

# MESSAGE TO SHAREHOLDERS

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## Dear Fellow Shareholders,

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

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

## Priorities Addressed

### De-risking our balance sheet

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

### Establishing a new dividend

In June, we established a new dividend level of \$0.30 per common share on an annualized basis. Our new dividend reflects our view on the long-term cash flow profile of our current

portfolio following the expiry of Cardinal's power purchase agreement at the end of 2014. We have also gained the flexibility to retain more cash to reinvest in new businesses that will improve the value, quality and cash-generating potential of our portfolio.

### Preserving and enhancing the value of our businesses

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

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

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

## Continuing to build our platform for growth and diversification

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

## Our Challenges

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



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

## Our Strengths

### Active Management

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

### Disciplined Approach

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

### Exceptional Capabilities

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

## Our Values

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

### Integrity

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

### Commitment

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

### Fulfillment for our People

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

### Teamwork

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

### Highest Standards

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

### Strive for Profitability

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

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

### Our Opportunities

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

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

Our strategy to unearth new infrastructure investment opportunities includes:

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

# “SECURING A NEW CONTRACT FOR CARDINAL REMAINS OUR TOP PRIORITY FOR 2013.”

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

## Creating Value

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

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

- ▶ An exceptionally high quality infrastructure portfolio of contractually defined, income-producing power facilities as well as utilities that deliver long-term, inflation-linked cash flow.

- ▶ A significantly strengthened balance sheet and a long-term dividend payout ratio target of approximately 70% to 80%, which together provide a solid foundation to support our company's continuing growth.
- ▶ And a top-notch team with more than six decades of combined expertise in infrastructure asset and investment management, which represents a tremendous competitive advantage for Capstone.

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

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

Sincerely,



**MICHAEL BERNSTEIN**  
President and Chief Executive Officer



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