3) Power completed financings of $85,000 for the CPC credit facilities and $70,000 of project debt at Cardinal and made draws of $137,511 for the construction of the GHG, Grey Highlands Clean, Snowy Ridge and Settlers Landing wind development projects.
(4) Power made $29,296 of scheduled debt payments. In addition, $9,966 of SkyGen promissory notes were repaid on February 8, 2016.
(5) On April 29, 2016, Capstone redeemed or converted the 2016 and 2017 convertible debentures and settled the corporate credit facility.
(6) On August 5, 2016, SkyGen and its existing lenders extended the term loan maturity date to February 2018.
(7) The power segment has a cumulative $45,370 utilized on its letter of credit facilities.

Power

As at December 31, 2016, the power segment's long-term debt consisted of $85,000 for the CPC credit facility and $697,220 of project debt. The current portion of long-term debt was $62,169, consisting of scheduled debt amortization. Capstone expects to repay the long-term debt from income generated by the power assets.

The new CPC credit facilities include $85,000 drawn on the non-revolving facility and $32,161 utilized on the revolving letter of credit facility. In addition, CPC has undrawn credit capacity of $5,000 as a source for future capital and development expenditures. The new CPC credit facilities mature on April 29, 2019 and bear interest at a variable rate plus an applicable margin. In addition, fixed annual minimum repayments are required, which are paid quarterly from excess cash as defined in the credit agreement.

CPC is subject to customary covenants, including specific limitations on leverage and interest coverage ratios. All of the power segment's project debt is non-recourse to Capstone, except for $9,000 of limited recourse guarantees provided to the lenders of the various wind projects.

Equity

Shareholders' equity comprised:

As at	**Dec 31, 2016**	Dec 31, 2015
Common shares (1)	**40,433**	715,989
Class B exchangeable units (1)	**—**	26,710
Preferred shares (2)	**72,020**	72,020
Share capital	**112,453**	814,719
Other equity items	**—**	9,284
Accumulated other comprehensive income (loss) (3)	**—**	51,151
Retained earnings (Deficit) (4), (5)	**2,800**	(366,579)
Equity to Capstone shareholders	**115,253**	508,575
Non-controlling interests (4)	**61,417**	273,505
Total shareholders' equity	**176,670**	782,080

(1) Refer to page 3 of "Changes in the Business" in this MD&A for details on the iCON III acquisition which closed on April 29, 2016.
(2) Capstone continues to publicly list its 3,000 Series A preferred shares on the Toronto Stock Exchange.
(3) 2015 balances include amounts relating to Bristol Water sold on December 15, 2016 (refer to page 3 "Changes in the Business" in this MD&A).
(4) Opening equity balances have been revised to reflect historical adjustments to non-controlling interests associated with Bristol Water, resulting in an increase to non-controlling interests of $11,960 as at December 31, 2014 and December 31, 2015, and a corresponding decrease to opening retained earnings (deficit).
(5) On April 29, 2016, the deficit balance of $389,178 was reclassified to share capital on the iCON III acquisition.

Contractual Obligations

As at December 31, 2016, Capstone had outstanding contractual obligations with amounts due as follows:

	Within one year	**One year to five years**	**Beyond five years**	**Total**
Long-term debt (1)	95,601	344,766	639,251	1,079,618
Promissory note payable	96,702	—	—	96,702
Operating leases	3,975	14,735	42,461	61,171
Asset retirement obligations	—	—	12,351	12,351
Purchase obligations	18,008	19,544	12,624	50,176
Total contractual obligations	**214,286**	**379,045**	**706,687**	**1,300,018**

(1) Long-term debt include principal and interest payments.

Long-term debt

- Long-term debt is discussed on page 16 "Long-term Debt" in this MD&A.

Promissory note payable

- The promissory note payable is discussed on page 16 "Promissory Note Payable" in this MD&A. The Promissory note is held by Irving, the owner of the Corporation's Class A shares, and is classified as current due to the demand feature of the note. Capstone does not expect to settle the promissory note from the current liquidity.

Operating leases

The following leases have been included in the table based on known minimum operating lease commitments:

- Capstone's operating wind facilities and wind development projects have entered into agreements for the use, or option to use, land in connection with the operation of existing and future wind farms. Payment under these agreements is typically a minimum amount with additional payments dependent on the amount of power generated by the wind facility. The agreements can be renewed and extend as far as 2061.
- Cardinal leases the site on which it is located from Ingredion Canada Incorporated ("Ingredion"). Under the lease, Cardinal pays monthly rent. The lease extends through 2034 and expires concurrently with the energy savings agreement between Ingredion and Cardinal.
- Amherstburg leases the land on which its operating facilities are located. The terms of the lease agreements extend to 2036.
- The Corporation has an operating lease for the corporate office ending in 2018, with an option to extend.

Capstone's operating lease commitments with no minimum operating lease commitments required were:

- Capstone has agreements with the Provinces of Ontario and British Columbia for the lease of certain lands and water rights necessary for the operation of its hydro power facilities. The payments under these agreements vary based on actual power production. The terms of the lease agreements extend to 2033 and 2042.

Asset retirement obligations

Commitments associated with our asset retirement obligations for Capstone's power infrastructure facilities are projected to occur principally over the next 25 years.

Purchase obligations

Capstone enters into contractual commitments in the normal course of business, either directly or through its subsidiaries. These contracts include capital commitments and operations and management agreements:

Capital commitments

- As part of Capstone's power development operations, Capstone enters various construction and purchase agreements. As at December 31, 2016, Capstone had commitments of $7,153 for construction and turbine supply agreements for the Settlers Landing project.
- Capstone plans to refurbish Whitecourt's steam turbine and boiler in 2017. This project is expected to cost approximately $14,000 and to extend the life of the facility by 20 years. As at December 31, 2016, Capstone had commitments of approximately$1,260.

Operations and maintenance ("O&M") agreements

- On October 15, 2016, Capstone renegotiated its O&M agreement with SunPower Energy Systems Canada to operate and maintain Amherstburg to internalize several O&M functions. The agreement expires October 15, 2018 with a one-year renewal option. Capstone has the ability to terminate the agreement during the term of the contract.
- On November 30, 2016, Cardinal entered into a maintenance contract with Siemens Canada Limited covering the gas turbine at the 15 MW cogeneration plant that Ingredion is building. The contract has a 6 year term.
- Capstone has several service and maintenance agreements covering the turbines in operation on various wind facilities. The agreements provide for scheduled and unscheduled maintenance and require annual minimum payments, subject to inflationary increases, as applicable.
- Capstone has an O&M agreement with Regional Power OPCO Inc. ("Regional") to operate and maintain the hydro power facilities. Regional is paid a monthly management fee and is eligible for an annual incentive fee. The agreement expires on November 30, 2021.

Other commitments

In addition to the commitments included in the table on page 17, Capstone has the following other commitments with no fixed minimum payments:

Power Purchase Agreements

A significant portion of the Corporation's electricity revenue is earned through long-term PPAs. The majority of these contracts include terms and conditions customary to the industry. For Cardinal's contract, the nature of commitments includes: electricity capacity; availability; and production targets. For the remaining facilities in the power segment, Capstone is not obligated to deliver electricity; however, in certain circumstances if a facility fails to meet the performance requirements under its respective PPA, liquidated damages may apply for development facilities, or the operating facilities' PPA may be terminated after a specified period of time.

Management services agreements

Capstone has agreements with all the partially owned wind facilities and development projects, including Glen Dhu, Fitzpatrick, Amherst, Saint-Philémon, Goulais, GHG, Snowy Ridge and Settlers Landing. For the operating projects, these agreements are primarily for the provision of management and administration services and are based on an agreed percentage of revenue. The development projects additionally include a development fee for the successful completion of the projects, which pays an agreed fee per MW on completion of development.

Wood waste supply agreement

The Whitecourt and Millar Western fuel supply agreement for wood waste includes sharing mechanisms regarding the price received for electricity sold by Whitecourt.

Energy savings agreement ("ESA")

In December 2014, Cardinal entered into an ESA with Ingredion which matures on December 31, 2034. Under the terms of the ESA, Cardinal is required to provide O&M services in respect of the 15 MW cogeneration plant that Ingredion is building, and supply steam and compressed air to Ingredion for the use of its manufacturing facility. Cardinal entered into a maintenance contract with Siemens Canada Limited in connection with the operation and maintenance of the 15 MW plant in order to support Cardinal's satisfaction of the O&M terms of the ESA.

Guarantees

Capstone has provided limited recourse guarantees on the project debt of certain wind projects totalling $9,000 as at December 31, 2016. Capstone has also provided a guarantee to the former 25% owner of the Grey Highlands Clean wind facility which provides future contractual payments based on operational performance up to an aggregate amount of $4,614. The guarantee terminates when the final payment is made on March 21, 2021.

There have been no other significant changes to the specified contractual obligations that are outside the ordinary course of business, aside from the iCON III acquisition and related changes. Refer to page 3 of "Changes in the Business" in this MD&A for details. Capstone is not engaged in any off-balance sheet financing transactions.

Equity Accounted Investments

Equity accounted investments decreased by $928 mainly because of distributions of $1,886 from Glen Dhu, offset by $958 for Capstone's share of equity accounted comprehensive income.

Capstone's significant equity accounted investments were:

Name of entity	Principal place of business and country of incorporation	Ownership at December 31, 2016	2015	Principal activity
Värmevärden AB ("Värmevärden")(1)	Sweden	33.3%	33.3%	District heating
Glen Dhu Wind Energy Limited Partnership ("Glen Dhu")(2)	Canada	49%	49%	Power generation
Fitzpatrick Mountain Wind Energy Inc. ("Fitzpatrick")	Canada	50%	50%	Power generation

(1) 2015 balance for Värmevärden was nil as a result of a cumulative excess of dividends and equity accounted losses above the carrying value. Capstone has $3,210 of cumulative unrecognized losses. For 2016, Capstone had $3,071 of unrecognized losses and $642 in 2015. In 2016, this investment was transferred to assets held for sale (refer to note 3b(ii)).
(2) Under the limited partnership agreement, Capstone has the option to acquire an additional 1% interest from November 2017 to November 2018 at a price based on a predetermined calculation.

Capital Asset Expenditure Program

Capstone incurred $168,411 of capital asset expenditures during 2016, which included $67,864 of additions to capital assets and $100,547 of additions to projects under development. The capital asset expenditures by operating segment were:

	For the year ended Dec 31, 2016	Dec 31, 2015
Power	**114,719**	141,447
Utilities – water	**53,590**	69,738
Corporate	**102**	—
	168,411	211,185

In 2016, capital asset expenditures for the power segment mainly related to additions of $108,505 for the development and construction of GHG, Grey Highlands Clean, Snowy Ridge and Settlers Landing. The majority of the remaining difference related to capital expenditures of $4,406 at Erie Shores and Cardinal. In 2015, capital asset expenditures in the power segment of $111,406 were primarily related to developing the Saint-Philémon, Goulais, GHG, Grey Highlands Clean, Snowy Ridge and Settlers Landing wind projects. In addition, Cardinal invested $24,640 to prepare the plant to operate as a cycling facility.

Capital expenditures for the utilities – water segment, included both growth and maintenance activities as planned in Bristol Water's regulatory capital expenditure program. On December 15, 2016, Capstone sold its 50% interest in Bristol Water.

Income Taxes

In 2016, the current income tax expense was $1,658 (2015 - $74 recovery), all related to the Canadian operations. The current income taxes primarily relate to amounts for a shortfall of Canadian renewable and conservation expenses arising from flow through shares issued by a previously acquired business.

Deferred income tax assets and liabilities are recognized on Capstone's consolidated statement of financial position based on temporary differences between the accounting and tax bases of existing assets and liabilities. Deferred income tax assets and liabilities are calculated on a net basis where there is a legal right of offset within the same tax jurisdictions. Capstone's total deferred income tax assets of $14,750 (December 31, 2015 - $220) were due to a temporary difference attributable to the cost base of the shares of Värmevärden.

Deferred income tax liabilities of $72,673 (December 31, 2015 - $204,125) represent for Capstone's Canadian operations (December 31, 2015 - $64,399) and nil (December 31, 2015 - $139,506) for Bristol Water. Deferred income tax liabilities primarily relate to the differences between the amortization of intangible and capital assets for tax and accounting purposes.

In 2016, Capstone's net deferred income tax liability decreased by $145,982. The net liability decreased primarily due to derecognition of the Bristol Water's net deferred income tax liability upon sale of Capstone's interest (refer to page 3 "Changes in the Business" in this MD&A).

DERIVATIVE FINANCIAL INSTRUMENTS

Capstone has exposure to market, credit and liquidity risks from its use of financial instruments as described in note 8 financial Instruments and note 9 financial risk management in the consolidated financial statements as at and for the year ended December 31, 2016. These notes contain further details on the implicit risks and valuation methodology employed for Capstone's financial instruments.

To manage the certain financial risks inherent in the business, Capstone enters into derivative contracts primarily to mitigate the economic impact of the fluctuations in interest rates, foreign exchange rates and gas commodity prices for Cardinal in 2015. The fair values of these contracts, as well as the Whitecourt embedded derivative included in the consolidated statement of financial position, were:

As at	**Dec 31, 2016**	Dec 31, 2015
Derivative contract assets	**18,526**	166
Derivative contract liabilities	**(3,572)**	(6,540)
Net derivative contract assets (liabilities)	**14,954**	(6,374)

Net derivative contracts increased by $21,328 from December 31, 2015 to a net asset, primarily due to a gain on derivatives in net income from continuing operations of $27,480 and the disposal of Bristol Water's $2,271 interest rate swap liability. These increases were partially offset by contractual settlement payments of $8,142 received from Millar Western. The remaining difference relates to the settlement of the foreign currency option contracts.

In 2016, Cardinal, GHG, Grey Highlands Clean, Snowy Ridge and Settlers Landing entered into swap agreements to convert floating interest rate obligations under the respective credit agreements to a fixed rate. These swaps are effective for the remaining amortization periods, respectively.

The gains (losses) attributable to fair value changes of derivatives in the consolidated statements of income and comprehensive income comprised:

For the year ended	**Dec 31, 2016**	Dec 31, 2015
Whitecourt embedded derivative	**24,964**	886
Interest rate swap contracts	**2,401**	(3,659)
Foreign currency option contracts	**115**	(1,552)
Cardinal gas purchase agreement	**—**	4,364
Cardinal embedded derivative	**—**	169
Forward gas sale and purchase contracts	**—**	(3,330)
Gains (losses) on derivatives in net income from continuing operations	**27,480**	(3,122)
Interest rate swap contracts in other comprehensive income from discontinued operations	**(608)**	553
Gains (losses) on derivatives in total comprehensive income	**26,872**	(2,569)

The gain on derivatives was primarily attributable to increases in the Whitecourt embedded derivative, mainly because of significantly lower estimated forward Alberta power pool prices since December 31, 2015. In addition, the interest rate swap contracts and settlement of the foreign currency contracts contributed to the gains. The gains from the interest rate swaps primarily reflect higher long-term interest rates since inception.

FOREIGN EXCHANGE

Capstone recorded a $397 foreign exchange gain in 2016 compared with a $193 gain in 2015. The 2016 foreign exchange gain was primarily due to $408 realized on the partial settlement of the SEK tranche of the promissory note held by Irving.

RISKS AND UNCERTAINTIES

Introduction

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

The Corporation recognizes the importance and benefits of timely identification, assessment and management of risks that may impact the Corporation's ability to achieve its strategic and financial objectives. In this respect, the Corporation is committed to prudent risk management practices within the context of an enterprise risk management ("ERM") framework. The Corporation maintains a registry of risks that is reviewed by management and the Board of Directors at least quarterly. The Corporation also undertakes an annual comprehensive review of its ERM framework and practices to continuously improve its risk management practices.

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

Risk Management Principles and Governance

The Corporation's ERM framework is based on five core principles which establish the culture and tone that guide risk management decisions. Risk management is everyone's responsibility, about decision-making, embedded within existing management routines, about people and culture, and specific to each business unit. The Corporation's interpretation of the ERM framework includes the following hierarchy of responsibilities:

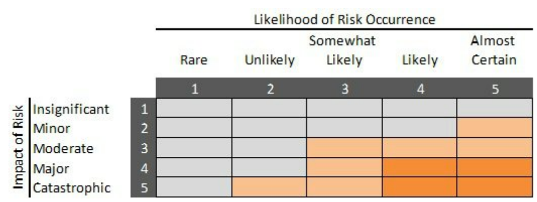
- **Board of Directors and Audit Committee** have overall governance responsibility for setting and overseeing management's implementation of the risk management policy.
- **Internal Audit** reports to the Audit Committee and is responsible for reviewing management's practices to manage risks in specific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

Risk Management Processes

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

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

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



Managing Risk

The Corporation requires that risk assessments (which encompass operational, strategic, financial and legal and regulatory risks) be performed at the power segment and at the corporate level.

In addition to these risks, there are numerous other risk factors, many of which are beyond the Corporation's control and the effects of which can be difficult to predict, that could be material to investors or cause the Corporation's results to differ significantly from its plans, objectives and estimates. For a more comprehensive list and description of the risks affecting the Corporation refer to the “Risk Factor” section of the Corporation's most recently filed Annual Information Form, as supplemented by risk factors contained in any of the following documents filed by the Corporation with securities commissions or similar authorities in Canada after the date of this annual MD&A, which are available on SEDAR at www.sedar.com: material change reports; business acquisition reports; interim financial statements; and interim management's discussion and analysis.

Risks Related to the Corporation and its Businesses

Risks that have materially affected the Corporation's financial statements, or that have a reasonable likelihood of affecting them materially in the future, are presented in the table below. Risks specific to Capstone's power segment, as well as at the corporate-level, are included. The table excludes risks related to the utilities segments because the risks are not considered to have a material financial impact to Capstone's consolidated results. This is because Capstone sold its interest in the Water segment in 2016 and the District heating segment accounts for its investment using the equity method, which is carried at a nil value.

Therefore changes from risks disclosed in the MD&A for the year-ended December 31, 2015 predominately reflect changes to the strategic direction of the Corporation, since the acquisition by iCON III, to focus on the power segment.

Risk and Description	Impact	Monitoring and Mitigation
Operational Risks		
Succession and human resources retention risks concern the ability to replace senior management and attract, retain and motivate key staff.	Inability to retain or replace key staff or senior management could prevent or delay Capstone from executing its business strategy, thereby causing Capstone to fall short of its financial forecasts.	Capstone mitigates this risk by providing competitive compensation, as well as career and development opportunities to its employees.
PPA renewal risk concerns the ability to recontract expiring PPA's on economically feasible terms and failing to align with the useful lives of the power facilities.	If Capstone is unsuccessful or delayed in recontracting its expiring PPAs, it would cause Capstone to fall short of its financial forecasts, as revenue short-falls could result from operating in merchant or other markets.	Capstone mitigates by starting negotiations with counter-party(ies), utilizing external advisors where applicable, and working to ensure the broader benefits of the facility are considered in the process. In addition, company-wide mitigation is provided by maintaining a diversified portfolio to reduce the impact of any one facility to the overall consolidated financial results.
Production resources risk concerns the dependence of power production on adequate resources such as wind, sunlight and water flow.	Inadequate wind, sunlight or water flow leads to lower power production which results in lower revenues.	Capstone maintains facilities in quality condition to maximize availability for power generation when renewable resources are available and strongest. Capstone also seeks to diversify its portfolio of businesses to mitigate the dependency on a single resource or geography.
Development and capital delivery risks concern the construction of new power generation facilities in line with the requirements of awarded PPAs and refurbishment of existing facilities to maintain operations.	Delays and cost overruns in the construction of new facilities or refurbishments could lead to lower cash flows, and where PPA requirements are not met, cancellation of the PPA resulting in lost revenue and impairment of any capitalized costs for the facility.	Capstone has professional project management processes and uses experienced contractors and advisors. Capstone contracts include a combination of incentives, liquidated damages, or fixed-pricing to align suppliers interests to achieve the commercial operation dates.
Strategic Risks		
Business development risk concerns the ability to source and complete attractive investment opportunities that support Capstone's growth initiatives within the power segment.	Inability to source and execute attractive growth opportunities may lead to lower long-term cash flow as businesses operating under finite term contracts experience uncertainty about their longer term cash flow potential.	Management annually reviews and updates strategy with the Board of Directors to determine a mandate. Capstone actively monitors the power segment for opportunities using internal resources and external advisers.
Financial Risks		
Expense management risk concerns unexpected non-recoverable increases in operating and administrative costs.	Unanticipated increases in costs could result in lower earnings and cash flow.	Capstone attempts to mitigate this risk by seeking high operating margin businesses that operate under long-term, fixed-price contracts and have contractual frameworks that accommodate cost escalation.
Forecasting Risk concerns the accuracy of projections for results from operations due to error or unpredictable economic, market and specific business factors.	Volatility of financial forecasts increases liquidity reserve requirements to pay expenses, reducing cash flows.	Capstone targets businesses which have inherently predictable financial results from operations and requires periodic external review of its financial models to track and forecast future cash flows. Capstone maintains adequate levels of liquidity to manage during periods of uncertainty.
Taxation risk concerns higher income and other taxes attributable to adverse legislation changes, including tax rate increases, or interpretations by tax authorities on audit. As a multi-national corporation, Capstone is exposed to global taxation initiatives.	Higher taxation results in both lower income and cash flow available.	Capstone minimizes exposures to adverse tax rulings by choosing structures that adhere to taxation regulations, are commonly used in practice and wherever practical supported by opinions of external advisers. In addition, Capstone monitors the trends and policies of taxation authorities in the OECD jurisdictions where its businesses operate.
Foreign currency risk concerns volatility of the Canadian dollar against currencies from countries where Capstone entities either operate or make purchases. For 2016, this primarily reflects Capstone's interest in Värmevärden and former interest in Bristol Water.	In the absence of mitigation, appreciation of the Canadian dollar could result in lower Canadian-dollar equivalent cash flows and earnings from foreign operations to Capstone, presenting a risk at the corporate-level.	Capstone's exposure to its interests in foreign businesses is significantly hedged by the foreign denominated promissory notes reducing the risk to cash flows between Canada and the Corporation's foreign jurisdictions. In addition, this was further reduced on December 15, 2016 when Capstone sold its ownership interest in Bristol Water.
Financing risk concerns the ability to access timely and cost effective debt or equity to support the development and construction of power facilities, business acquisitions and replace maturing debt.	Inability to access cost-effective debt or equity could result in higher interest costs, lower cash flow or liquidity difficulties. For an acquisition, this could also prevent Capstone from realizing a growth opportunity.	Capstone maintains relationships with multiple financial institutions that have the resources to provide some or all financing requirements. In addition, most existing project debt amortizes over the term of the PPAs to minimize refinancing requirements and debt maturities are staggered. Capstone endeavours to secure committed financing prior to making offers to acquire businesses.

Risk and Description	Impact	Monitoring and Mitigation
Legal and Regulatory Risks		
Permit compliance risk concerns the ability to operate Capstone's power businesses within the allowances of an increasing number of requirements.	Failure to comply with permits can impact Capstone's power contracts, debt facilities, and other agreements, which can lead to lower cash flow from the existing businesses by reducing revenue or increasing costs to restore the ability to operate at capacity.	Capstone maintains its permits and licenses, works with knowledgeable contractors and responds to adverse findings promptly to minimize the impact.

ENVIRONMENTAL, HEALTH AND SAFETY REGULATION

Capstone's power facilities (collectively the "Facilities") hold all material permits and approvals required for their construction and operation, depending on project phase and operational status. All assets are managed to comply with health, safety and environmental ("HSE") laws in addition to Capstone's corporate and facility-specific HSE policies.

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

- Commitment to identify, eliminate, mitigate and manage health and safety issues for all workers, visitors, nearby landowners and other personnel at each of the Facilities;
- Regulatory compliance of emissions and discharges related to air, noise, water, and sewage.
- Proper storage, handling, use, transportation and distribution of dangerous goods and hazardous and residual materials including the prevention of releases of these materials to the environment;
- Management of construction and operation related permits to ensure compliance with all HSE regulations; and
- Protection of the natural and built environment including environmentally sensitive features and wildlife.

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

Climate Change, Greenhouse Gases and Policy Changes

Due to the emission of greenhouse gases, such as carbon dioxide ("CO2") and nitrous oxides ("NOx), some of the Facilities, particularly the Cardinal and Whitecourt facilities, have an ongoing operational impact on the environment. All Facilities comply in all material respects with the applicable Canadian, Swedish and European Union legislation and guidelines regarding greenhouse gases and other emissions. Capstone mitigates the potential impact of future changes to environmental legislation and guidelines by remaining diligent in the operation of the Facilities, including stringent policies and procedures to prevent the contravention of permits and approvals.

There are a number of proposals in respect of changes to climate change legislation and guidelines (including proposed limits on greenhouse gas emissions) in various stages of development, in various jurisdictions. The Canadian federal government ratified the Paris Accord, negotiated under the United Nations Framework Convention on Climate Change, in the fall of 2016. Pursuant to the Paris Accord, the parties committed, in a non-binding manner, to accelerate actions and investments needed to limit global average temperatures to below 2°C above pre-industrial levels and to pursue efforts to limit the increase to 1.5°C.

The federal government and each of the Provinces, with the exception of Saskatchewan, jointly issued the Pan-Canadian Framework on Clean Growth and Climate Change ("Framework"). The Framework is the blueprint by which the federal government and the provinces will attempt to meet their previously agreed-upon target of a 30% reduction in greenhouse gas emissions from 2005 levels by 2030. Elements of the Framework include all provincial jurisdictions being required to price carbon by 2018. However, provincial jurisdictions have the flexibility to implement a variety of carbon regimes ranging from price-based regimes such as a carbon tax, to performance-based emissions regimes such as cap and trade. For jurisdictions with a price-based regime, the price should at least start at $10/tonne in 2018 and rise by $10/tonne each year to $50/tonne by 2022.

The Alberta Climate Leadership Act was proclaimed in force as of January 1, 2017. It imposes a carbon levy on certain fuels, such as natural gas and oil, imported into the Province or sold in the Province. This legislation will not have a direct effect on renewable generation including the Whitecourt facility.

The Ontario cap-and-trade regime came into force on January 1, 2017 under the Climate Change Mitigation and Low-carbon Economy Act. Under the regime, a participating facility, which does not include any of the Capstone Facilities, can only emit as much carbon as it has allowances for. The total number of allowances for all participating facilities (i.e. the cap) will steadily decline each year during the first compliance period effective from January 1, 2017 until December 31, 2020. The regime will be updated in the course of 2017 to include provisions addressing offset credits and early reduction credits, which may allow for Capstone's involvement as a voluntary market participant.

Cardinal

There is currently no restriction on the amount of CO_2 that the Cardinal facility may emit, although the facility is required to report its CO_2 emissions under various federal and provincial regulations. Environmental regulations in Ontario also provide for, among other things, the reporting, allocation and retirement of NOx emissions. NOx emissions from Cardinal's generating equipment are lower than the levels mandated by legislation.

Whitecourt

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

Hydro Facilities

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

Wind Farms

Capstone's wind farms do not produce greenhouse gases, but are subject to regulations and/or approvals relating to the natural and built environment.

Amherstburg Solar Park

The operation of Amherstburg does not generate greenhouse gases.

Värmevärden

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

Bristol Water

Bristol Water complied in all material respects with the applicable UK legislation and guidelines regarding greenhouse gases and other emissions. Subsequent to Bristol Water's sale on December 15, 2016, Capstone is no longer be subject to UK legislation.

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

RELATED PARTY TRANSACTIONS

Capstone's 2016 related party transactions and balances are primarily comprised of the sale of Bristol Water and promissory note payable to Irving, management fees paid by Capstone's equity accounted investments and compensation to key management.

Sale of Bristol Water and Promissory Note

On December 15, 2016, Capstone's 50% ownership interest in Bristol Water was sold to iCON III Bristol Limited, a related party subsidiary of Capstone's ultimate parent entity, iCON III. Capstone's shares of CSE Water UK Limited were sold for an agreed upon amount of £115,690. The transaction was reviewed and approved by a special committee of independent directors of the Corporation (the "Special Committee"). In the course of its deliberations, the Special Committee retained legal counsel and engaged a valuation advisor. The valuation advisor delivered a fairness opinion to the Special Committee to the effect that the price received by the Corporation in the transaction is fair, from a financial point of view, to the Corporation. As a result, the GBP tranche of the promissory note payable held by Irving was converted into Class A shares of Capstone, leaving a $96,702 balance as at December 31, 2016. In addition, no balances remain outstanding with iCON III Bristol Limited.

Management Fees Paid

Management fees earned from Capstone's equity accounted investments are reported in the consolidated statements of income as revenue. During 2016, Capstone earned fees of $406, primarily related to the management of Glen Dhu and Fitzpatrick. In addition, Bristol Water has a joint venture interest in a shared billing services entity, providing meter reading, billing and debt recovery and customer contract management services to Bristol Water and its partner, under a cost sharing arrangement. Up to its sale on December 15, 2016, Bristol Water incurred charges of $5,909 for management charges and shared expenditures.

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, short-term employee benefits and termination benefits. Eligible directors and senior management of the Corporation also received forms of stock-based compensation, prior to April 29, 2016, before the Corporation was acquired by iCON. Key management compensation is described in note 26 related party transactions in the consolidated financial statements for the year ended December 31, 2016.

Linking Management Compensation to Performance

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

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

Financial performance targets are set each year to provide management with an incentive to exceed annual budgeted financial results and are therefore aligned with shareholder interests.

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

	Salary	**Short-term incentive plan ("STIP")**	**Long-term incentive plan ("LTIP")**
Description	Salary is a fixed component of compensation that provides income certainty by establishing a base level of compensation for executives fulfilling their roles and responsibilities.	The STIP provides the possibility of an additional annual cash award based on the achievement of corporate and individual goals.	Capstone is evaluating options available to motivate and retain executives on a long-term basis. The pre-existing plan was settled on April 29, 2016, when Capstone's common shares were acquired by iCON.
Purpose	To attract and retain qualified executives.	To motivate, attract and retain qualified executives.	To reward long-term performance and align interests of executives with security holders.
Link to performance	No direct link.	A significant portion of this award is based on actual business performance against Capstone's non-GAAP performance measures, Adjusted EBITDA and AFFO.	Capstone is evaluating options.

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

SUMMARY OF QUARTERLY RESULTS

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

	2016				2015			
	Q4	**Q3**	**Q2**	**Q1**	Q4	Q3	Q2	Q1
Revenue (1)	**40,128**	**66,145**	**32,492**	**34,175**	32,794	27,063	29,349	28,750
Net income (loss) (2), (3)	**18,407**	**(9,488)**	**(18,170)**	**(4,507)**	8,885	301	(9,273)	222
Adjusted EBITDA (3)	**31,424**	**52,308**	**12,201**	**29,929**	30,327	26,657	28,768	29,549
AFFO (3)	**5,160**	**25,674**	**(9,616)**	**2,257**	1,888	1,949	932	6,464
Preferred dividends	**613**	**938**	**938**	**938**	938	938	938	938

(1) Comparative figures for revenue have been adjusted to remove amounts from discontinued operations.
(2) Net income (loss) attributable to the common shareholders of Capstone, which excludes non-controlling interests.
(3) Results include continuing operations and discontinued operations for all periods.

FOURTH QUARTER 2016 HIGHLIGHTS

	Three months ended	
	Dec 31, 2016	Dec 31, 2015
Revenue	**40,128**	32,794
Operating expenses	**(11,684)**	(10,146)
Administrative expenses	**(2,945)**	(3,548)
Project development costs	**(672)**	(2,808)
Equity accounted income	**747**	763
Interest income	**51**	363
Other gains and (losses), net	**11,007**	(552)
Foreign exchange gain (loss)	**(46)**	44
Earnings before interest, taxes, depreciation and amortization	**36,586**	16,910
Interest expense	**(8,645)**	(8,689)
Depreciation of capital assets	**(18,080)**	(9,708)
Amortization of intangible assets	**(2,573)**	(2,379)
Earnings (loss) before income taxes	**7,288**	(3,866)
Income tax recovery (expense)		
Current	**(1,637)**	(8)
Deferred	**14,236**	50
Total income tax recovery (expense)	**12,599**	42
Net income (loss) from continuing operations	**19,887**	(3,824)
Net income (loss) from discontinued operations, net of tax	**1,708**	25,113
Net income (loss)	**21,595**	21,289
Net income (loss) attributable to:		
Shareholders of Capstone	**18,407**	8,885
Non-controlling interest	**3,188**	12,404
	21,595	21,289

Revenue increased by $7,334, or 22%, due to higher power segment revenue mainly from the new wind facilities.

Expenses decreased by $1,201, or 7%.

- **Operating expenses** increased by $1,538, due to higher power segment expenses mainly from the new wind facilities and higher expenses at the hydro facilities related to the Sechelt re-contracting.
- **Administrative expenses** decreased by $603 primarily due to lower staff costs.
- **Project development costs** decreased by $2,136, mainly due to costs for the strategic review in 2015.

Other gains and (losses) increased by $11,559, or 2,094%, to a net gain of $11,007 in 2016. The increase is primarily due to gains of $7,285 on new interest rate swaps and $3,905 on the existing GHG interest rate swap.

Depreciation of capital assets increased by $8,372, or 86.2%, due to the wind facilities.

Income taxes were a $12,599 recovery in 2016 compared with a $42 recovery in 2015 from the Canadian operations. For 2016, the income tax expense consists of $1,637 of current income taxes and a deferred income tax recovery of$14,236. The current income taxes primarily relate to amounts for a shortfall of Canadian renewable and conservation expenses arising from flow through shares issued by a previously acquired business. The deferred income taxes primarily relate to differences in accounting and tax treatments for depreciation of capital assets and intangibles, as well as the recognition of $14,750 relating to the cost base of Värmevärden's shares.

Depreciation of capital assets increased by $8,372, or 86.2%, due to higher power segment depreciation mainly from the new wind facilities.

Net income (loss) from discontinued operations decreased by $23,405, or 93%, primarily due to a deferred income tax recovery at Bristol Water in 2015 of $10,585 due to a decrease in the substantively enacted rate at Bristol Water from 20% to 17%. In addition, lower Bristol Water EBITDA of $7,195 was due to the sale on December 15, 2016.

ACCOUNTING POLICIES AND INTERNAL CONTROLS

Significant Changes in Accounting Standards

The consolidated financial statements have been prepared in accordance with IFRS and are consistent with policies for the year ended December 31, 2015. Refer to note 2 to the December 31, 2016 consolidated financial statements for a summary of significant accounting policies.

Future Accounting Changes

The IASB has announced that a number of new standards and amendments will be effective for future reporting periods; these have not yet been adopted by the Corporation. None of them are expected to have a significant effect on the consolidated financial statements of Capstone, except the following standards that Capstone continues to assess as follows:

Title of the New IFRS (1)
• **IFRS 15**, Revenue from Contracts with Customers [Effective: Jan 1, 2018]
• **IFRS 9**, Financial Instruments [Effective: Jan 1, 2018]
• **IFRS 16**, Leases [Effective: Jan 1, 2019]

(1) See note 2 to the consolidated financial statements for the year ended December 31, 2016 for further detail about the nature of these future accounting changes.

Accounting Estimates

The consolidated financial statements require the use of estimates and judgment in reporting assets, liabilities, revenues, expenses and contingencies. Capstone's significant accounting estimates and judgments used in the preparation of the consolidated financial statements were:

Area of Significance	Critical Estimates and Judgments
Capital assets, projects under development and intangible assets:	
• Purchase price allocations	• Initial fair value of net assets.
• Depreciation on capital assets	• Estimated useful lives and residual value.
• Amortization on intangible assets	• Estimated useful lives.
• Asset retirement obligations	• Expected settlement date, amount and discount rate.
• Impairment assessments of capital assets, projects under development and intangibles assets	• Future cash flows and discount rate.
Deferred income taxes	• Timing of reversal of temporary differences, tax rates and current and future taxable income.
Financial instruments and fair value measurements	• Forward Alberta power pool prices, volatility, credit spreads, cost and inflation escalators and fuel supply volumes and electricity sales.
Accounting for investments in non-wholly owned subsidiaries	• Determine how relevant activities are directed (either through voting rights or contracts); • Determine if Capstone has substantive or protective rights; and • Determine Capstone's ability to influence returns.

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

Internal Controls over Financial Reporting and Disclosure Controls and Procedures

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

Capstone's management, under the supervision of and with the participation of the CEO and CFO, has designed internal controls over financial reporting, as defined in NI 52-109. The purpose of internal controls over financial reporting is to provide reasonable assurance regarding the reliability of Capstone's financial reporting, in accordance with IFRS, focusing in particular on controls over information contained in the audited annual and unaudited interim consolidated financial statements. The internal controls are not expected to prevent and detect all misstatements due to error or fraud. Consistent with the prior year, Capstone uses the 2013 version of Committee of Sponsoring Organizations (COSO) internal control framework.

The CEO and CFO have concluded that Capstone's disclosure controls and procedures were effective as at December 31, 2016 to ensure that information required to be disclosed in reports that Capstone files or submits under Canadian securities legislation is recorded, processed, summarized and reported within applicable time periods.

As at December 31, 2016, Capstone's management had assessed the effectiveness of Capstone's internal control over financial reporting using the criteria set forth by COSO of the Treadway Commission in Internal Control – Integrated Framework (2013). Based on this assessment, management has determined that Capstone's internal control over financial reporting was effective as at December 31, 2016.