## MANAGEMENT'S DISCUSSION AND ANALYSIS

### GENERAL

TransAlta Renewables Inc. (“the Company”) was incorporated on May 28, 2013, and issued one Common Share to TransAlta Corporation (“TransAlta”) for a subscription price of $10.00. As such, it has not completed its first fiscal year and has had limited activity. Accordingly, this Management's Discussion and Analysis (“MD&A”) has been prepared for the Company and should be read in conjunction with the audited Statement of Financial Position of the Company as at June 30, 2013. The financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”). All tabular amounts in the following discussion are in thousands of Canadian dollars unless otherwise noted. This MD&A is dated Aug. 8, 2013.

The Company's objective is to: (i) create stable, consistent returns for investors through the ownership of contracted renewable power generation assets that provide stable cash flow through long-term Power Purchase Agreements (“PPAs”) with creditworthy counterparties, including TransAlta; (ii) pursue and capitalize on strategic growth opportunities in the renewable power generation sector; and (iii) pay out a portion of cash available for distribution to the shareholders of the Company on a monthly basis.

### CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

All such forward-looking information is based on certain assumptions and analyses made by management in light of its experience and perception of historical trends, current conditions, and expected future developments, as well as other factors management believes are appropriate in the circumstances. Actual results, performance or achievements could differ materially from those expressed in, or implied by, such forward-looking information and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking information will transpire or occur, or if any of them do so, what benefits will be derived therefrom. Investors should not place undue reliance on forward-looking information. Except as required by law, the Company does not intend to update or revise any forward-looking information, whether as a result of new information, future events or otherwise. The information contained in this MD&A is expressly qualified by this cautionary statement.

### SIGNIFICANT ACQUISITION

The Company and TransAlta will enter into the Purchase and Sale Agreement, pursuant to which the Company will indirectly acquire certain wind and hydroelectric power generation assets held by Western Sustainable Power Inc. (“Western Sustainable Power”) and Canadian Hydro Developers, Inc. (“CHD”) (the “Acquired Assets”). The Company will complete this acquisition by acquiring all of the issued and outstanding common shares of Western Sustainable Power and CHD (the “Acquisition”), which are entities that directly and indirectly own the Acquired Assets. The purchase price for the transfer of the issued and outstanding shares of Western Sustainable Power and CHD to the Company will be approximately $1,721 million (subject to customary closing adjustments), which will be satisfied by: (i) paying the net proceeds of the offering contemplated by the prospectus dated July 31, 2013 (the “Offering”) to TransAlta; (ii) issuing Common Shares to TransAlta at a deemed price per Common Share of $10.00, being the Offering price; (iii) issuing an Acquisition Note to TransAlta; (iv) entering into an Amortizing Term Loan with TransAlta in the aggregate principal amount of $200 million; and (v) indirectly assuming CHD debt.

## ACTIVITIES OF THE COMPANY SINCE ITS INCORPORATION THROUGH TO CLOSING OF THE OFFERING

Between the date of its formation through to closing of the Offering and the Acquisition, the Company will not have any active operations. The $2.5 million estimated total expenses related to the Offering (excluding the Underwriters' commission) will be funded from the proceeds of the Offering.

## SELECTED FINANCIAL INFORMATION AND RESULTS OF OPERATIONS OF THE ACQUIRED ASSETS

The results of operations of the Acquired Assets are presented on a combined basis for information purposes only. The Acquired Assets remain under the ownership of TransAlta. Some of the accounting policies require management to make estimates or assumptions that in some cases may relate to matters that are inherently uncertain.

The following tables depict key financial results and statistical operating data for the Acquired Assets:

| *(In thousands $)* | **3 months ended June 30, 2013** | **6 months ended June 30, 2013** |
|---|---|---|
| Production (GWh) | **732** | **1,500** |
| Revenues | **70,940** | **131,857** |
| Gross margin(1) | **67,174** | **124,531** |
| Operations, maintenance, and administration | **10,137** | **19,311** |
| Operating income(1) | **34,597** | **62,071** |
| Net earnings attributable to TransAlta(2) | **19,512** | **33,516** |
| Comparable net earnings(3) | **19,512** | **31,486** |
| Comparable EBITDA(3) | **55,193** | **101,577** |
| Funds from operations(3) | **47,764** | **86,955** |
| Cash flow from operating activities | **45,738** | **98,966** |

| **As at** *(in thousands $)* | **June 30, 2013** |
|---|---|
| Total assets | **2,229,506** |
| Total long-term liabilities | **517,188** |

- Production decreased during the quarter compared to the previous quarter primarily due to lower wind volumes, partially offset by higher hydro volumes. Historically, wind volumes in the second quarter are lower than in the first quarter.
- Gross margins were $67,174 million and $124,531 million for the three and six months ended June 30, 2013, respectively. During the quarter, overall gross margins increased compared to the previous quarter primarily due to higher merchant prices and higher hydro volumes, partially offset by lower wind volumes.

*(1) These items are additional IFRS measures. Refer to the "Additional and Non-IFRS Measures - Additional IFRS Measures" section of this MD&A for further discussion of these items.*

*(2) The Acquired Assets have a non-controlling interest in the Kent Hills wind farm which is not presented as a part of net earnings attributable to TransAlta.*

*(3) These comparable items are not defined under IFRS. Presenting these items from period to period provides management and investors with the ability to evaluate earnings trends more readily in comparison with prior periods' results. Refer to the "Additional and Non-IFRS Measures - Non-IFRS Measures" section of this MD&A for further discussion of these items, including, where applicable, reconciliations to measures calculated in accordance with IFRS.*

- Operations, Maintenance, and Administration (“OM&A”) costs have increased during the quarter compared to the previous quarter primarily due a full three months of commercial operations at the New Richmond wind farm. The New Richmond wind farm began commercial operations on March 13, 2013.
- Funds from Operations increased during the quarter primarily due to higher net earnings.

## 2013 OUTLOOK

***Business Environment***

**Environmental Legislation**

The finalization of the federal Canadian Greenhouse Gas regulations for coal-fired power has initiated further environmental legislation activities.

There are ongoing discussions between the federal and provincial governments regarding a national Air Quality Management System for air pollutants. In Alberta's Clean Air Strategy, the province indicated that its provincial air quality management system will operationalize any national system. The Company's current outlook is that, for Alberta, provincial regulations will be considered as equivalent to any future national framework.

The Company continues to closely monitor the progress and risks associated with environmental legislation changes on the future operations.

The siting, construction, and operation of electrical energy facilities requires interaction with many stakeholders. Recently, certain stakeholders have brought actions against government agencies and owners over alleged adverse impacts of wind projects. The Company is monitoring these claims in order to assess the risk associated with these activities.

**Economic Environment**

The Company expects slow to moderate growth in Alberta and low growth in Eastern Canada in 2013. Global events are monitored to assess their potential impact on the economy and supplier and commodity counterparty relationships.

***Operations***

**Capacity, Production, and Availability**

Generating capacity is expected to increase in 2013 due to the completion of the New Richmond facility. Availability is expected to be in the range of 95 per cent to 96 per cent in 2013 across the fleet.

**Contracted Cash Flows**

Through the use of long-term contracts and the TransAlta PPAs, all of the Acquired Assets’ capacity will be contracted. Substantially all of the capacity will be contracted over the next 10 to 20 years.

**Operations, Maintenance, and Administration Costs**

The Company expects OM&A costs for 2013 to increase primarily due the commencement of operations at the New Richmond wind farm.

## ADDITIONAL IFRS AND NON-IFRS MEASURES

### *Additional IFRS Measures*

An additional IFRS measure is a line item, heading, or subtotal that is relevant to an understanding of the financial statements but is not a minimum line item mandated under IFRS, or the presentation of a financial measure that is relevant to an understanding of the financial statements but is not presented elsewhere in the financial statements. Line items entitled "gross margin" and "operating income" are presented in the MD&A. Presenting these items provides the Company and investors with a measurement of ongoing operating performance that is readily comparable from period to period.

### *Non-IFRS Measures*

The Company will evaluate performance using a variety of measures. Those discussed below, and elsewhere in this MD&A, are not defined under IFRS and, therefore, should not be considered in isolation or as an alternative to or to be more meaningful than net earnings or cash flow from operating activities, as determined in accordance with IFRS, when assessing financial performance or liquidity. These Non-IFRS measures are not necessarily comparable to a similarly titled measure of another company.

Presenting earnings on a comparable basis, comparable operating income, and comparable Earnings Before Interest, Taxes, Depreciation, and Amortization ("EBITDA") from period to period provides management and investors with supplemental information to evaluate earnings trends in comparison with results from prior periods. In calculating these items, the Company excludes adjustments to earnings, such as the income tax recovery related to the deferred tax rate adjustment as the Company believes this transaction is not representative of the business operations.

**Net Earnings on a Comparable Basis**

Net earnings on a comparable basis are reconciled to net earnings below:

| *(In thousands $)* | **3 months ended June 30, 2013** | **6 months ended June 30, 2013** |
|---|---|---|
| Net earnings attributable to TransAlta | **19,512** | **33,516** |
| Income tax recovery related to deferred tax rate adjustment | **-** | **(2,030)** |
| **Net earnings on a comparable basis** | **19,512** | **31,486** |

### Comparable EBITDA

Presenting comparable EBITDA from period to period provides management and investors with a proxy for the amount of cash generated from operating activities before net interest expense, non-controlling interests, income taxes, and working capital adjustments. A reconciliation of comparable EBITDA to operating income is as follows:

| *(In thousands $)* | 3 months ended June 30, 2013 | 6 months ended June 30, 2013 |
|---|---|---|
| Operating income | **34,597** | **62,071** |
| Depreciation and amortization | **20,596** | **39,506** |
| **Comparable EBITDA** | **55,193** | **101,577** |

### Funds from Operations

Presenting funds from operations from period to period provides management and investors with a proxy for the amount of cash generated from operating activities, before changes in working capital, and provides the ability to evaluate cash flow trends more readily in comparison with results from prior periods.

| *(In thousands $)* | 3 months ended June 30, 2013 | 6 months ended June 30, 2013 |
|---|---|---|
| Cash flow from operating activities | **45,738** | **98,966** |
| Change in non-cash operating working capital balances | **2,026** | **(12,011)** |
| **Funds from operations** | **47,764** | **86,955** |

## INDEPENDENT AUDITORS' REPORT

**To the shareholder of TransAlta Renewables Inc.**

We have audited the accompanying statement of financial position of TransAlta Renewables Inc., as at June 30, 2013 and the summary of significant accounting policies and other explanatory information.

### Management's responsibility for the financial statement

Management is responsible for the preparation and fair presentation of this financial statement in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of the financial statement that is free from material misstatement, whether due to fraud or error.

### Auditors' responsibility

Our responsibility is to express an opinion on this financial statement based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statement.

We believe that the audit evidence we have obtained in our audit is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion the statement of financial position presents fairly, in all material respects, the financial position of TransAlta Renewables Inc. as at June 30, 2013 in accordance with International Financial Reporting Standards.

Ernst & Young LLP

Calgary, Canada
August 8, 2013

Chartered Accountants

**TRANSALTA RENEWABLES INC.**

**STATEMENT OF FINANCIAL POSITION**

*(in Canadian dollars)*

| Audited | **June 30, 2013** | May 28, 2013 |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents | **10** | 10 |
| **Total assets** | **10** | 10 |
| | | |
| **Shareholder's equity** | | |
| Share capital *(Note 4)* | **10** | 10 |
| **Total shareholder's equity** | **10** | 10 |

Subsequent Events *(Note 5)*

*See accompanying notes*

## NOTES TO THE FINANCIAL STATEMENTS

*(Amounts in Canadian dollars, except as otherwise noted)*

### 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

TransAlta Renewables Inc. (the “Company”) was incorporated under the Canada Business Corporations Act and has been formed to own a portfolio of renewable power generation facilities.

These audited financial statements have been prepared by management in compliance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

The audited financial statements have been prepared on a historical cost basis.

These audited financial statements were authorized for issue by the Board of Directors on Aug. 8, 2013.

### 2. ACCOUNTING POLICIES

**A. Cash and Cash Equivalents**

Cash and cash equivalents are comprised of cash and highly liquid investments with original maturities of three months or less.

### 3. FUTURE ACCOUNTING CHANGES

**I. Financial Instruments**

In November 2009, the IASB issued IFRS 9 *Financial Instruments,* which replaced the classification and measurement requirements in IAS 39 *Financial Instruments: Recognition and Measurement* for financial assets. Financial assets must be classified and measured at either amortized cost or at fair value through profit or loss or through Other Comprehensive Income (“OCI”) depending on the basis of the entity’s business model for managing the financial asset, and the contractual cash flow characteristics of the financial asset.

In October 2010, the IASB issued additions to IFRS 9 regarding financial liabilities. The new requirements address the problem of volatility in net earnings arising from an issuer choosing to measure a liability at fair value and require that the portion of the change in fair value due to changes in the entity’s own credit risk be presented in OCI, rather than within net earnings.

In December 2011, the IASB amended the effective date of these requirements, which are now effective for annual periods beginning on or after Jan. 1, 2015, and must be applied on a modified retrospective basis. Earlier adoption is permitted. The December amendment also provided relief from restating comparative periods and from the associated disclosures required under IFRS 7 *Financial Instruments: Disclosures*.

The Company does not expect that any material impacts will result from these standards, however, continues to assess the impact of adopting these amendments on the financial statements.

### II. Offsetting Financial Assets and Liabilities

In December 2011, the IASB issued amendments to IAS 32 *Financial Instruments: Presentation.* The amendments are intended to clarify certain aspects of the existing guidance on offsetting financial assets and financial liabilities due to the diversity in application of the requirements on offsetting. The amendments to IAS 32 are effective for annual periods beginning on or after Jan. 1, 2014. The Company is currently assessing the impact of adopting the IAS 32 amendments on the financial statements.

## 4. SHARE CAPITAL

The Company's authorized share capital consists of an unlimited number of Common Shares and an unlimited number of Preferred Shares, issuable in series. The Common Shares entitle the holders thereof to one vote per share at meetings of shareholders. The Preferred Shares are issuable in series and have such rights, restrictions, conditions, and limitations as the Board may from time to time determine.

The Company's issued and outstanding share capital consists of 1 Common Share which was issued to TransAlta Corporation ("TransAlta") on incorporation, for cash proceeds of $10.00.

## 5. SUBSEQUENT EVENTS

On July 31, 2013, the Company filed a final prospectus to qualify the distribution of 20,000,000 Common Shares the Company to be issued pursuant to the terms of the Underwriting Agreement at a price of $10.00 per Common Share (the "Offering").

The Company has granted to the Underwriters an option (the "Over-Allotment Option"), exercisable in whole or in part for a period of 30 days following Closing, to purchase, at the Offering price, up to an additional 3,000,000 Common Shares (representing 15 per cent of the Common Shares offered under the prospectus).

TransAlta has advised the Company that it intends to remain the majority shareholder of the Company. Upon Closing, it is expected that TransAlta will own approximately 82.6 per cent of the outstanding Common Shares (79.9 per cent of the outstanding Common Shares if the Over-Allotment Option is exercised in full).

The net proceeds of the Offering are expected to be approximately $187.0 million, after deducting the Underwriters' commission of $10.5 million and the Company's expenses related to the Offering estimated to be $2.5 million. If the Over-Allotment Option is exercised in full, the net proceeds are expected to be $215.4 million, after deducting the Underwriters' commission of $12.1 million and the Company's expenses related to the Offering estimated to be $2.5 million. The Company intends to use the net proceeds from the Offering (excluding any proceeds from the exercise of the Over-Allotment Option) to repay in full the Closing Note issued as partial satisfaction of the purchase price for the Acquired Assets under the Purchase and Sale Agreement and intends to the use the net proceeds, if any, from the exercise of the Over-Allotment Option to repay a portion of the indebtedness under the Acquisition Note.

The Company will initially acquire (the "Acquisition") certain wind and hydroelectric power generation assets (the "Acquired Assets") held indirectly by TransAlta. The Acquired Assets consist of 28 renewable power generation facilities having an aggregate installed generating capacity of 1,234 MW, in which the Company will have a net ownership interest of approximately 1,112 MW. Generation output from the Acquired Assets will be sold pursuant to long-term power purchase and sale agreements with investment grade counterparties, including public power authorities and load-serving utilities. TransAlta and the Company will enter into long-term power purchase and sale agreements, each, a TransAlta Power Purchase Agreement, in respect of each of the Acquired Assets that is not currently subject to a power purchase and sale agreement. The wind and hydroelectric power generation assets and related intangible assets were transferred at their carrying value of approximately $1.9 billion, net of a $211 million distribution to TransAlta, which will be reflected in equity.

On or before Closing, the Company will enter into a management, administrative and operational services agreement (the "Management and Operational Services Agreement") with TransAlta. Under the Management and Operational Services Agreement, TransAlta will provide management and administrative services to the Company, including day-to-day management services and general administrative services required by the Company, along with such operational and maintenance services as may be required or advisable for the operation of the Company's renewable power generation assets. The individuals providing such services to the Company pursuant to the Management and Operational Services Agreement will remain employees of TransAlta and will be those individuals presently performing those services for TransAlta.

Pursuant to the terms of a Governance and Cooperation Agreement between the Company and TransAlta to be entered into on or before Closing, TransAlta will provide the Company with the opportunity to purchase, or participate in the development of, renewable power generation facilities with stable, long-term cash flows which meet the objectives of the Company and which TransAlta, acting as the manager, determines to be suitable for the Company.