

TransAlta renewables ^{inc.}

TransAlta Renewables Inc.

Management's Discussion and Analysis

December 31, 2017

Management's Discussion and Analysis

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This Management's Discussion and Analysis ("MD&A") should be read in conjunction with our 2017 audited consolidated financial statements and our 2018 Annual Information Form ("AIF") for the year ended Dec. 31, 2017. Our consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") for Canadian publicly accountable enterprises as issued by the International Accounting Standards Board ("IASB") and in effect at Dec. 31, 2017. Certain financial measures included in this MD&A do not have a standardized meaning as prescribed by IFRS. These measures may not be comparable to similar measures presented by other issuers and should not be considered in isolation or as a substitute for measures prepared in accordance with IFRS. See the Non-IFRS Measures section of this MD&A for additional information. All dollar amounts in the tables are in millions of Canadian dollars, except amounts per share, which are presented in whole dollars to the nearest two decimals. In this MD&A, unless the context otherwise requires, "we", "our", "us", "TransAlta Renewables", and the "Corporation" refer to TransAlta Renewables Inc. and its subsidiaries, and "TransAlta" refers to TransAlta Corporation and its subsidiaries, other than TransAlta Renewables. Capitalized terms not otherwise defined herein have their respective meanings set forth in the Glossary of Key Terms. This MD&A is dated February 22, 2018. Additional information respecting TransAlta Renewables, including our 2018 AIF, is available on SEDAR at www.sedar.com and on our website at www.transaltarenewables.com. Information on or connected to our website is not incorporated by reference herein.

Operations of the Corporation

As at Dec. 31, 2017, TransAlta Renewables owned and operated 13 hydro facilities, 17 wind farms and one gas plant in Canada, and held economic interests in TransAlta's Wyoming Wind farm and in TransAlta's 450 megawatt ("MW") Australian gas fired generation assets, including the 150 MW South Hedland Power Station.

We own, directly or through economic interests, 2,344 MW of Capacity,⁽¹⁾ including the 150 MW South Hedland Facility. TransAlta manages and operates these facilities on our behalf under the terms of a Management, Administrative and Operational Services Agreement, as amended (the "Management Agreement"). Our power-generating capacity is among the largest of any publicly traded renewable independent power producer in Canada. Substantially all of our generation output is sold under long-term PPAs with a weighted average remaining duration of approximately 12 years.⁽²⁾

As we have an economic interest, and not direct ownership, of the Australian Assets and the Wyoming Wind farm, the operational results of these assets are not consolidated into our results; however, the finance income we receive on the underlying investments is included in our consolidated net earnings.

Non-IFRS Measures

We evaluate our performance using a variety of measures. Certain of the measures discussed 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 measures as determined in accordance with IFRS when assessing our financial performance or liquidity. These measures may not be comparable to similar measures presented by other issuers.

The Corporation's key non-IFRS measures are Comparable Earnings before Interest, Taxes, Depreciation, and Amortization ("Comparable EBITDA"), Adjusted Funds from Operations ("AFFO") and Cash Available for Distribution ("CAFD"). Comparable EBITDA is comprised of our reported EBITDA adjusted to include Comparable EBITDA of the facilities in which we hold an economic interest, which is the facilities' reported EBITDA adjusted for: 1) finance lease income and the change in the finance lease receivable amount; 2) contractually fixed management costs; and 3) impact of the change in value of Class B shares, foreign exchange gains and losses and impairment. Reported EBITDA and Comparable EBITDA are presented to provide management and investors with a proxy for the amount of cash generated from operating activities before net interest expense, non-controlling interest, income taxes and the impacts of timing on the finance income from subsidiaries of TransAlta in which we have an economic interest. We present Comparable EBITDA along with operational information of the assets in which we own an economic interest so that readers can better understand and evaluate the drivers of those assets in which we have the economic interest. Since the economic interests are designed to provide the Corporation with returns as if we owned the assets themselves, presenting the operational information and Comparable EBITDA provides a more complete picture for readers to understand the underlying nature of the investments and the resultant cash flows that would otherwise only be presented as finance income from the investments. AFFO is calculated as the cash flow from operating activities before changes in working capital, less sustaining capital expenditures, distributions paid to subsidiaries' non-controlling interest and finance income, plus AFFO of the assets owned through economic interests, which is calculated as Comparable EBITDA from the economic interests less the change in long-term receivable, sustaining capital expenditures, and current income tax expense. AFFO provides users with a proxy for the amount generated from operating activities and investments in subsidiaries of TransAlta in which we have an economic interest. CAFD is calculated as AFFO less scheduled principal repayments of amortizing debt. CAFD can be used as a proxy for the cash that will be available to common shareholders of the Corporation. One of the primary objectives of the Corporation is to provide reliable and stable cash flows, and presenting AFFO and CAFD assists readers in assessing our cash flows in comparison to prior periods. See the Reconciliation of Non-IFRS Measures section of this MD&A for additional information.

(1) We measure Capacity as Net Maximum Capacity which is consistent with industry standards. Capacity figures represent Capacity owned and in operation unless otherwise stated. The gross capacity reflects the basis of consolidation of underlying assets owned, plus those in which we hold an economic interest. Net capacity deducts capacity attributable to non-controlling interest in these assets.

(2) Weighted average based on capacity.

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. We have included line items entitled "gross margin" and "operating income" in our Consolidated Statements of Earnings. Presenting these line items provides management and investors with a measure of ongoing operating performance that is readily comparable from period to period.

Forward-Looking Statements

This MD&A and other reports and filings made with securities regulatory authorities include forward-looking statements. All forward-looking statements are based on our beliefs as well as assumptions based on information available at the time the assumptions were made and on management's experience and perception of historical trends, current conditions and expected future developments, as well as other factors deemed appropriate in the circumstances. Forward-looking statements are not facts, but only predictions and generally can be identified by the use of statements that include phrases such as "may", "will", "believe", "expect", "anticipate", "intend", "plan", "foresee", "potential", "enable", "continue" or other comparable terminology. These statements are not guarantees of our future performance and are subject to risks, uncertainties and other important factors that could cause our actual performance to be materially different from that projected.

In particular, this MD&A contains forward-looking statements pertaining to our business and anticipated future financial performance including, but not limited to: the forecasted business environment in Canada, Australia and the United States; spending on growth and sustaining capital and productivity projects, including sustaining capital expenditures of subsidiaries of TransAlta in which we have an economic interest; our 2018 Outlook, including Comparable EBITDA, AFFO and CAFD; renewable energy production from our wind and hydro assets in 2018; the closing of the acquisition of two US wind projects and, the costs related to such projects and expected commercial operation dates; our foreign exchange risk strategy; expectations regarding net interest and volume of debt; our ability to maintain adequate availability; expectations regarding project level debt; statutory blended tax rates and our cash tax horizon; expectations in terms of the cost of operations and maintenance, including maintenance performed by third parties, and including the variability of those costs; the payment of future dividends; expectations in respect of generation availability, Capacity and production; the timing and completion of projects under development, including the Kent Hills 3 Wind Project and the costs thereof and the funding of such costs; the anticipated financial impact to be realized from the commercial operation of the South Hedland Power Station; expected governmental regulatory regimes, legislation and programs, including the Canadian federal legislation pertaining to greenhouse gas emissions and provincial legislation pertaining to carbon emissions and credits and the procurement process for renewable generation in Alberta and its expected impact on us, as well as the cost of complying with resulting regulations and laws; the value of offsets generated by our renewable facilities; expectations regarding the implementation of new IFRS standards; expectations regarding seasonality of wind and hydro production; expectations on our ability to access capital markets on reasonable terms; expectations regarding our decommissioning and restoration activities; our expectations regarding the outcome of existing or potential legal or contractual claims, regulatory investigations and disputes, including the dispute with Fortescue Metals Group Ltd. ("FMG") over the purchase of the Solomon Power Station and the commissioning of the South Hedland Power Station; and the impact of accounting changes.

Factors that may adversely impact our forward-looking statements include, but are not limited to, risks relating to: changes in general economic conditions, including interest rates; operational risks involving our facilities, including Unplanned Outages at such facilities; risks pertaining to the timing and cost of the construction and commissioning of the Kent Hills 3 Wind Project; disruptions in the transmission and distribution of electricity; the effects of weather; disruptions in the source of water, wind, or gas required to operate our facilities; natural disasters; the threat of domestic terrorism, cyberattacks, and other man-made disasters; equipment failure and our ability to carry out repairs in a cost-effective or timely manner; industry risk and competition; fluctuations in the value of foreign currencies; the need for additional financing and the ability to access financing at a reasonable cost; structural subordination of securities; counterparty credit risk; insurance coverage; our provision for income taxes; disputes with counterparties and legal and contractual proceedings involving the Corporation; reliance on key personnel; the regulatory and political environments in the jurisdictions in which we operate; increasingly stringent environmental requirements and changes in, or liabilities under, these requirements; and the risks associated with development projects and acquisitions. The foregoing risk factors, among

others, are described in further detail in the Risk Factors section of our Annual Information Form for the year ended Dec. 31, 2017, which is available on SEDAR at www.sedar.com.

Readers are urged to consider these factors carefully in evaluating the forward-looking statements and are cautioned not to place undue reliance on these forward-looking statements. The forward-looking statements included in this document are made only as of the date hereof and we do not undertake to publicly update these forward-looking statements to reflect new information, future events, or otherwise, except as required by applicable laws. The purpose of the financial outlooks contained herein is to give the reader information about management's current expectations and plans and readers are cautioned that such information may not be appropriate for other purposes. In light of these risks, uncertainties, and assumptions, the forward-looking events might occur to a different extent or at a different time than we have described, or might not occur. We cannot assure that projected results or events will be achieved.

Highlights

Consolidated Financial Highlights

Year ended Dec. 31	2017	2016	2015
Renewable energy production (GWh) ⁽¹⁾	3,623	3,541	3,262
Revenues	459	259	236
Net earnings (loss) attributable to common shareholders	9	(2)	195
Reported EBITDA ⁽²⁾	224	150	340
Comparable EBITDA ⁽²⁾	424	407	261
Adjusted funds from operations ⁽²⁾	328	284	200
Cash flow from operating activities	290	282	189
Cash available for distribution ⁽²⁾	284	245	177
Net earnings (loss) per share attributable to common shareholders, basic and diluted	0.04	(0.01)	1.18
Adjusted funds from operations per share ⁽²⁾	1.40	1.27	1.22
Cash available for distribution per share ⁽²⁾	1.21	1.10	1.08
Dividends declared per common share	0.91	0.96	0.82
Dividends paid per common share	0.90	0.88	0.81

(1) Includes production from Wyoming Wind and excludes Canadian and Australian gas-fired generation. Production is not a key revenue driver for gas-fired facilities as most of their revenues are capacity based.

(2) Refer to the Non-IFRS Measures section of this MD&A for further discussion of these items.

As at Dec. 31	2017	2016	2015
Gas installed capacity (MW) ⁽¹⁾	956	931	425
Renewables installed capacity (MW)	1,388	1,388	1,283
Total assets	3,628	3,835	3,336
Long-term debt ⁽²⁾	1,043	827	797
Total long-term liabilities	1,075	1,237	1,120

(1) Includes Australian gas-fired generation.

(2) Including current portion.

During the year, we maintained our track record of delivering solid and stable performance and achieved an important milestone when the South Hedland Power Station achieved commercial operation on July 28, 2017, and, as expected, the dividend was increased approximately 7 per cent at that time. In November 2017, one of TransAlta's customers exercised their option to repurchase the Solomon Power Station for US\$335 million and terminate the PPA. We used the proceeds to repay debt in the near term and our plan is to redeploy the capital in growth projects in 2018 and 2019. We don't expect our dividend to be impacted by the addition of South Hedland and the sale of the Solomon Power Station. Our gas installed capacity increased 25 MW and our renewable energy production increased 82 GWh, which contributed to Comparable EBITDA increasing \$17 million from 2016.

Our AFFO and CAFD also increased \$44 million and \$39 million, respectively, primarily through the Australian Assets and Canadian Wind portfolio of assets. The Australian Assets contributed AFFO of \$125 million during the year. AFFO from assets owned directly was impacted by higher levels of sustaining capital.

Reported net earnings (loss) attributable to common shareholders increased primarily as a result of the lower fair value change of the Class B shares liability of \$140 million and a foreign exchange gain of \$6 million, which was partially offset by the \$137 million impairment of the Australian Tracking Preferred Shares. The impairment was caused by revaluation of the future cash flows attributable to the impact of the Solomon Power Station sale and FMG issuing a notice of purported termination of its South Hedland PPA.

Significant Events in 2017

We achieved significant milestones in 2017:

- During the second quarter, we entered into a long-term contract for the sale of all power generated by our 17.25 MW Capacity Kent Hills expansion project, which is currently under development.
- On July 24, 2017, we entered into a syndicated credit agreement giving us access to a \$500 million committed credit facility. In conjunction with the new credit agreement, the \$350 million credit facility provided by TransAlta was cancelled.
- On July 28, 2017, the South Hedland Power Station achieved commercial operation.
- On Nov. 1, 2017, FMG repurchased the Solomon Power Station for approximately US\$335 million. We had an economic interest in the cash flows generated from the Solomon Power Station. We received approximately US\$325 million of proceeds from TEA, which were, among other things, used to repay the \$215 million convertible debenture issued to TransAlta.
- On Oct. 2, 2017, our subsidiary, Kent Hills Wind LP, closed a \$260 million bond offering. The proceeds were used to early redeem the \$191 million of unsecured debentures issued by our subsidiary, Canadian Hydro Developers, Inc. The debentures were scheduled to mature in June 2018.

These actions, coupled with our solid financial and operational performance in 2017, demonstrate our ability to provide stable, consistent returns through the ownership of, and investment in, highly contracted renewable and natural gas power generation.

In November 2017, TransAlta received a notice from one of its customers purporting to terminate its PPA at the South Hedland Power Station. The capacity contracted to this customer is 35 MW. TransAlta is disputing the notice purporting to terminate and continues to invoice the customer for the contracted capacity.

See the Significant and Subsequent Events section of this MD&A for more information on these events.

Reconciliation of Non-IFRS Measures

Presenting AFFO provides users with a proxy for the amount of cash generated from operating activities of our business and from investments in subsidiaries of TransAlta in which we have an economic interest, before changes in working capital. CAFD provides users with a proxy for the cash that will be available to common shareholders of the Corporation. One of the primary objectives of the Corporation is to provide reliable and stable cash flows, and presenting AFFO and CAFD assists readers in assessing our cash flows in comparison to prior periods. See the Non-IFRS Measures section of this MD&A for additional information. AFFO per share and CAFD per share are calculated using the weighted average number of common shares outstanding during the period.

The table below reconciles our cash flow from operating activities to our AFFO and CAFD:

Year ended Dec. 31	2017	2016	2015
Cash flow from operating activities	290	282	189
Change in non-cash operating working capital balances	17	(7)	26
Cash flow from operations before changes in working capital	307	275	215
Adjustments:			
Sustaining capital expenditures	(27)	(11)	(10)
Distributions paid to subsidiaries' non-controlling interest	(3)	(5)	(5)
Finance income	(86)	(151)	(81)
AFFO - economic interests ⁽¹⁾	137	176	81
AFFO	328	284	200
Deduct:			
Principal repayments of amortizing debt	(44)	(39)	(23)
CAFD	284	245	177
Weighted average number of common shares outstanding in the period (millions)	235	223	165
AFFO per share	1.40	1.27	1.22
CAFD per share	1.21	1.10	1.08

(1) Refer to the reconciliation of the Comparable EBITDA of the facilities in which we hold an economic interest to the reported finance income table in this MD&A.

Presenting Comparable EBITDA provides management and investors with a proxy for the amount of cash generated from operating activities before net interest expense, non-controlling interest, income taxes and the impacts of timing on the finance income from subsidiaries of TransAlta in which we have an economic interest. We present Comparable EBITDA along with operational information of the assets in which we own an economic interest so that readers can better understand and evaluate the drivers of those assets in which we have the economic interest. See the Non-IFRS Measures section of this MD&A for additional information.

The tables below reconcile our reported EBITDA to Comparable EBITDA:

Year ended Dec. 31, 2017

	Reported	Adjustments	Economic interests	Comparable total
Revenues ⁽¹⁾	459	—	202	661
Fuel, royalties and other costs of sales ⁽²⁾	97	—	14	111
Gross margin	362	—	188	550
Operations, maintenance and administration ⁽³⁾	83	—	35	118
Taxes, other than income taxes	8	—	—	8
Finance income	(86)	86	—	—
Change in fair value of Class B shares	2	(2)	—	—
Foreign exchange gain	(6)	6	—	—
Impairment of investment	137	(137)	—	—
Earnings before interest, taxes, depreciation and amortization	224	47	153	424

(1) Amounts related to economic interests include finance lease income adjusted for change in finance lease receivable amount.

(2) Commencing in the third quarter of 2017, amounts related to economic interests include interest earned on the prepayment of certain transmission costs.

(3) Amounts related to economic interests include the effect of contractually fixed management costs.

Year ended Dec. 31, 2016

	Reported	Adjustments	Economic interests ⁽³⁾⁽⁴⁾	Comparable total
Revenues ⁽¹⁾	259	—	371	630
Fuel, royalties and other costs of sales	23	—	83	106
Gross margin	236	—	288	524
Operations, maintenance and administration ⁽²⁾	53	—	56	109
Taxes, other than income taxes	7	—	1	8
Finance income	(151)	151	—	—
Change in fair value of Class B shares	142	(142)	—	—
Foreign exchange loss	35	(35)	—	—
Earnings before interest, taxes, depreciation and amortization	150	26	231	407

(1) Amounts related to economic interests include finance lease income adjusted for change in finance lease receivable amount.

(2) Amounts related to economic interests include the effect of contractually fixed management costs.

(3) Includes results for the Canadian Assets, which were acquired on Nov. 30, 2016.

(4) Revenue and Fuel, royalties, and other costs revised to reflect netting of intercompany gas sales with purchases. This adjustment had no effect on Comparable EBITDA.

Year ended Dec. 31, 2015

	Reported	Adjustments	Economic interests	Comparable total
Revenues ⁽¹⁾	236	—	123	359
Fuel, royalties and other costs of sales	13	—	13	26
Gross margin	223	—	110	333
Operations, maintenance and administration ⁽²⁾	45	—	20	65
Taxes, other than income taxes	8	—	—	8
Insurance recovery	(1)	—	—	(1)
Finance income	(81)	81	—	—
Change in fair value of Class B shares	(36)	36	—	—
Foreign exchange gain	(52)	52	—	—
Earnings before interest, taxes, depreciation and amortization	340	(169)	90	261

(1) Amounts related to economic interests include finance lease income adjusted for change in finance lease receivable amount.

(2) Amounts related to economic interests include the effect of contractually fixed management costs.

The table below reconciles the Comparable EBITDA of the facilities in which we hold an economic interest to the reported finance income:

Year ended Dec. 31	2017			2016						2015		
	US Wind	Australian Gas	Total	Canadian Wind ⁽¹⁾	Canadian Hydro ⁽¹⁾	US Wind	Canadian Gas ⁽¹⁾	Australian Gas	Total	US Wind	Australian Gas	Total
Comparable EBITDA	14	139	153	9	2	15	75	130	231	10	80	90
Sustaining capital	(2)	(10)	(12)	(3)	—	(2)	(6)	(14)	(25)	(1)	(7)	(8)
Change in long-term receivable	—	—	—	—	—	—	—	(15)	(15)	—	—	—
Current income tax	—	—	—	—	—	—	(11)	—	(11)	—	—	—
Unrealized risk management loss	—	—	—	—	—	—	1	—	1	—	—	—
Reserves and other	—	1	1	—	(1)	—	(2)	—	(3)	—	—	—
Currency adjustment	—	(5)	(5)	—	—	—	—	(2)	(2)	—	(1)	(1)
AFFO	12	125	137	6	1	13	57	99	176	9	72	81
Return of capital ⁽²⁾	(3)	(42)	(45)	—	—	—	(20)	—	(20)	—	—	—
Effects of changes in working capital and other timing on finance income	(3)	(3)	(6)	—	—	(2)	—	(3)	(5)	—	—	—
Finance income	6	80	86	6	1	11	37	96	151	9	72	81

(1) On Nov. 30, 2016, we acquired the Canadian Assets.

(2) Includes redemptions of preferred shares tracking earnings and distributions of TransAlta Wyoming Wind.

Reconciliation of Comparable EBITDA to AFFO

Year ended Dec. 31	2017			2016			2015		
	Owned assets	Economic interests	Total	Owned assets	Economic interests	Total	Owned assets	Economic interests	Total
Comparable EBITDA	271	153	424	176	231	407	171	90	261
Interest expense	(50)	–	(50)	(48)	–	(48)	(35)	–	(35)
Change in long-term receivable	–	–	–	–	(15)	(15)	–	–	–
Sustaining capital expenditures	(27)	(12)	(39)	(11)	(25)	(36)	(10)	(8)	(18)
Current income tax expense	(6)	–	(6)	(5)	(11)	(16)	(3)	–	(3)
Distributions paid to subsidiaries' non-controlling interest	(3)	–	(3)	(5)	–	(5)	(5)	–	(5)
Unrealized risk management (gain) loss	1	–	1	(1)	1	–	–	–	–
Realized foreign exchange gain (loss)	1	–	1	–	–	–	–	–	–
Reserves and other	–	1	1	–	–	–	–	–	–
Currency adjustment	–	(5)	(5)	–	(2)	(2)	–	(1)	(1)
Other	4	–	4	2	(3)	(1)	1	–	1
AFFO	191	137	328	108	176	284	119	81	200

Discussion of Comparable EBITDA

The amounts discussed in this section include operational metrics and financial information related to our fuel types and include investments in the economic interests of TransAlta subsidiaries. Since the investments in these economic interests provide us with returns as if we owned the assets, presenting the operational information provides users with more information to be able to assess the performance of the assets that generate the finance income related to the economic interests. For the year ended Dec. 31, 2017, the Canadian Wind discussion includes the results of the Le Nordais facility, the Canadian Hydro discussion includes the results of the Ragged Chute facility and the Canadian Gas discussion includes the results of the Sarnia facility. From Jan. 6, 2016 through Nov. 30, 2016, the results of the Le Nordais facility, the Ragged Chute facility and the Sarnia facility are included in the Canadian Wind, Canadian Hydro, and Canadian Gas discussions, respectively, when we owned an economic interest. We acquired direct ownership of these assets on Nov. 30, 2016. All the assets in the US Wind and Australian Gas discussions continue to be owned through an investment in an economic interest. The Comparable EBITDA of the assets in which we have an economic interest is reconciled to the finance income recognized in our financial statements in the Reconciliation of Non-IFRS Measures section of this MD&A. The following table summarizes operational data and Comparable EBITDA by fuel type:

Year ended Dec. 31	Long-term average renewable energy production (GWh) ⁽¹⁾	Production (GWh)		Comparable EBITDA	
		2017	2016	2017	2016
Canadian Wind	2,871	2,840	2,735	194	175
Canadian Hydro	464	419	444	19	21
US Wind	350	364	362	14	15
Total - Renewable energy	3,685	3,623	3,541	227	211
Canadian Gas		1,272	1,376	77	83
Australian Gas		1,803	1,529	139	130
Corporate		–	–	(19)	(17)
Total		6,698	6,446	424	407

(1) Long-term average is calculated on an annualized basis from the average annual energy yield predicted from our simulation model based on historical resource data performed over a period of typically 15 years for wind and 30 years for hydro.

Renewable energy production for the year ended Dec. 31, 2017, increased 82 GWh compared to 2016. Our Canadian Wind assets achieved an increase in production in line with our long-term average renewable production.

Canadian Wind

Year ended Dec. 31	2017	2016
Production (GWh)	2,840	2,735
Gross installed capacity (MW)	1,132	1,132
Revenues	241	225
Royalties and other costs of sales	11	10
Comparable gross margin	230	215
Operations, maintenance and administration	31	35
Taxes, other than income taxes	5	5
Comparable EBITDA	194	175

Production for the year ended Dec. 31, 2017, increased 105 GWh compared to 2016 due to higher wind resources and lower Unplanned Outages in Eastern Canada. Comparable EBITDA for the year ended Dec. 31, 2017 increased \$19 million compared to 2016, due to higher volumes, contract price escalation, higher Green Attribute revenue in the first quarter of 2017 and lower operating costs arising from long-term service contracts renegotiated in the third quarter of 2016.

Canadian Hydro

Year ended Dec. 31	2017	2016
Production (GWh)	419	444
Gross installed capacity (MW)	112	112
Revenues	27	29
Royalties and other costs of sales	3	3
Comparable gross margin	24	26
Operations, maintenance and administration	3	3
Taxes, other than income taxes	2	2
Comparable EBITDA	19	21

Production for the year ended Dec. 31, 2017, decreased 25 GWh compared to 2016, due to unfavourable water resource in British Columbia in the first half of 2017. The lower water resource resulted in Comparable EBITDA for the year ended Dec. 31, 2017, decreasing \$2 million compared to 2016.

US Wind

Year ended Dec. 31	2017	2016
Production (GWh)	364	362
Gross installed capacity (MW)	144	144
Revenues	22	21
Royalties and other costs of sales	2	1
Comparable gross margin	20	20
Operations, maintenance and administration	6	5
Comparable EBITDA	14	15

Production and Comparable EBITDA at the Wyoming Wind farm were consistent with the prior year.

Canadian Gas

Year ended Dec. 31	2017	2016 ⁽¹⁾⁽²⁾
Production (GWh)	1,272	1,376
Gross installed capacity (MW)	506	506
Revenue	191	181
Fuel and purchased power	83	72
Comparable gross margin	108	109
Operations, maintenance, and administration	30	25
Taxes, other than income taxes	1	1
Comparable EBITDA	77	83

(1) Period from Jan. 6 to Nov. 30, 2016.

(2) Revenue and Fuel and purchased power revised to reflect netting of intercompany gas sales with purchases. This adjustment had no effect on Comparable EBITDA.

For the year ended Dec. 31, 2017, Comparable EBITDA decreased \$6 million from 2016. This was driven by increased operating costs due to higher maintenance requirements for water treatment plants and boiler tubes and severance costs related to workforce reductions. Higher fuel costs were offset by higher revenues as fuel is mostly supplied by customers.

The Sarnia facility is highly contracted and is therefore not typically impacted by fluctuations in production.

Australian Gas

Year ended Dec. 31	2017	2016
Production (GWh)	1,803	1,529
Gross installed capacity (MW)	450	425
Revenues	135	119
Finance lease income ⁽¹⁾	45	55
Fuel and purchased power ⁽²⁾	(12)	(20)
Comparable gross margin	168	154
Operations, maintenance and administration ⁽³⁾	29	24
Comparable EBITDA	139	130

(1) Finance lease income adjusted for change in finance lease receivable.

(2) Commencing in the third quarter of 2017, adjusted for interest earned on the prepayment of certain transmission costs.

(3) Includes the effect of contractually fixed management costs.

Comparable EBITDA for the year ended Dec. 31, 2017, increased \$9 million compared to 2016, due to the South Hedland Power Station achieving commercial operation on July 28, 2017, and contributing \$50 million of EBITDA. This was partially offset by the impact of the termination of the Solomon PPA on Nov. 1, 2017 (see Significant Events). Also impacting our results was a lower contribution from Parkeston resulting from re-contracting for an additional 10 years at reduced tariffs. Due to the nature of our contracts, the increased production from the change in customer load does not have a significant financial impact as revenues are generally derived from capacity payments and fuel costs are passed through to the customers.

Corporate

Year ended Dec. 31	2017	2016
Operations, maintenance, and administration	19	17
Comparable EBITDA	(19)	(17)

Corporate costs increased \$2 million mostly attributable to the Kent Hills 3 development fee paid to TransAlta upon entering into a long-term contract with New Brunswick Power Corporation ("NB Power").

Business Environment

Demand and Supply

Our business is cyclical due to the nature of electricity, which is generally consumed as it is generated. Wind and run-of-river hydro resources fluctuate based on both seasonal patterns and naturally occurring weather variation. Typically, run-of-river hydro facilities generate most of their electricity and revenues during the spring and summer months when melting snow starts feeding watersheds and rivers. Wind generation is historically greater during the cold winter months and lower in the warm summer months.

Generally, market demand, supply conditions and changes in such conditions do not have a significant impact on our business operations due to our highly contracted position.

Regulatory and Environmental Legislation

Generation of electricity from wind and hydro sources results in low environmental impacts when compared to other fuel types. Wind power facilities do not produce any emissions. They can be erected with minimal disturbance to the environment and utilize a known, predictable and recurring resource. Run-of-river hydro generation produces virtually no emissions and returns the original fuel source, water, into the river. Run-of-river facilities provide a smaller hydro generation option with a smaller footprint than traditional reservoir technology and operate with the seasonality of water flow within a given area. Run-of-river facilities also have a minimal impact on surrounding vegetation, fish, bird and wildlife habitats.

Although our operations generally have low environmental impacts, our activities are subject to stringent environmental laws and regulations promulgated and administered by the federal, provincial, state and municipal governments where we operate. These laws and regulations generally concern use of water, wildlife protection, wetlands preservation, remediation of contamination, waste disposal requirements, preservation of archaeological artifacts, endangered species preservation, air emissions and noise limitations, among others. Our operations must be in compliance with the applicable environmental laws and regulations and we must also obtain or comply with any necessary environmental permits issued pursuant to such laws and regulations.

Gas-fired generation has substantially lower greenhouse gas ("GHG") and other air pollutant emissions when compared to diesel-or coal-fired generation. It is increasingly attractive to jurisdictions that are reducing the use of coal to meet emission reduction objectives. The operational flexibility allowed by gas generation enables it to back up intermittent renewable generation, and its high capacity factor provides value to industrial and mining customers in need of high reliability. Cogeneration is a form of gas generation used at the Sarnia facility in which a portion of the steam generated by the combined-cycle operation is used in industrial applications, giving rise to further efficiency and value to customers.

Canada

On Oct. 3, 2016, the Canadian federal government announced its intention to implement a national price on GHG emissions. Under this proposal, beginning in 2018, there would be a price of \$10 per tonne of carbon dioxide equivalent ("CO₂e") emitted, rising to \$50 per tonne by 2022. The application of the price would be co-ordinated with provincial jurisdictions. We do not know yet how such a price mechanism will affect our operations. Legislation is still pending, but will likely be brought forward in 2018.

Alberta

We estimate the Alberta Electric System Operator ("AESO") will need to procure up to 5,000 MW, of renewable generation under the Renewable Electricity Program ("REP") by 2030 to meet the 30 per cent target for renewable generation established by the Government of Alberta. The AESO completed its consultation on the Round 1 400 MW Request for Proposal ("RFP") process for the REP in the first quarter of 2017. The Round 1 RFP closed on Dec. 13, 2017, when the successful bidders were notified. The AESO, with approval from the Government of Alberta, awarded contracts for 595 MW to three proponents with a total of four projects. The projects will receive a Renewable Energy Supply Agreement ("RESA") that will provide a fixed price for energy under a contract for differences payment structure. Projects are required to reach commercial operation by 2019. The average cost of the bid was \$37/MWh. TransAlta's bid was not awarded an RESA.

The AESO, with government approval, has announced initial Round 2 and 3 REP RFP details and continues to work on a roadmap to outline future calls for proposals. The Round 2 call will have an indigenous equity requirement and will seek 300 MW of renewable energy projects. Round 3 will be similar to Round 1 in seeking 400 MW of renewable projects capable of interconnecting with the existing transmission or distribution grid. The Round 2 and 3 contract structures have not yet been described in detail but will need to align with the change in Alberta's electricity market to a capacity market. The

AESO will provide procurement details to Alberta Energy at the end of February 2018 with details of RFP timelines and project delivery being made public in March 2018.

The Carbon Competitiveness Incentive Regulation ("CCIR") replaced the Specified Gas Emitters Regulation ("SGER") on Jan. 1, 2018. Under SGER, some of our wind facilities received offset carbon credits based on generation. For entities subject to SGER, these credits could be purchased to meet such entity's SGER carbon compliance obligations. As a generator of offset carbon credits, the sales of the carbon credit provide a revenue stream. The government has confirmed offset crediting will continue and that credits will be fungible under the CCIR on a one-to-one basis, providing for the continuance of this revenue stream. The government has limited carbon credit usage initially to 50 per cent rising to 60 per cent over time of covered entities' compliance requirements. Nonetheless, increased carbon compliance pricing of up to \$30 per tonne of carbon dioxide equivalents ("tCO₂e") potentially rising to \$50/tCO₂e in 2022 should mitigate the carbon credit limit's impact on market pricing. The CCIR will allow all renewables generation not currently receiving carbon crediting to do so post-2018 by opting into the CCIR. These incremental carbon credits would not be delivered until mid-2019. Most of TransAlta's hydro facilities are under PPAs until 2021, following which time they will be eligible to generate credits to the Corporation under CCIR. The wind facilities currently not getting crediting will also be eligible for carbon crediting. Further, cogeneration facilities will continue to receive carbon credit but at a lower level compared to carbon credits received under SGER.

Ontario

Effective January 1, 2017, the Government of Ontario put regulations into effect to implement a greenhouse gas cap-and-trade program. Gas-fired electricity generation will be regulated at the gas distribution level. Our gas-fired generation facility in Ontario will not be significantly impacted by virtue of change-in-law provisions within our existing contracts.

Australia

In March 2017, state elections were held in Western Australia and a change of government took place. The new Labor government announced a road map for electricity initiatives (Electricity Sector Reform Initiatives - A roadmap for the current reform work program). The reform program focuses on three pillars of work that are improving access to Western Power's network, improving reserve capacity pricing signals, and improving access to, and operation of, the Pilbara electricity network. With respect to improving access to Western Power's network, the government intends to introduce a constrained network access model for Western Power's network to optimize use at the least cost to electricity consumers. With an aim of improving access to, and operation of, the Pilbara electricity network, the Government of Western Australia intends to implement a fit-for-purpose light-handed regulatory regime to facilitate fair and reasonable access by third parties to Horizon Power's network and to more efficiently operate the electricity system.

Contracted Cash Flows

Substantially all of our wind, hydro and gas facilities have contracts in place for the sale of electricity they produce. Most of our wind and hydro facilities located in Alberta are contracted under long-term PPAs with TransAlta. The remaining wind and hydro facilities are contracted with government-owned corporations and large utility customers. The Sarnia facility is contracted to commercial users in various industries, with the remainder of the generation being sold into the Ontario market under contract with the Independent Electricity System Operator ("IESO"). The Australian gas facilities are contracted to mining companies and a government-owned corporation in Western Australia. In 2017, the 110 MW Parkeston gas facility was re-contracted until 2026, while the remaining PPAs and other long-term contracts generally expire between 2023 and 2042.

In addition to contracting for power, we have entered into long-term and short-term contracts to sell the Green Attributes from our wind and hydro facilities. For 2017, approximately 79 per cent and 100 per cent of the Green Attributes from our wind and hydro facilities, respectively, were sold.

Strategy and Capability to Deliver Results

Our objectives are to (i) provide stable, consistent returns for investors through the ownership of, and investment in, highly contracted renewable and natural gas power generation and other infrastructure assets that provide stable cash flow primarily through long-term contracts with strong counterparties; (ii) pursue and capitalize on strategic growth opportunities in the renewable and natural gas power generation and other infrastructure sectors; (iii) maintain diversity in terms of geography, generation and counterparties; and (iv) pay out 80 to 85 per cent of cash available for distribution to the shareholders of the Corporation on an annual basis.

Our strategies and capabilities to deliver on our objectives are as follows:

Financial Strategy

Our financial strategy is to maintain a strong financial position to provide a solid foundation for our core business and growth. A strong financial position improves our ability to create stable, consistent returns.

Contracting Strategy

Through the use of PPAs, including the TransAlta PPAs, our facilities and those in which we have an economic interest are highly contracted. Substantially all the capacity is contracted over the next six years, and gradually decreases thereafter over a period extending to 30 years. The weighted average remaining contractual life of our PPAs is approximately 12 years.

Operational Strategy

Our wind, hydro and gas facilities have an established track record of operating history and performance. Excluding the gas pipeline in Western Australia and the South Hedland Power Station which was commissioned in 2017, the assets have been in operation from approximately five to 27 years.

TransAlta provides management, administrative and operational services to the Corporation. The members of TransAlta's management team who are responsible for managing our operations have extensive experience in the power generation business. The employees of TransAlta providing operational services at our facilities are the same individuals who perform such services for TransAlta.

Growth Strategy

Our growth strategy is to develop or acquire highly contracted renewable and natural gas power generation facilities and other infrastructure assets that generate stable cash flows, with the objective of achieving returns on invested capital. The successful execution of our growth strategy requires careful timing and business judgment, as well as the resources to complete the due diligence and evaluation of such assets.

TransAlta, our sponsor, has indicated that the sale of certain of its contracted assets to us could form one source of their financing. Assets that have been identified as candidates for acquisition by us include certain renewable facilities in Canada and the United States. Acquisitions from TransAlta will be subject to independent assessments and approval by the independent directors of the Corporation's Board of Directors.

Other longer-term growth opportunities may also be sought, primarily through acquisitions, contracted new build projects, industry consolidation and other growth opportunities in new markets, other technologies or investment classes.

Significant and Subsequent Events

South Hedland Power Station, Conversion of Class B Shares, FMG PPA

On July 28, 2017, the South Hedland Power Station achieved commercial operation. On Aug. 1, 2017, we converted the 26.1 million Class B shares held by TransAlta into 26.4 million common shares. The Class B shares were converted at a ratio greater than 1:1 because the construction and commissioning costs for the project were below the referenced costs agreed upon in the amended contribution agreement dated July 26, 2017, between us and TransAlta. As a result of commissioning the facility, the dividend was increased by approximately 7 per cent from \$0.88 per share to \$0.94 per share annually.

On Aug. 1, 2017, FMG notified TransAlta and the Corporation, that, in its view, the South Hedland Power Station had not yet satisfied the requisite performance criteria under the South Hedland PPA between FMG and TransAlta. In our view, all conditions to establish commercial operations have been fully satisfied under the terms of the South Hedland PPA. Horizon Power, the local utility and pricing offtaker of the majority of generation from the facility, has confirmed and not disputed commercial operation. On Nov. 13, 2017, FMG issued a notice purporting to terminate the South Hedland PPA. TransAlta's view is that the purported termination is invalid and, as such, they are taking all steps necessary to protect our interest in the facility and ensure all cash flows expected under the South Hedland PPA are realized.

Kent Hills Wind Project

During the second quarter, we entered into a long-term contract with NB Power for the sale of all power generated by an additional 17.25 MW of capacity from the Kent Hills wind project. At the same time, the term of the Kent Hills 1 contract with NB Power was extended from 2033 to 2035, matching the life of the Kent Hills 2 and Kent Hills 3 wind projects.

The additional 17.25 MW at Kent Hills is an expansion project of our existing Kent Hills wind farm, increasing the total operating capacity of the Kent Hills wind farm to approximately 167 MW. We expect to begin the construction phase in the spring of 2018.

On Oct. 2, 2017, we closed an approximate \$260 million bond offering, by way of a private placement, which is secured by, among other things, a first ranking charge over all assets of Kent Hills Wind LP, a subsidiary of the Corporation. The bonds are amortizing and bear interest at an annual rate of 4.454 per cent, payable quarterly and maturing on Nov. 30, 2033. Proceeds from the financing will partly fund the expansion at Kent Hills, with the remaining proceeds, net of \$30 million held in a construction reserve account, being distributed to each partner in the Kent Hills wind project.

Syndicated Credit Facility

On July 24, 2017, we entered into a syndicated credit agreement giving us access to a \$500 million committed credit facility. The agreement is fully committed for four years, expiring in 2021. The facility is subject to a number of customary covenants and restrictions in order to maintain access to the funding commitments. In conjunction with the entering into the new credit agreement, the \$350 million credit facility provided by TransAlta was cancelled.

Repurchase of Solomon Power Station

On Aug. 1, 2017, TransAlta received notice of FMG's intention to repurchase the Solomon Power Station from TEC Pipe Pty Ltd., a wholly owned subsidiary of TransAlta, for approximately US\$335 million. We have an economic interest in the cash flows generated from the Solomon Power Station. FMG completed its acquisition of the Solomon Power Station on Nov. 1, 2017, and TEC Pipe Pty Ltd. received approximately US\$325 million as consideration. FMG has held back the balance from the purchase price. It is TransAlta's view that this should not be held back and TransAlta is taking action to recover all, or a significant portion, of this amount from FMG.

TEA used part of the proceeds received to redeem \$179 million of the MRPS and \$39 million of the preferred shares of TEA (refer to Note 8 of the financial statements for additional information). In addition, we received a loan in the amount of \$194 million (AUD199 million) from TEA. The loan is due on the earlier of receipt of a demand notice or Dec. 31, 2018 (refer to Note 16 of the financial statements for additional information).

We utilized the remaining proceeds to repay the credit facility used to fund the development of the South Hedland Power Station and to repay the \$215 million convertible debenture issued to TransAlta. The repayment of the convertible debenture will reduce our interest expense by approximately \$10 million per year in each of the years 2018 through 2020 and eliminates the potential for additional common shares to be issued in 2021 upon conversion.

As a result of FMG's determination to repurchase the Solomon Power Station, we recognized an impairment during the third quarter on the preferred shares tracking adjusted TEA amounts in the amount of \$114 million. While our economic interest in the Australian business is based on the net underlying cash flows of the Australian Assets, the fair value of the investment in the Australian Tracking Preferred Shares does not depreciate in line with the assets. The fair value is based on the underlying cash flows of the Australian business and is impacted by foreign currency and discount rate assumptions. Over time the accounting value of the Australian Tracking Preferred Shares was also increased to reflect lower discount rates. Since acquiring the investment in 2015, the Solomon Power Station has generated over \$100 million in free cash flow.

As disclosed in Note 4 of the 2017 audited consolidated financial statements, on Nov. 13, 2017, FMG issued a notice purporting to terminate its South Hedland PPA. Due to the purported PPA termination, which, in TransAlta's view is invalid, we revised the expected underlying cash flows of the Australian Tracking Preferred Shares based upon the best estimates of recovery through legal recourse and other means. As a result, in the fourth quarter of 2017, we recognized an impairment on the Australian Tracking Preferred Shares of \$23 million.

Refer to Notes 2(Q) and 8 of the 2017 audited consolidated financial statements for additional information.

Unsecured Debentures Early Redemption

On Sept. 27, 2017, we provided notice of the early redemption of the unsecured debentures issued by our subsidiary, Canadian Hydro Developers, Inc., on Oct. 12, 2017, with a weighted average interest rate of 6.3 per cent. The debentures were scheduled to mature in June 2018. On Oct. 12, 2017, we redeemed the unsecured debentures for \$201 million in total, comprised of principal of the \$191 million, an early redemption premium of \$6 million and accrued interest of \$4 million.

Management and Board Changes

The Corporation announced on Nov. 2, 2017, the appointment of John Kousinioris as President of the Corporation and as a member of the Board of Directors. Mr. Kousinioris is the Chief Legal and Compliance Officer and Corporate Secretary of TransAlta and will continue this role in addition to his duties at TransAlta.

Brett Gellner will remain on the Board of TransAlta Renewables and as Chief Investment Officer of TransAlta. Mr. Gellner will dedicate his time to evaluating and pursuing growth opportunities for both TransAlta and the Corporation.

Mr. Kousinioris replaces Aron Willis on the Board of Directors of TransAlta Renewables. Mr. Willis will continue in his role as Senior Vice-President Gas and Renewables for both TransAlta and the Corporation.

Acquisition of US Wind Projects

On Feb. 20, 2018, we announced that we entered into an arrangement to acquire two construction-ready projects in the Northeast United States. The wind development projects consist of: (i) a 90 Megawatt ("MW") project located in Pennsylvania which has a 15-year Power Purchase Agreement PPA and (ii) a 29 MW project located in New Hampshire with two 20-year PPAs. All three counterparties have S&P credit ratings of A+ or better.

Total cost of the two projects is estimated to be US \$240 million, of which approximately 70 per cent will be funded in 2018 and the remainder in 2019. The commercial operation date for both projects is expected during the second half of 2019.

We will fund the acquisition and construction costs using existing liquidity and tax equity.

Liquidity and Capital Resources

Liquidity risk arises from our ability to meet general funding needs, engage in hedging activities and manage the assets, liabilities, and capital structure of the Corporation. Liquidity risk is managed by maintaining sufficient liquid financial resources to fund obligations as they come due in the most cost-effective manner.

Our liquidity needs are met through a variety of sources, including cash generated from operations, capital markets and funding from TransAlta. Our primary uses of funds are operational expenses, capital expenditures, distributions to the non-controlling interest, and interest and principal payments on debt and dividends.

Financial Position

The following chart highlights significant changes in the Consolidated Statements of Financial Position from Dec. 31, 2016 to Dec. 31, 2017:

	Increase/ (decrease)	Primary factors explaining change
Cash and cash equivalents	5	Timing of receipts and payments
Trade and other receivables	29	Timing of receipts
Property, plant, and equipment, net	(55)	Increased depreciation expense due to the acquisition of the Canadian Assets on Nov. 30, 2016, partially offset by additions
Intangible assets	(10)	Amortization
Restricted cash	30	A portion of the proceeds from the Kent Hills wind project financing held in a construction reserve account
Investments in subsidiaries of TransAlta	(208)	Decrease in the Australian Tracking Preferred Shares due to impairment, a decrease in fair value and a return on capital. Redemptions of MRPS, preferred shares of TEA, and the tracking preferred shares of TransAlta Wyoming Wind also contributed to the decrease in the investment balance. These were partially offset by an increase in MRPS and preferred shares of TEA for additional investments in the Australian Assets
Other assets	32	Long-term loan receivable from the Kent Hills wind farm non-controlling interest partner
Accounts payable and accrued liabilities	10	Timing of payments and accruals
Dividends payable	10	Increase in common shares outstanding
Long-term debt (including current portion)	216	Increase due to proceeds from the Kent Hills wind project financing and from the TEA loan, partially offset by scheduled repayments made on the Melancthon Wolfe, New Richmond, and Kent Hills bonds as well as on the Canadian Assets working capital loan, and early redemption of the unsecured debentures
Convertible debenture	(215)	Repayment of convertible debenture on Nov. 9, 2017
Class B shares liability (including current portion)	(384)	Class B shares converted to common shares on Aug. 1, 2017
Decommissioning and other provisions (including current portion)	15	Increase due to the acquisition of the Canadian Assets on Nov. 30, 2016 and accretion
Equity attributable to shareholders	135	Issuance of common shares for Class B shares conversion, partially offset by dividends declared for the period

Cash Flows

The following chart highlights significant changes in the Consolidated Statements of Cash Flows for the year ended Dec. 31, 2017, compared to the same period in 2016:

Year ended Dec. 31	2017	2016	Primary factors explaining change
Cash and cash equivalents, beginning of period	15	2	
Provided by (used in):			
Operating activities	290	282	Higher cash earnings of \$32 million partially offset by unfavourable changes in working capital of \$24 million
Investing activities	(65)	(241)	Proceeds from the redemptions of investments of \$217 million along with an increase in return of capital on investments in subsidiaries of TransAlta of \$23 million, offset by an increase in property, plant, and equipment of \$24 million, the loan receivable of \$38 million, and restricted cash of \$30 million
Financing activities	(220)	(28)	Higher long-term debt repayments of \$160 million, lower proceeds on issuance of common shares of \$162 million and the repayment of the convertible debenture of \$215 million was partially offset by the proceeds of the TEA loan of \$194 million, higher issuance of long-term debt of \$101 million and an increase in borrowings under the Credit Facility of \$84 million
Cash and cash equivalents, end of period	20	15	

Debt

Debt, including amounts owing to TransAlta, totalled \$1,043 million as at Dec. 31, 2017, compared to \$1,042 million as at Dec. 31, 2016. Although debt remained flat, we issued the Kent Hills Wind bond in October and the TEA loan in November. These increases in debt were offset by the convertible debenture repayment and the early redemption of the unsecured debentures.

As at Dec. 31, 2017, we had a \$500 million syndicated Credit Facility available to us for general corporate purposes, including financing ongoing working capital requirements, construction capital requirements, growth opportunities and the repayment of outstanding borrowings. As at Dec. 31, 2017, \$27 million was drawn and outstanding on the Credit Facility. At Dec. 31, 2016, \$15 million was outstanding on the TransAlta credit facility. This external syndicated Credit Facility replaced the credit facility with TransAlta, as discussed in Note 16 of our financial statements. We also have an uncommitted \$100 million demand letter of credit facility, under which \$69 million of letters of credit have been issued as at Dec. 31, 2017.

In March 2017, we repaid \$13 million of the Canadian Assets working capital loan. In June 2017, we made scheduled semi-annual principal repayments of \$18 million on the Melancthon Wolfe bond and \$3 million on the New Richmond bond. In the fourth quarter, we made a scheduled semi-annual \$17 million principal payment on the Melancthon Wolfe bond and another \$4 million principal payment on the New Richmond bond. Also in the fourth quarter, we made a scheduled semi-annual \$2 million principal payment on the Kent Hills Wind bond. On Oct. 12, 2017, we early redeemed the unsecured debentures of Canadian Hydro Developers, Inc., for \$201 million. On Nov 9, 2017, we repaid the convertible debentures issued to TransAlta for \$218 million in total, comprised of principal of \$215 million and accrued interest of \$3 million.

We are subject to customary positive and negative covenants related to debt. We are not in violation of any of these covenants.

At Dec. 31, 2017, \$202 million of our debt was due to TransAlta (2016 – \$249 million), comprised of the TEA loan and the Canadian Assets working capital loan; in 2016 our debt to TransAlta also additionally included the TransAlta credit facility and the convertible debenture.

The Melancthon Wolfe Wind, Pingston, New Richmond and Kent Hills Wind bonds are subject to customary financing conditions and covenants that restrict the Corporation's ability to access funds generated by the facilities' operations. Upon meeting certain distribution tests, typically performed once per quarter, the funds can be distributed by the subsidiary entities to their respective parent entity. These restrictions include the ability to meet a debt service coverage ratio prior

to distribution. Funds in these entities that have accumulated since the fourth quarter test will remain there until the next debt service coverage ratio can be calculated in the first quarter of 2018. As at Dec. 31, 2017, \$14 million of cash was subject to these financial restrictions.

Additionally, the Melancthon Wolfe Wind, Pingston, New Richmond and Kent Hills Wind bonds require that certain reserve accounts be established and funded through cash held on deposit and/or by providing letters of credit. The Corporation has elected to use letters of credit as at Dec. 31, 2017. Accordingly, no cash was subject to these restrictions.

The Corporation has \$30 million of cash received from the Kent Hills Wind bond financing that is held in a construction reserve account. The restricted cash will be released from the construction reserve account upon satisfaction of certain conditions, including the Kent Hills 3 wind expansion project achieving commercial operations.

Share Capital

On Dec. 31, 2017, and February 22, 2018, we had approximately 250 million common shares and nil Class B shares issued and outstanding. On July 28, 2017, the South Hedland Power Station achieved commercial operation and on Aug. 1, 2017, we converted the 26.1 million Class B shares into 26.4 million common shares. At Dec. 31, 2016, we had approximately 224 million common shares and 26.1 million Class B shares issued and outstanding.

Capital Structure

Our capital structure consists of the following components as shown below:

As at Dec. 31	2017		2016	
	Amount	%	Amount	%
Debt, net of available cash and cash equivalents ⁽¹⁾	1,023	32	812	23
Class B shares liability	—	—	384	11
Convertible debenture	—	—	215	7
Non-controlling interest	36	1	35	1
Equity attributable to shareholders	2,161	67	2,026	58
Total capital	3,220	100	3,472	100

(1) The Corporation includes available cash and cash equivalents as a reduction of capital, as capital is managed internally and evaluated by management using a net debt position.

Commitments

Payments required under the Corporation's contractual obligations are as follows:

	Long-term service agreements ⁽¹⁾	General administrative services ⁽²⁾	Long-term debt	Interest on long-term debt	Land access and leases	Purchase contracts ⁽³⁾	Total
2018	28	20	250	39	2	5	344
2019	24	18	49	31	2	—	124
2020	41	19	51	29	2	—	142
2021	30	19	78	27	2	—	156
2022	14	20	54	25	2	—	115
2023 and thereafter	32	230	570	108	37	—	977
Total	169	326	1,052	259	47	5	1,858

(1) Operating leases of less than \$1 million per year are included in long-term service agreements.

(2) Excludes portion charged directly to Wyoming Wind.

(3) Includes natural gas purchase and transportation.

Line Loss Rule Proceeding

TransAlta has been participating in a line loss rule proceeding ("LLRP") before the Alberta Utilities Commission ("AUC"). The AUC determined that it has the ability to retroactively adjust line loss charges going back to 2006 and directed the AESO to, among other things, perform such retroactive calculations. The various decisions by the AUC are, however, subject to appeal and challenge. The AUC recently issued a decision (which is subject to appeal) that determined the methodology to be used retroactively. Based on that methodology, TransAlta has concluded that our maximum potential exposure for retroactive line loss charges is not material.

FMG Disputes

In the normal course of business, we may become party to litigation claims. While we are not directly involved in the ongoing dispute with FMG over the purported termination of the South Hedland PPA, the results of the litigation could impact the finance income received as a result of our economic interest in the Australian Assets. In addition, FMG withheld approximately AUD43 million in tax applicable to the repurchase of the Solomon Power Station. TransAlta has commenced proceedings to recover the tax payable by FMG by filing and serving FMG with a Writ and Statement of Claim on Nov. 17, 2017, and also applied for summary judgment for this amount. The hearing is scheduled for March 23, 2018.

Other Consolidated Results

Net Interest Expense

The components of net interest expense are shown below:

Year ended Dec. 31	2017	2016
Interest on long-term debt	38	36
Interest on convertible debenture	9	10
Loss on redemption of unsecured debentures	6	1
Other net interest ⁽¹⁾	3	1
Accretion of provisions	2	1
Net interest expense	58	49

(1) Consists of letters of credit and guarantees, credit facility commitments, other interest and banking fees. For the year ended Dec. 31, 2017, interest on letters of credit and guarantees pledged by TransAlta was \$2 million (2016 - \$1 million).

For the year ended Dec. 31, 2017, net interest expense increased compared to 2016 primarily due to the issuance of the Kent Hills Wind bond, the impact of the New Richmond bond being outstanding for the full year compared to six months in 2016, and the loss on the redemption of unsecured debentures. The increase in net interest expense was partially offset by the repayment of the convertible debenture.

Class B Shares Liability

As at Dec. 31, 2017, nil Class B shares were outstanding (2016 - 26.1 million). On July 28, 2017, commissioning of the South Hedland Power Station was achieved and on Aug. 1, 2017, the Corporation converted the 26.1 million Class B shares into 26.4 million common shares. The Class B shares were converted at a ratio greater than 1:1 because the construction and commissioning costs for the project were below the referenced costs agreed upon in the amended contribution agreement dated July 26, 2017 between the Corporation and TransAlta. On the conversion date, the \$385 million carrying amount of the Class B shares liability was derecognized and the common shares issued on conversion were recognized at that same amount.

Income Taxes

Our income tax rates and tax expense are based on the earnings generated in each jurisdiction in which we operate and any permanent differences between how pre-tax income is calculated for accounting and tax purposes. If there is a timing difference between when an expense or revenue item is recognized for accounting and tax purposes, these differences result in deferred income tax assets or liabilities and are measured using the income tax rate expected to be in effect when these temporary differences reverse. The impact of any changes in income tax rates on deferred income tax assets or liabilities is recognized in earnings in the period the new rates are enacted.

Non-Controlling Interest

Natural Forces Technologies, Inc. owns a 17 per cent interest in the Kent Hills 1 and 2 wind farms ("Kent Hills"), which collectively have 150 MW of gross generating capacity, and in the Kent Hills 3 expansion project, currently under development.

Since we have a controlling interest in Kent Hills, 100 per cent of the earnings, assets and liabilities are consolidated into our financial statements. The non-controlling interest on the Consolidated Statements of Earnings and Consolidated Statements of Financial Position relate to the earnings and net assets attributable to the portion of Kent Hills that we do not own. On the Consolidated Statements of Cash Flows, cash paid to the minority owners of Kent Hills is shown in the financing activities section as distributions to non-controlling interest.

Net earnings attributable to the non-controlling interest of \$4 million for the year ended Dec. 31, 2017, were consistent with \$3 million for 2016.

Other Comprehensive Income ("OCI")

During the year ended Dec. 31, 2017, we recognized a \$37 million decrease in fair value in OCI. The changes in the fair value of available-for-sale instruments during the period are primarily attributable to the Australian Tracking Preferred Shares. See Note 8 of our annual consolidated financial statements for additional information.

Sustaining Capital Expenditures

Actual sustaining capital expenditures for assets we directly own, as well as the facilities in which we own economic interests, are noted below for our annual total sustaining capital expenditures:

Year ended Dec. 31

	Canadian Wind	Canadian Hydro	US Wind	Canadian Gas	Australian Gas	Total
2017 Total sustaining expenditures	9	2	2	16	10	39
2016 Total sustaining expenditures	10	4	2	6	14	36

Sustaining capital expenditures increased \$3 million from 2016 primarily due to engine replacements in Australia and generator replacements at Canadian Gas. The majority of sustaining capital spent in Canadian Gas related to a planned major overhaul of a gas turbine at the Sarnia facility.

We have incurred \$9 million on growth capital associated with the Kent Hills 3 expansion project. We also incurred \$2 million in 2017 on productivity capital on the Wolfe Island turbine power curve upgrade.

2018 Outlook

The following table outlines our expectation on key financial targets for 2018:

Measure	Target
Comparable EBITDA	\$400 million to \$420 million
Adjusted funds from operations	\$315 million to \$340 million
Cash available for distribution	\$260 million to \$290 million

Business Environment

Economic Environment

Through the use of PPAs, including TransAlta PPAs, substantially all of our owned facilities and Australian Assets are currently contracted, and we therefore expect to see no significant impact on our business from the weak Western Canadian and Australian economies.

Counterparty credit risk is monitored and we operate in accordance with our established risk management policies. We do not anticipate any material change to our existing credit practices.

Environmental Legislation

We anticipate an increase in revenue from carbon offset credits generated in Alberta for 2018. Total revenues from Green Attributes, which include carbon offset credits, amounted to \$14 million in 2017.

As part of the Climate Leadership Plan, the Government of Alberta has established a new system of obligations and allowances, benchmarked against highly efficient gas generation. The initial compliance price has been set at \$30 per tonne of carbon dioxide emissions.

Operations

Production

We expect renewable energy production from our wind and hydro assets in 2018 to be in the range of 3,400 to 3,800 GWh. Contracts for gas-fired generation primarily provide compensation for capacity, and accordingly, production is not a significant performance indicator of these assets.

Contracted Cash Flows

Through the use of PPAs, including the TransAlta PPAs, our facilities and those in which we have an economic interest have a weighted average remaining contractual life of approximately 12 years.

Operating Costs

We have established long-term service agreements with suppliers to stabilize operations, maintenance and administration costs. Most of our generation from gas is sold under contracts with pass-through provisions for fuel. For gas generation with no pass-through provision, we purchase natural gas coincident with production, thereby minimizing our exposure to changes in price.

Exposure to Fluctuations in Foreign Currencies

We are exposed to fluctuations in the exchange rate between the Canadian and the Australian and US dollars as a result of our economic interest in the Wyoming Wind farm and the Australian Assets. We also have exposure to the euro due to the Kent Hills 3 expansion project. The securities acquired from TransAlta and the related dividends received are denominated in Canadian, Australian and US dollars. TransAlta has agreed to provide us with protection against fluctuations in the exchange rates until June 30, 2020 on cash flows from the Australian Assets. Any changes in foreign investments or foreign-denominated debt may change our exposure. All of our other assets are located in Canada. We may acquire equipment from foreign suppliers in various foreign currencies for future capital projects, which could create exposure to fluctuations in the value of the Canadian dollar related to these currencies.

Our strategy is to mitigate foreign exchange risk on foreign-denominated cash flows to ensure our ability to meet dividend requirements. Cash flows relating to the Australian Assets are predominantly hedged under agreements with TransAlta. In addition, we entered into foreign exchange forward contracts to hedge US dollar cash flows primarily related to Wyoming Wind.

Net Interest Expense

Exposure to interest rate risk is not significant as interest rates on long-term debt are largely fixed. Net interest for 2018 is expected to be higher than 2017, due to a higher volume of debt. On July 24, 2017, we entered into a syndicated credit agreement giving us access to \$500 million in direct borrowings at a variable interest rate. As a result, we have some exposure to interest rate risk. Changes in interest rates can affect the amount of net interest expense incurred.

Net Debt, Liquidity and Capital Resources

If there are low wind volumes, low hydro resources or unexpected maintenance costs, we may need additional liquidity in the future. We expect to maintain adequate available liquidity under our Credit Facility.

The receipt of the proceeds from the repurchase of the Solomon Power Station from TransAlta and its Australian subsidiaries have allowed us to revise the timing of our future project level financings against fully contracted assets. We do not anticipate raising any additional project level debt in respect of our existing assets in the next 12 to 18 months.

Capital Expenditures

Sustaining Capital

Our sustaining capital is comprised of the ongoing capital costs associated with maintaining the existing generating capacity of our facilities. The facilities of TransAlta in which we own economic interests also incur sustaining capital expenditures. While we are not required to fund these expenditures, they reduce the finance income from these investments.

For 2018, our estimate for total sustaining capital expenditures for owned assets and those in which we own an economic interest ranges from \$30 million to \$40 million.

Construction of South Hedland

The South Hedland Power Station achieved commercial operation on July 28, 2017. As at Dec. 31, 2017, we have fully funded all of the South Hedland Power Station construction costs.

Financing

Financing for these capital expenditures is expected to be provided by cash flow from operating activities, capital markets transactions and our new Credit Facility.

Kent Hills 3 Wind Expansion

Total construction costs of our 17.25 MW Kent Hills 3 wind expansion in New Brunswick are expected to be approximately \$36 million. To date we have spent \$9 million. Our 17 per cent partner on the existing Kent Hills facilities is participating in the expansion project and also owns a 17 per cent interest. They will be funding their share of the total project costs. Our target completion date is the fourth quarter of 2018.

Risk Management

Our business activities expose us to a variety of risks including, but not limited to, increased regulatory changes, rapidly changing market dynamics and volatility in commodity markets. Our goal is to manage these risks so that we are reasonably protected from an unacceptable level of earnings, cash available for distribution or financial exposure while still enabling business development. We use a multilevel risk management oversight structure to manage the risks arising from our business activities, the markets in which we operate, and the political environments and structures with which we interface.

The responsibilities of various stakeholders of our risk management oversight structure are described below:

The Board of Directors of TransAlta Renewables (the "Board") is responsible for the stewardship of the Corporation. Subject to the provisions of the *Canada Business Corporations Act*, the Board may delegate certain of its powers and authority that the Board, or independent members of the Board, as applicable, deem necessary or desirable to effect the actual administration of the duties of the Board. Pursuant to the Management Agreement, the Board has delegated broad discretion to administer and manage the business and affairs of the Corporation to TransAlta. Nonetheless, the Board retains certain responsibilities that are described in the Board of Directors' Charter, a copy of which is available on our website and on SEDAR under the electronic profile of the Corporation. The Board of Directors includes three independent members.

The Audit Committee's (the "Committee") primary role is to assist the Board in fulfilling its oversight responsibilities regarding our internal controls, financial reporting and risk management processes. The Committee is composed entirely of independent members of the Board of Directors.

The Committee is directly responsible for overseeing the work of the external auditor engaged for the purpose of preparing and issuing an auditor's report or performing other audit, review or attestation services, including the resolution of disagreements between the external auditor and management. The external auditor reports directly to the Committee. In addition, the Committee pre-approves all non-audit services undertaken by the external auditor.

The Committee is responsible for establishing and maintaining satisfactory procedures for the receipt, retention and treatment of complaints and for the confidential, anonymous submission of questionable accounting or auditing matters. The Committee is accountable to the Board and provides a report to the Board at each regularly scheduled Board meeting outlining the results of the Committee's activities and any reviews it has undertaken.

Risk Controls

Our risk controls have several key components:

Enterprise Tone

We strive to foster beliefs and actions that are true to, and respectful of, our many stakeholders. We do this by investing in communities where we live and work, operating and growing sustainably, putting safety first, and being responsible to the many groups and individuals with whom we work.

Policies

Under the Management Agreement, TransAlta provides all the general administrative and operational services as may be required or advisable for the management of the affairs of the Corporation and operation and maintenance of our facilities. TransAlta maintains a comprehensive set of enterprise-wide policies. These policies establish delegated authorities and limits for business transactions, as well as allow for an exception approval process. Periodic reviews and audits are performed to ensure TransAlta's compliance with these policies. All TransAlta employees are required to comply with a corporate code of conduct. Our directors and officers are also required to sign a code of conduct on an annual basis.

Risk Factors

Risk is an inherent factor of doing business. The following section addresses some, but not all, risk factors that could affect our future results and our activities in mitigating those risks. These risks do not occur in isolation, but must be considered in conjunction with each other. Further information on these risk factors can be found in our AIF for the year ended Dec. 31, 2017.

For some risk factors we show the after-tax effect on net earnings of changes in certain key variables. The analysis is based on business conditions in 2017 and includes the indirect effects of risks on the facilities in which we have an economic interest. The actions that we describe as being part of our management of these risks include those carried by TransAlta as owner of those facilities. Each item in the sensitivity analysis assumes all other potential variables are held constant. While these sensitivities are applicable to the period and the magnitude of changes on which they are based, they may not be applicable in other periods, under other economic circumstances or for a greater magnitude of changes. The changes in rates should also not be assumed to be proportionate to earnings in all instances.

Volume Risk

Volume risk relates to the variances from our expected production. The financial performance of our wind and hydro operations is highly dependent upon the availability of their input resources in a given year. Shifts in weather or climate patterns, seasonal precipitation, and the timing and rate of melting and runoff may impact the water flow to our facilities. The strength and consistency of the wind resource at our facilities impacts production. The operation of thermal plants can also be impacted by ambient temperatures and the availability of water and fuel. Where we are unable to produce sufficient quantities of output in relation to contractually specified volumes we may be required to pay penalties or purchase replacement power in the market.

The volume risk is managed by TransAlta by:

- actively managing the assets and their condition in order to be proactive in plant maintenance so that our plants are available to produce when resources are available,
- placing our facilities in locations that we believe to have adequate resources to generate electricity to meet the requirements of our contracts. However, we cannot guarantee that these resources will be available when we need them or in the quantities that we require,
- diversifying our fuels and geography as one way of mitigating regional or fuel-specific events, and
- entering into supply contracts for fuel, or requiring provision thereof from our customers.

Generation Equipment and Technology Risk

There is a risk of equipment failure due to wear and tear, latent defect, design error or operator error, among other things, which could have a material adverse effect on the Corporation. Although our generation facilities have generally operated in accordance with expectations, there can be no assurance that they will continue to do so. Our plants are exposed to operational risks such as failures due to cyclic, thermal and corrosion damage in generators and turbines, and other issues that can lead to outages and increased volume risk. If plants do not meet availability or production targets specified in their PPA or other long-term contracts, we may be required to compensate the purchaser for the loss in the availability of production or record reduced energy or capacity payments.

As well, we are exposed to procurement risk for specialized parts that may have long lead times. If we are unable to procure these parts when they are needed for maintenance activities, we could face an extended period where our equipment is unavailable to produce electricity.

This generation equipment and technology risk is managed by TransAlta by:

- operating our generating facilities within defined and proven operating standards that are designed to maximize the availability of our generating facilities for the longest period of time,
- performing preventive maintenance on a regular basis,
- adhering to a comprehensive plant maintenance program and regular turnaround schedules,
- adjusting maintenance plans by facility to reflect the equipment type and age,
- having sufficient business interruption coverage in place in the event of an extended outage,
- having force majeure clauses in our PPAs and other long-term contracts,
- using technology in our generating facilities that is selected and maintained with the goal of maximizing the return on those assets,
- monitoring technological advances and evaluating their impact upon our existing generating fleet and related maintenance programs,
- negotiating strategic supply agreements with selected vendors to ensure key components are available in the event of a significant outage, and
- developing a long-term asset management strategy with the objective of maximizing the life cycles of our existing facilities and/or replacing of selected generating assets.

Environmental Compliance Risk

Our activities are subject to stringent environmental laws and regulations promulgated and administered by the federal, provincial, state and municipal governments where we operate. These laws and regulations generally concern use of water, wildlife protection, wetlands preservation, remediation of contamination, waste disposal requirements, preservation of archaeological artifacts, endangered species preservation and noise limitations, among others.

Environmental compliance risks are associated with existing and/or changes in environmental regulations. New emission reduction objectives for the power sector are being established by governments in the regions in which we operate. We anticipate continued and growing scrutiny by investors relating to sustainability performance. These changes to regulations may affect our earnings by imposing additional costs on the generation of electricity, such as emission caps, requiring additional capital investments in emission capture technology, or requiring us to invest in offset credits. It is anticipated that these compliance costs will increase due to increased political and public attention to environmental concerns, with a potential negative impact on our natural gas facilities and uncertain impact on our renewable facilities.

This environmental compliance risk is managed by TransAlta by:

- seeking continuous improvement in numerous performance metrics such as emissions, safety, land and water impacts, and environmental incidents,
- having an International Organization for Standardization and Occupational Health and Safety Assessment Series-based environmental health and safety management system in place that is designed to continuously improve performance,
- committing significant experienced resources to work with regulators to advocate that regulatory changes are well designed and cost effective,
- developing compliance plans that address how to meet or exceed emission standards,
- purchasing and selling Green Attributes,
- investing in renewable energy projects, and
- incorporating change-in-law provisions in contracts that allow recovery of certain compliance costs from our customers.

We strive to be in compliance with all environmental regulations relating to operations and facilities. Compliance with both regulatory requirements and management system standards is regularly audited through our performance assurance policy.

Credit Risk

Credit risk is the risk to our business associated with changes in the creditworthiness of entities with which we have commercial exposures. This risk results from the ability of a counterparty to either fulfil its financial or performance obligations to us or where we have made a payment in advance of the delivery of a product or service. The inability to collect cash due to us or to receive products or services may have an adverse impact upon our net earnings and cash flows. We are also exposed indirectly to the credit risks of TEA through our investment in the Australian Tracking Preferred Shares.

This exposure to credit risk is managed by TransAlta by:

- establishing and adhering to policies that define credit limits based on the creditworthiness of counterparties, contract term limits, and the credit concentration with any specific counterparty,
- requiring formal sign-off on contracts that include commercial, financial, legal and operational reviews,
- requiring security instruments, such as parental guarantees, letters of credit, cash collateral or third-party credit insurance that can be collected if a counterparty fails to fulfil its obligation or goes over its limits, and
- reporting our exposure using a variety of methods that allow key decision-makers to assess credit exposure by counterparty. This reporting allows us to assess credit limits for counterparties and the mix of counterparties based on their credit ratings.

If established credit exposure limits are exceeded, we take steps to reduce this exposure, such as requesting collateral, if applicable, or by halting commercial activities with the affected counterparty. However, there can be no assurances that we will be successful in avoiding losses as a result of a contract counterparty not meeting its obligations.

Our credit risk management profile and practices have not changed materially from Dec. 31, 2016. We had no material counterparty losses in 2017. We continue to keep a close watch on changes and trends in the market and the impact these changes could have on our business activities, and will take appropriate actions as required, although no assurance can be given that we will always be successful.

A summary of our direct and indirect credit exposures at Dec. 31, 2017 is provided below:

Counterparty credit rating	Direct exposure		Indirect exposure	
	Receivables ⁽¹⁾	MRPS	Trade accounts receivable	Finance lease receivable
Investment grade	88	—	36	—
Non-investment grade	23	—	66	—
No external rating	38	601	—	—

¹⁾ Includes trade accounts receivable, distributions receivable from subsidiaries of TransAlta, and a loan receivable.

The indirect exposure includes accounts receivable of TEA, comprised of one unrelated non-investment grade customer. Risk of significant loss arising from this counterparty has been assessed as low in the near term, but could increase to moderate in an environment of sustained low commodity prices over the mid to long term. Our assessment takes into consideration the counterparty's financial position, external rating assessments, and how TEA provides its services in an area of the counterparty's lower-cost operations, and TransAlta's other credit management practices.

Currency Rate Risk

We have exposure primarily to the US and Australian currencies as a result of our investments in and loans from subsidiaries of TransAlta, and the euro and US dollar due to equipment purchases. Changes in the values of these currencies relative to the Canadian dollar may affect our earnings or the value of our foreign investments to the extent that these positions or cash flows are not hedged or the hedges are ineffective.

We manage currency rate risk by:

- entering into contractual arrangements with TransAlta to fix in Canadian dollars the US- and Australian-denominated income from all sources arising from our investment in the Australian Assets. The exchange rates at which we will recognize income denominated in US and Australian dollars is fixed until June 30, 2020, and
- offsetting our US dollar cash flows primarily related to the Wyoming Wind assets with foreign exchange forward contracts. Going forward, we may enter into forward foreign exchange contracts, as considered necessary, to hedge other foreign-denominated cash flows.

As at Dec. 31, 2017, a four cent increase or decrease in the Australian dollar relative to the Canadian dollar would increase or decrease net earnings of the Corporation by \$15 million, and result in an increase or decrease in other comprehensive income, including underlying valuation impacts of non-monetary available-for-sale securities, of \$23 million.

As at Dec. 31, 2017, a four cent increase or decrease in the US dollar relative to the Canadian dollar would result in an increase or decrease in other comprehensive income, including underlying valuation impacts of non-monetary available-for-sale securities, of \$6 million.

The Wyoming Wind tracking preferred shares contain embedded US-denominated cash flows. A four cent increase or decrease in the US dollar relative to the Canadian dollar relative to this indirect exposure would increase or decrease net earnings of the Corporation by \$3 million.

Liquidity Risk

Liquidity risk arises from our ability to meet general funding needs, and manage the assets, liabilities, and capital structure of the Corporation. Our liquidity needs are met through a variety of sources, including capital markets, cash generated from operations and funding from our Credit Facility. Our primary uses of funds are operational expenses, capital expenditures, interest and principal payments on debt, funding growth and dividends.

We manage liquidity risk by:

- maintaining sufficient liquid financial resources to fund obligations as they come due in the most cost-effective manner,
- preparing and revising longer-term financing plans to reflect changes in business plans and the market availability of capital, and
- maintaining a \$500 million syndicated Credit Facility to support potential liquidity requirements.

Interest Rate Risk

Changes in interest rates can impact our borrowing costs, and changes in our cost of capital may also affect the feasibility of new growth initiatives.

We manage interest rate risk by establishing and adhering to policies that include:

- employing a combination of fixed and floating rate debt instruments, and
- monitoring the mixture of floating and fixed rate debt and adjusting where necessary to ensure a continued efficient mixture of these types of debt.

At Dec. 31, 2017, approximately 21 per cent (2016 – 2 per cent) of our total debt portfolio was subject to changes in floating interest rates.

Project Management Risk

On capital projects, we face risks associated with cost overruns, delays and performance.

These project risks are managed by TransAlta by:

- ensuring all projects are reviewed to see that established processes and policies are followed, risks have been properly identified and quantified, input assumptions are reasonable, and returns are realistically forecasted prior to senior management and Board approvals,
- using consistent and disciplined project management methodology and processes,
- performing detailed analysis of project economics prior to construction or acquisition and by determining our asset contracting strategy to ensure the right mix of contracted and merchant capacity before starting construction,
- partnering with those who have previously been able to deliver projects economically and on budget,
- developing and following through with comprehensive plans that include identifying critical paths, key delivery points and backup plans,
- managing project closeouts so that any learnings from the project are incorporated into the next significant project,
- fixing the price and availability of the equipment, foreign currency rates, warranties and source agreements as much as is economically feasible prior to proceeding with the project, and
- entering into labour agreements to provide security around cost and productivity.

Human Resource Risk

Human resource risk relates to the potential impact upon our business as a result of changes in the workplace. Human resource risk can occur in several ways:

- potential disruption as a result of labour action at our generating facilities,
- reduced productivity due to turnover in positions,
- inability to complete critical work due to vacant positions,
- failure to maintain fair compensation with respect to market rate changes, and
- reduced competencies due to insufficient training, failure to transfer knowledge from existing employees or insufficient expertise within current employees.

We do not have employees but rather rely on the Management Agreement with TransAlta for the provision of all our management, administrative and operational services, including making available appropriate personnel. The Human Resources risk is managed by TransAlta by:

- monitoring industry compensation and aligning salaries with those benchmarks,
- using incentive pay to align employee goals with corporate goals,
- monitoring and managing target levels of employee turnover, and
- ensuring new employees have the appropriate training and qualifications to perform their jobs.

Regulatory and Political Risk

Regulatory and political risk describes the risk to our business associated with potential changes to the existing regulatory structures and the political influence upon those structures. This risk can come from market re-regulation, increased oversight and control, structural or design changes in markets, or other unforeseen influences. Market rules are often dynamic and we are not able to predict whether there will be any material changes in the regulatory environment or the ultimate effect of changes in the regulatory environment on our business. This risk includes the qualification of our Alberta facilities to the generation of tradeable GHG allowances as part of the transition from the SGER to new regulations to be formulated to give effect to the Climate Leadership Plan, in 2018, as well as the influence of federal and provincial regulation on the value of allowances or credits generated.

We manage these risks systematically through TransAlta's legal and regulatory compliance programs, which are reviewed periodically to ensure their effectiveness, as well as through TransAlta's government relations team. TransAlta works with governments, regulators, electric system operators and other stakeholders to resolve issues as they arise. TransAlta actively monitors changes to market rules and market design and presents to the Corporation the impact such changes are expected to have on us. TransAlta also engages in market-sponsored stakeholder engagement processes.

International investments are subject to unique risks and uncertainties relating to the political, social and economic structures of the respective country and such country's regulatory regime. We mitigate this risk through the use of non-recourse financing and insurance.

Transmission Risk

Access to transmission lines and transmission capacity for existing and new generation are key in our ability to deliver energy produced at our power plants to our customers. The risks associated with the aging existing transmission infrastructure in the markets in which we operate continue to increase because new connections to the power system are consuming transmission capacity quicker than it is being added by new transmission developments.

Reputation Risk

Our reputation is one of our most valued assets. Reputation risk relates to the risk associated with our business because of changes in opinion from the general public, private stakeholders, governments and other entities.

We manage reputation risk by:

- striving to build viable relationships based on mutual understanding leading to workable solutions with our neighbours and other community stakeholders in the regions where we operate,
- clearly communicating our business objectives and priorities to a variety of stakeholders on a routine basis,
- maintaining positive relationships with various levels of government,
- pursuing sustainable development as a longer-term corporate strategy,
- ensuring that each business decision is made with integrity and in line with our corporate values,
- communicating the impact and rationale of business decisions to stakeholders in a timely manner, and
- maintaining strong corporate values that support reputation risk management initiatives.

Corporate Structure Risk

TransAlta

TransAlta is the majority shareholder of the Corporation and is also responsible for the management and operation of the Corporation pursuant to the Management Agreement. In addition, TransAlta is able to nominate directors to the Board and we rely on TransAlta to identify acquisition and growth opportunities. As a result, TransAlta is able to exercise substantial influence over our operations, administration and growth. Any failure to effectively manage our operations or to implement our growth strategy could have a material adverse effect on our business, financial condition and results of operations. Our risk management procedures in respect of this corporate structure risk include incorporating Board members that are independent of TransAlta.

Other

We conduct a significant amount of business through subsidiaries and partnerships. Our ability to meet and service debt obligations is dependent upon the results of operations of our subsidiaries and the payment of funds by our subsidiaries in the form of distributions, loans, dividends or otherwise. In addition, our subsidiaries may be subject to statutory or contractual restrictions that limit their ability to distribute cash to us.

General Economic Conditions

Changes in general economic conditions impact product demand, revenue, operating costs, the timing and extent of capital expenditures, the net recoverable value of property, plant and equipment ("PP&E"), financing costs, credit and liquidity risk, and counterparty risk.

Investment in TransAlta's Australian Assets

Following the investments in economic interests in assets owned by TransAlta, some, but not all, additional risk factors that could affect our future results, and our activities in mitigating those risks, are outlined below:

Nature of interests

The Corporation indirectly retains an economic interest in, and has no legal rights, in respect of the Australian Assets. We own securities providing an economic interest based on the cash flows from the assets broadly equal to the underlying net distributable profits. This means that we are not be able to dispose of the Australian Assets or exercise other rights of ownership of the Australian Assets, nor do we have any ability to directly oversee or manage the ownership and operation of the Australian Assets. Consequently, the rights to us in relation to the Australian Assets may be of less value compared to direct ownership of the Australian Assets.

Insufficient funds to satisfy distributions

We are entitled to receive quarterly preferential cash dividend payments on the Australian Tracking Preferred Shares. This subsidiary's only source of income is the distributions it receives from a 43 per cent owned limited partnership with TransAlta. In turn, the assets the limited partnership owns are the Australian Assets. There can be no certainty that the Australian Assets will generate sufficient income, such that the distributions it pays will, in aggregate, be sufficient to satisfy the dividend payments in respect of the Australian Tracking Preferred Shares.

Effective Jan. 6, 2016, TransAlta and a subsidiary of TransAlta signed a funding support agreement under which, among other things, TransAlta agreed to subscribe for securities of the subsidiary that issued the Australian Tracking Preferred Shares upon receipt of a funding notice to ensure that the subsidiary of TransAlta has sufficient funds to satisfy the dividend payable on the Australian Tracking Preferred Shares and Canadian Tracking Preferred Shares. The funding support agreement was amended Nov. 30, 2016, concurrent with the redemption of the Canadian Tracking Preferred Shares.

Dependence on financial performance of the Australian Assets

The value of our common shares depends, in part, on the financial performance and profitability derived from the Australian Assets. Any decline in the financial performance of the Australian Assets or adverse change in such other factors could have an adverse effect on us and the value and market price of our common shares. In addition, the Australian Assets are potentially subject to the liabilities attributed to TransAlta, even if those liabilities arise from lawsuits, contracts or indebtedness that do not relate or are otherwise attributed to the assets or the Corporation.

Income Tax Risk

Our operations are complex and located in several jurisdictions. The computation of the provision for income taxes involves tax interpretations, regulations and legislation that are continually changing. Our tax filings are subject to audit by taxation authorities. Management believes that it has adequately provided for income taxes as required by IFRS, based on all information currently available.

The Corporation and the subsidiaries of TransAlta in which we hold economic interests are subject to changing laws, treaties and regulations in and between countries. Various tax proposals in the countries we operate in could result in changes to the basis on which deferred taxes are calculated or could result in changes to income or non-income tax expense. There has recently been an increased focus on issues related to the taxation of multinational corporations. Australia has proposed anti-hybrid rules and enacted a diverted profits tax, which, if enacted, will impact the tax benefits of certain financing structures including our MRPS. A change in tax laws, treaties or regulations, or in the interpretation thereof, could result in a materially higher income or non-income tax expense that could have a material adverse impact to the Corporation.

The sensitivity of changes in income tax rates upon our net earnings is shown below:

Factor	Increase or decrease (%)	Approximate impact on net earnings
Tax rate	1	1

The Corporation's statutory blended tax rate is expected to remain at 26 per cent. The effective income tax rate can change depending on the mix of earnings from various countries and certain deductions that do not fluctuate with earnings.

The Corporation's anticipated cash tax horizon is subject to risks, uncertainties and other factors that could cause the cash tax horizon to occur sooner than our current projection of approximately four years. In particular, our anticipated cash tax horizon is subject to risk pertaining to a change in our operations, asset base, corporate structure or changes to tax legislation, regulations or interpretations. In the event we become cash taxable sooner than projected, our cash available for distribution and our dividend could decrease.

Legal Contingencies

We are occasionally named as a party in various claims and legal proceedings that arise during the normal course of our business. We review each of these claims, including the nature of the claim, the amount in dispute or claimed, and the availability of insurance coverage. There can be no assurance that any particular claim will be resolved in our favour or that such claims may not have a material adverse effect on us.

Other Contingencies

We maintain a level of insurance coverage deemed appropriate by management. There were no significant changes to our insurance coverage during renewal of the insurance policies on Dec. 31, 2017, except for a decrease in the wind deductible under the property policy. Our insurance coverage may not be available in the future on commercially reasonable terms. There can be no assurance that our insurance coverage will be adequate to fully compensate for potential losses incurred. In the event of a significant economic event, the insurers may not be capable of paying all claims in full.

Cybersecurity

We rely on our information technology to process, transmit and store electronic information, including information we use to safely operate our assets. Cyberattacks or other breaches of network or information technology systems security may cause disruptions to our operations. Cyberattackers may use a range of techniques, from manipulating people to using sophisticated malicious software and hardware on a single or distributed basis. Some cyberattackers use a combination of techniques in their attempt to evade safeguards such as the firewalls, intrusion prevention systems and antivirus software found in our systems and networks. A successful attack on our systems, networks and infrastructure may allow for the unauthorized interception, destruction, use or dissemination of our information and may cause disruptions to our operations.

We take measures to secure our infrastructure against potential cyberattacks that may damage our infrastructure, systems and data. TransAlta's cybersecurity program aligns with industry best practices to ensure that a holistic approach to security is maintained. TransAlta has implemented security controls to help secure our data and business operations, including access control measures, intrusion detection and prevention systems, logging and monitoring of network activities, and implementing policies and procedures to ensure the secure operations of the business.

While we have systems, policies, hardware, practices, data backups and procedures designed to prevent or limit the effect of the security breaches of our generation facilities and infrastructure, there can be no assurance that these measures will be sufficient and that such security breaches will not occur or, if they do occur, that they will be adequately addressed in a timely manner. Both preventive and detective measures are monitored to manage these risks.

Growth Risk

Our growth strategy is to develop or acquire stable cash flows associated with high-quality contracted renewable and natural gas power generation facilities and other infrastructure assets, with the objective of achieving returns on invested capital. Our business plan includes growth through identifying suitable acquisition or contracted new build opportunities, pursuing such opportunities, consummating acquisitions or contracting development and construction, and effectively integrating such growth opportunities into our existing business. There can be no assurance that we will be able to identify attractive growth opportunities in the future (whether through our relationship with TransAlta or otherwise), that we will be able to complete growth opportunities that increase the amount of cash available for distribution, or that growth opportunities will be successfully integrated into our existing operations. The successful execution of the growth strategy requires careful timing and business judgment, as well as the resources to complete the due diligence and evaluation of such assets.

Financial Instruments

Our most significant financial instruments are as follows:

- The Australian-dollar-denominated MRPS are classified as a loan and receivable financial asset and are carried at amortized cost. We recognize the resulting foreign exchange gains or losses in net earnings.
- The Australian Tracking Preferred Shares and Preferred Shares of TEA have been designated as available-for-sale financial assets and are measured at fair value with changes recognized in OCI. Changes in foreign exchange forms part of the fair value change recognized in OCI.

At Dec. 31, 2017, Level III financial instruments were comprised of financial assets with a carrying value of \$616 million (2016 - \$841 million) and financial liabilities with a carrying value of nil (2016 - \$384 million). The decrease is in the net asset position attributable to the Australian Tracking Preferred Shares and the Class B shares liability. Refer to the Critical Accounting Policies and Estimates section for additional information on these measurements.

Financial instruments give rise to credit risk, foreign currency risk, interest risk and liquidity risk. Refer to the Risk Management section of this document for a discussion thereof and our management strategies. We accept the market risk that arises from our investment in Australian Tracking Preferred Shares and preferred shares.

Financial instruments can be used to manage exposure to interest rates, commodity prices and currency fluctuations, as well as other market risks. TransAlta enters into derivative contracts with external counterparties on our behalf. Derivative financial instruments are accounted for using the fair value method of accounting. The initial recognition of fair value and subsequent changes in fair value can affect reported earnings in the period the change occurs if hedge accounting is not elected. Otherwise, the effective portion of the changes in fair value will generally not affect earnings until the financial instrument is settled.

The two types of derivative financial instruments that we primarily use are: (i) those that are used in relation to energy trading activities, commodity hedging activities and other contracting activities; and (ii) those used in the hedging of foreign-denominated revenues, debt, projects and expenditures.

Related-Party Transactions and Balances

Related-Party Transactions

Amounts recognized from transactions with TransAlta or subsidiaries of TransAlta, excluding those described in the Significant Events section of this MD&A, are as follows:

Year ended Dec. 31	2017	2016
Revenue from TransAlta PPAs (I)	38	37
Revenue from Green Attributes ⁽¹⁾	—	3
Finance income related to subsidiaries of TransAlta	86	151
G&A Reimbursement Fee (II) ⁽²⁾	17	16
Natural gas purchases(III)	9	1
Power swap sales (financial)(III)	4	—
Interest expense on convertible debenture	9	10
Asset optimization fee ⁽³⁾	2	—
Realized foreign exchange gain on hedge of contribution agreement	6	—
Interest expense on credit facility	2	1

(1) The value of Green Attributes was determined by reference to market information for similar instruments, including historical transactions with third parties, with the transaction ultimately reviewed and approved by the Corporation's independent members of the Board.

(2) Includes portion charged directly to Wyoming Wind.

(3) A subsidiary of TransAlta provides asset management and optimization services for the Corporation's Sarnia facility. The Sarnia facility is charged a fixed fee of approximately \$0.125 million per quarter, plus a variable fee of 1.6 per cent of its gross margin.

I. TransAlta PPAs

We have agreements with TransAlta for certain wind and hydro facilities, providing for the purchase by TransAlta, for a fixed price, of all of the power produced by such facilities. The price paid by TransAlta in 2017 for output under the TransAlta PPAs was approximately \$30.88 per MWh for wind facilities and \$46.30 per MWh for hydro facilities, which are adjusted annually for changes in the Consumer Price Index ("CPI"). TransAlta is only required to purchase power that is actually produced. Each TransAlta PPA has a term of 20 years or end of asset life, where end of asset life is less than 20 years.

II. Management Agreement

Under the Management Agreement, TransAlta provides all the general administrative services, including key management personnel services, as may be required or advisable for the management of the affairs of the Corporation. As reimbursement for the services provided, we pay TransAlta a fee (the "G&A Reimbursement Fee"), adjusted annually for changes in the CPI. The G&A Reimbursement Fee is increased or decreased by an amount equal to 5.0 per cent of the amount of any increase or decrease, respectively, to the Corporation's total EBITDA resulting from the addition or divestiture of assets by the Corporation. TransAlta also provides operational and maintenance services under the Management Agreement, which generally includes all services as may be necessary or requested for the operation and maintenance of our gas, wind and hydro facilities. TransAlta is reimbursed for all out-of-pocket and third-party fees and costs, including salaries, wages and benefits associated with managing and operating the facilities not captured by the G&A Reimbursement Fee. The Management Agreement has an initial 20-year term, which is automatically renewed for further successive terms of five years after the expiry of the initial term or any renewal term, unless terminated by either party.

We have paid TransAlta a development fee of \$1 million upon signing the PPA with NB Power for Kent Hills 3, and will pay a further upfront fee of \$2 million upon achieving the commercial operation date of Kent Hills 3, in lieu of the annual 5 per cent of incremental EBITDA that would otherwise be paid pursuant to the Management Agreement.

On Jan. 6, 2016, the G&A Reimbursement Fee was increased by approximately \$5 million annually for 2016, which reflects the impact of the acquisition of the economic interest in the Canadian Assets and CPI adjustments.

III. Natural Gas Purchases, Sales, and Power Swap Sales

Our subsidiary, TransAlta (SC) LP ("Sarnia"), and TransAlta Energy Marketing Corp. ("TEMCO"), a Canadian subsidiary of TransAlta, are parties to a Gas Management Intercompany Agreement for the Sarnia facility to obtain its natural gas at the Dawn Hub from TEMCO in consideration of TEMCO being allowed to trade and profit from Sarnia's storage position. The terms of the Gas Management Intercompany Agreement are as follows:

- all gas burned at Sarnia is purchased by Sarnia from TEMC priced at the NGX Union Dawn Daily Spot Price published by the Canadian Gas Price Reporter ("CGPR") on the day the gas is burned;
- TEMC will purchase all customer make-up gas from Sarnia at the Dawn Daily Index at the day of occurrence;
- all gas not consumed and used by Sarnia for hedging purposes is purchased by TEM at the Dawn Daily Index; and
- in exchange for the gas, Sarnia grants TEMC the unlimited right to inject, store and withdraw gas from the Sarnia storage asset for proprietary purposes.

Additionally, Sarnia remains responsible for all storage and transportation costs, which are based on the volumes of gas taken in-kind by Union Gas for each day at the NGX Union Dawn Daily Spot Price of gas published by the CGPR.

Governance and Co-operation Agreement

Pursuant to the Governance and Co-operation Agreement, TransAlta serves as the primary vehicle through which we will acquire and/or develop renewable power projects. The Governance and Co-operation Agreement provides, among other things, that we will rely on TransAlta to: (i) identify acquisition and/or development opportunities for us (the "Opportunities"); (ii) evaluate the Opportunities for their suitability; (iii) present Opportunities suitable for, and meeting the strategic goals and objectives of the Corporation to the Board for assessment and approval; and (iv) execute and complete any Opportunities approved by the Board. TransAlta and its affiliates are not required to allocate any minimum level of dedicated resources for the pursuit of renewable power generation opportunities nor shall TransAlta or its affiliates be required to offer any specific opportunities to us. Approval of any Opportunities involving a transfer of interests from TransAlta or its affiliates to us must be supported and approved by a majority of the independent directors of the Board.

Related-Party Balances

Related-party balances include the following:

As at	Dec. 31, 2017	Dec. 31, 2016
Trade and other receivables	37	36
Accounts payable and accrued liabilities (including interest payable)	11	11
Dividends payable	37	29
Investments in subsidiaries of TransAlta	1,437	1,645
Convertible debenture	—	215
Class B shares liability	—	384
Credit facility	—	15
Canadian Assets working capital loan	6	19
Letters of credit issued by TransAlta on behalf of the Corporation (I) ⁽¹⁾	1	60
Guarantees provided by TransAlta on behalf of the Corporation (II) ⁽¹⁾	105	58
Indemnification guarantee provided by the Corporation to TransAlta (III) ⁽¹⁾	921	925

(1) Not recognized as a financial liability on the Consolidated Statements of Financial Position.

All of these balances are with TransAlta or subsidiaries of TransAlta.

I. Letters of Credit

TransAlta has provided letters of credit on behalf of the Corporation. Any amounts owed by the Corporation for obligations under the contracts to which the letters of credit pertain are reflected in the Consolidated Statements of Financial Position. All letters of credit expire within one year and are expected to be renewed, as needed, in the normal course of business. No amounts have been exercised by third parties under these arrangements.

II. Guarantees

If the Corporation does not perform under the related agreements, the counterparty may present claim for payment from TransAlta.

III. Indemnification Guarantee

As part of the acquisition of the Australian Assets, we entered into a Guarantee and Indemnification Agreement in favour of TransAlta related to certain guarantees it has provided to third parties in respect of certain obligations of TEA (the "TEA Guarantees"). We have agreed to indemnify TransAlta from and against all claims, actions, proceedings, liabilities, losses, costs, expenses, or damages against or incurred by it arising out of or in connection with the TEA Guarantees and to reimburse TransAlta in full for the amount of any payment made by it under and in accordance with the TEA Guarantees, relating to actions, omissions, events, and circumstances that occur on or after May 7, 2015. As consideration for this indemnity that we have provided, TransAlta is required to pay us the Canadian dollar equivalent of the guarantor fees it receives from TEA in respect of any of the TEA Guarantees.

Critical Accounting Policies and Estimates

The preparation of financial statements requires management to make judgments, estimates and assumptions that could affect the reported amounts of assets, liabilities, revenues, expenses and disclosures of contingent assets and liabilities during the period. These estimates are subject to uncertainty. Actual results could differ from those estimates due to factors such as fluctuations in interest rates, foreign exchange rates, inflation and commodity prices, and changes in economic conditions, legislation and regulations.

In the process of applying the Corporation's accounting policies, which are described below, management has to make judgments and estimates about matters that are highly uncertain at the time the estimate is made and that could significantly affect the amounts recognized in the consolidated financial statements. Different estimates with respect to key variables used in the calculations, or changes to estimates, could potentially have a material impact on the Corporation's financial position or performance. The key judgments and sources of estimation uncertainty are described below:

Fair Value

The fair value of a financial instrument is the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair values can be determined by reference to prices for instruments in active markets to which we have access. In the absence of an active market, we determine fair values based on valuation models or by reference to other similar products in active markets.

Fair values determined using valuation models require the use of assumptions. In determining those assumptions, we look primarily to external readily observable market inputs. In limited circumstances, we use inputs that are not based on observable market data.

Level Determinations and Classifications

The Level I, II and III classifications in the fair value hierarchy utilized by the Corporation are defined below. The fair value measurement of a financial instrument is included in only one of the three levels, the determination of which is based on the lowest level input that is significant to the derivation of the fair value.

Level I

Fair values are determined using inputs that are quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access at the measurement date.

Level II

Fair values are determined, directly or indirectly, using inputs that are observable for the asset or liability, either directly or indirectly.

Fair values within the Level II category are determined through the use of quoted prices in active markets, which in some cases are adjusted for factors specific to the asset or liability, such as basis, credit valuation and location differentials.

Our commodity risk management Level II financial instruments include over-the-counter derivatives with values based on observable commodity futures curves and derivatives with inputs validated by broker quotes or other publicly available market data providers. Level II fair values are also determined using valuation techniques, such as option pricing models and regression or extrapolation formulas, where the inputs are readily observable, including commodity prices for similar assets or liabilities in active markets, and implied volatilities for options.

In determining Level II fair values of other risk management assets and liabilities and the preferred shares of TEA measured and carried at fair value, we use observable inputs other than unadjusted quoted prices that are observable for the asset or liability, such as interest rate yield curves and currency rates. For certain financial instruments where insufficient trading volume or lack of recent trades exists, we rely on similar interest or currency rate inputs and other third-party information such as credit spreads. The fair value of the preferred shares of TEA is determined using a discounted cash flow methodology based on inputs including interest and currency rates and a discount rate reflecting the risks specific to TEA.

Level III

Fair values are determined using inputs for the asset or liability that are not readily observable. The largest financial instrument within this category are the Australian Tracking Preferred Shares.

In estimating the fair value of the Australian Tracking Preferred Shares, we use a discounted cash flow method and make estimates and assumptions about sales prices, production, capital expenditures, asset retirement costs and other related cash inflows and outflows over the life of the facilities, as well as the remaining life of the facilities. In developing these assumptions, we use estimates of contracted prices, anticipated production levels, planned and Unplanned Outages, changes to regulations, and transmission capacity or constraints for the estimated remaining life of the facilities. Appropriate discount rates reflecting the risks specific to TEA are used in the valuations. Management also develops assumptions in respect of ongoing financing and tax positions of TEA. These estimates and assumptions are susceptible to change from period to period and actual results can, and often do, differ from the estimates, and can have either a positive or negative impact on the estimate of the fair value of the instrument, and may be material. The model extends over 30 years. The table below summarizes quantitative data regarding these unobservable inputs:

Unobservable input	Dec. 31, 2017	Dec. 31, 2016
Discount rate	6.7%	7.2%
Quarterly cash flows	Average of \$10.50	Average of \$15.60

The estimated fair value of the Australian Tracking Preferred Shares decreased from \$841 million to \$616 million from the prior year. The changes in the fair value are primarily attributable to impairments recognized in 2017.

As a result of FMG repurchasing the Solomon Power Station, and purporting to terminate the South Hedland PPA, we revised the expected underlying cash flows of the Australian Tracking Preferred Shares for changes in the timing and nature due to the impacts of the repurchase by FMG of the Solomon Power Station and based upon the best estimates of recovery through legal recourse and other means in connection with the purported termination of the South Hedland PPA. As a result, for the year ended Dec. 31, 2017, we recognized an impairment of \$137 million.

The following table summarizes the impact on the fair value measurement of a change in the unobservable inputs to reflect reasonably possible alternative assumptions:

Unobservable input	Alternative assumption	Change in fair value as at Dec. 31, 2017	Change in fair value as at Dec. 31, 2016
Basis point change in discount rates	-10 basis points decrease	4.6	7.3
	+10 basis points increase	(4.5)	(7.1)
Quarterly cash flows	+1% increase	6.2	8.4
	- 1% decrease	(6.2)	(8.4)

Impairment of PP&E

Impairment exists when the carrying amount of an asset exceeds its recoverable amount, which is the higher of its fair value less costs of disposal and its value in use. An assessment is made at each reporting date as to whether there is any indication that an impairment loss may exist or that a previously recognized impairment loss may no longer exist or may have decreased. In determining fair value less costs of disposal, information about third-party transactions for similar assets is used and if none is available, other valuation techniques, such as discounted cash flows, are used. Value in use is computed using the present value of management's best estimates of future cash flows based on the current use and present condition of the asset. In estimating either fair value less costs of disposal or value in use using discounted cash flow methods, estimates and assumptions must be made about sales prices, production, asset retirement costs and other related cash inflows and outflows over the life of the facilities, which can range from 25 to 50 years. In developing these assumptions,

management uses estimates of contracted prices, anticipated production levels, planned and Unplanned Outages, changes to regulations, and transmission capacity or constraints for the remaining life of the facilities. Appropriate discount rates reflecting the risks specific to the asset under review are used in the assessments. These estimates and assumptions are susceptible to change from period to period and actual results can, and often do, differ from the estimates, and can have either a positive or negative impact on the estimate of the impairment charge, and may be material. Substantially all of the Corporation's generating assets are contracted under the TransAlta PPAs or other PPAs with various third parties.

Income Taxes

Preparation of the consolidated financial statements involves determining an estimate of, or provision for, income taxes in each of the jurisdictions in which the Corporation operates. The process also involves making an estimate of income taxes currently payable and income taxes expected to be payable or recoverable in future periods, referred to as deferred income taxes. Deferred income taxes result from the effects of temporary differences due to items that are treated differently for tax and accounting purposes. The tax effects of these differences are reflected in the Consolidated Statements of Financial Position as deferred income tax assets and liabilities. An assessment must also be made to determine the likelihood that the Corporation's future taxable income will be sufficient to permit the recovery of deferred income tax assets. To the extent that such recovery is not probable, deferred income tax assets must be reduced. Management must exercise judgment in its assessment of continually changing tax interpretations, regulations and legislation, to ensure deferred income tax assets and liabilities are complete and fairly presented. Differing assessments and applications than the Corporation's estimates could materially impact the amounts recognized for deferred income tax assets and liabilities.

Provisions for Decommissioning and Restoration Activities

We recognize decommissioning and restoration provisions for PP&E in the period in which they are incurred if there is a legal or constructive obligation to reclaim the plant and/or site. The amount recognized as a provision is the best estimate of the expenditures required to settle the present obligation. Expected values are probability weighted to deal with the risks and uncertainties inherent in the timing and amount of settlement of many decommissioning and restoration provisions. Expected values are discounted at the risk-free interest rate adjusted to reflect the market's evaluation of our credit standing.

At Dec. 31, 2017, the total provision recognized for decommissioning and restoration activities was \$44 million (2016 - \$28 million). We estimate the undiscounted amount of cash flow required to settle these provisions is approximately \$189 million (2016 - \$190 million). An increase of one per cent and 20 per cent for the discount rate and undiscounted cash flows, respectively, would each approximately result in a net earnings decrease of \$1 million.

Useful Life of PP&E

Each significant component of an item of PP&E is depreciated over its estimated useful life. Estimated useful lives are determined based on current facts and past experience, and take into consideration the anticipated physical life of the asset, existing long-term sales agreements and contracts, current and forecasted demand, the potential for technological obsolescence, and regulations. The useful lives of PP&E are reviewed at least annually to ensure they continue to be appropriate.

Future Accounting Changes

Accounting standards that have been previously issued by the IASB but that were not yet effective as at Dec. 31, 2017, and have not been applied by us, include IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers*, and IFRS 16 *Leases*.

As part of each implementation plan, a centralized project team has been created to manage project activities. A stakeholder committee has been formed to oversee the implementation process and it includes individuals from the relevant functions and business units.

IFRS 9 *Financial Instruments*

In July 2014, on completion of the impairment phase of the project to reform accounting for financial instruments and replace International Accounting Standard ("IAS") 39 *Financial Instruments: Recognition and Measurement*, the IASB issued the final version of IFRS 9 *Financial Instruments*. IFRS 9 includes guidance on the classification and measurement of financial assets and financial liabilities, impairment of financial assets (i.e., recognition of credit losses) and a new hedge accounting model. IFRS 9 is effective for annual periods beginning on or after Jan. 1, 2018, with early application permitted. IFRS 9 will be applied by the Corporation on January 1, 2018.

Under the classification and measurement requirements, financial assets must be classified and measured at either amortized cost, at fair value through profit or loss, or through 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.

The classification requirements for financial liabilities are unchanged from IAS 39. IFRS 9 requirements address the problem of volatility in net earnings arising from an issuer choosing to measure certain liabilities 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.

The new general hedge accounting model is intended to be simpler and more closely focus on how an entity manages its risks, replaces the IAS 39 effectiveness testing requirements with the principle of an economic relationship, and eliminates the requirement for retrospective assessment of hedge effectiveness.

The new requirements for impairment of financial assets introduce an expected loss impairment model that requires more timely recognition of expected credit losses. IAS 39 impairment requirements are based on an incurred loss model where credit losses are not recognized until there is evidence of a trigger event.

With respect to IFRS 9, we have completed our assessment of the impacts of IFRS 9, with the following results:

- Classification and measurement:
 - A classification change has been identified that will lead to a material opening balance sheet adjustment related to our investment in the preferred shares of a subsidiary of TransAlta related to TEA. The transition adjustment will result in the reclassification of \$137 million from retained earnings to accumulated other comprehensive income ("AOCI"), arising from the 2017 impairments on the Australian Tracking Preferred Shares. Under IFRS 9, gains or losses recognized in OCI for investments in equity instruments designated at fair value through OCI are not reclassified subsequently to net earnings. We intend to use the IFRS 9 election to continue to recognize changes in fair value on this equity investment through OCI, as opposed to through net earnings.
 - A measurement change has been identified that is expected to result in a \$4 million opening balance sheet adjustment. Our investment in the preferred shares of a subsidiary of TransAlta related to Wyoming Wind is required to be measured at fair value through profit and loss under IFRS 9, as opposed to cost as permitted under IAS 39. We intend to use the IFRS 9 election to recognize changes in fair value on this equity through OCI, as opposed to through net earnings.
- Impairment: IFRS 9 introduces a new impairment model based on expected credit losses, rather than incurred losses as required under IAS 39. Expected credit losses are required to be measured through a loss allowance at an amount equal to 12-month expected credit losses or lifetime expected credit losses. We have determined that no material expected credit losses are required to be recognized on transition to IFRS 9.
- Hedge accounting: We have elected not to apply the hedge accounting requirements of IAS 39 to hedging relationships on transition to IFRS 9, and thus are applying the requirements of IFRS 9 prospectively, and have reviewed our hedge documents to confirm all qualifying hedge criteria under IFRS 9 have been met.
- As permitted under IFRS 9, we are not required to restate prior periods for any of the above-noted impacts.

IFRS 15 Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*, which replaces existing revenue recognition guidance with a single comprehensive accounting model. The model specifies that an entity recognizes revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which it expects to be entitled in exchange for those goods or services. In April 2016, the IASB issued an amendment to IFRS 15 to clarify the identification of performance obligations, principal versus agent considerations, licences of intellectual property, and transition practical expedients. IFRS 15, including the amendment, is required to be adopted either retrospectively or using a modified retrospective approach for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. IFRS 15 will be applied by the Corporation on January 1, 2018.

With respect to IFRS 15, we have completed the review and accounting assessment of our revenue streams and underlying contracts with customers. The majority of our revenues within the scope of IFRS 15 are earned through the sale of energy and Green Attributes under long-term contracts. IFRS 15 requires the application of a five-step model to determine when to recognize revenue, and at what amount. The model specifies that revenue should be recognized when (or as) an entity transfers control of goods or services to a customer at the amount to which the entity expects to be entitled. Depending on whether certain criteria are met, revenue is recognized either over time, in a manner that depicts the entity's performance, or at a point in time, when control is transferred to the customer.

We have chosen to apply the modified retrospective method of transition. Under this method, the comparative periods presented in the consolidated financial statements as at and for the year ended Dec. 31, 2018, will not be restated. Instead, we will recognize the cumulative impact of the initial application of the standard in retained earnings as at Jan. 1, 2018.

We have concluded that no material changes to our current revenue recognition practices from contracts with customers is required.

IFRS 16 Leases

In January 2016, the IASB issued IFRS 16 *Leases*, which replaces the current IFRS guidance on leases. Under current guidance, lessees are required to determine if the lease is a finance or operating lease, based on specified criteria. Finance leases are recognized on the statement of financial position, while operating leases are not. Under IFRS 16, lessees must recognize a lease liability and a right-of-use asset for virtually all lease contracts. An optional exemption to not recognize certain short-term leases and leases of low value can be applied by lessees. For lessors, the accounting remains essentially unchanged. IFRS 16 is effective for annual periods beginning on or after Jan. 1, 2019, with early application permitted if IFRS 15 is also applied at the same time. The standard is required to be adopted either retrospectively or using a modified retrospective approach. IFRS 16 will be applied by the Corporation on January 1, 2019.

We are in the process of completing our initial scoping assessment for IFRS 16 and have prepared a detailed project plan. We anticipate that most of the effort under the implementation plan will occur in mid-to-late 2018. It is not yet possible to make a reliable estimate of the potential impact of IFRS 16 on our financial statements and disclosures.

Fourth Quarter Results

Consolidated Financial Highlights

Three months ended Dec. 31	2017	2016
Renewable energy production (GWh) ⁽¹⁾	1,123	975
Revenues	134	94
Net earnings attributable to common shareholders	33	26
Reported EBITDA ⁽²⁾	91	68
Comparable EBITDA ⁽²⁾	118	121
Adjusted funds from operations ⁽²⁾	111	91
Cash flow from operating activities	30	69
Cash available for distribution ⁽²⁾	88	69
Net earnings per share attributable to common shareholders, basic and diluted	0.13	0.12
Adjusted funds from operations per share ⁽²⁾	0.44	0.41
Cash available for distribution per share ⁽²⁾	0.35	0.31
Dividends declared per common share	0.31	0.29
Dividends paid per common share	0.23	0.22

(1) Includes production from Wyoming Wind and excludes Canadian and Australian gas-fired generation. Production is not a key revenue driver for gas-fired facilities as most of their revenues are capacity based.

(2) Refer to the Non-IFRS Measures section of this MD&A for further discussion of these items.

- Reported net earnings attributable to common shareholders increased by \$7 million, primarily due to the change in the foreign exchange gain of \$34 million, which was partially offset by the \$23 million impairment of the Australian Tracking Preferred Shares.
- Comparable EBITDA was lower in the fourth quarter of 2017, primarily due to the decrease of \$9 million and \$5 million for Canadian Gas and Australian Gas, respectively, partially offset by Canadian Wind's Comparable EBITDA increasing \$14 million.
- Renewable energy production increased 148 GWh as higher generation from Canadian Wind and US Wind was partially offset by lower generation in Canadian Hydro.

Reconciliation of Non-IFRS Measures

Presenting AFFO provides users with a proxy for the amount from operating activities and investments in subsidiaries of TransAlta in which we have an economic interest. CAFD provides users with a proxy for the cash that will be available to common shareholders of the Corporation. One of the primary objectives of the Corporation is to provide reliable and stable cash flows, and presenting AFFO and CAFD assists readers in assessing our cash flows in comparison to prior periods. See the Non-IFRS Measures section of this MD&A for additional information.

The table below reconciles our cash flow from operating activities to our AFFO and comparable CAFD:

	3 months ended Dec. 31	
	2017	2016
Cash flow from operating activities	30	69
Change in non-cash operating working capital balances	62	20
Cash flow from operations before changes in working capital	92	89
Adjustments:		
Sustaining capital expenditures	(6)	(4)
Distributions paid to subsidiaries' non-controlling interest	1	—
Finance income	(18)	(39)
AFFO - economic interests ⁽¹⁾	42	45
AFFO	111	91
Deduct:		
Principal repayments of amortizing debt	(23)	(22)
CAFD	88	69
Weighted average number of common shares outstanding in the period (millions)	250	224
AFFO per share	0.44	0.41
CAFD per share	0.35	0.31

(1) Refer to the reconciliation of the Comparable EBITDA of the facilities in which we hold an economic interest to the reported finance income table in this MD&A.

Presenting Comparable EBITDA provides management and investors with a proxy for the amount of cash generated from operating activities before net interest expense, non-controlling interest, income taxes and the impacts of timing on the finance income from subsidiaries of TransAlta in which we have an economic interest. We present Comparable EBITDA along with operational information of the assets in which we own an economic interest so that readers can better understand and evaluate the drivers of those assets in which we have the economic interest.

The tables below reconcile our reported EBITDA to Comparable EBITDA:

Three months ended Dec. 31, 2017

	Reported	Adjustments	Economic interests	Comparable total
Revenues ⁽¹⁾	134	—	50	184
Fuel, royalties and other costs of sales ⁽²⁾	25	—	5	30
Gross margin	109	—	45	154
Operations, maintenance and administration ⁽³⁾	23	—	11	34
Taxes, other than income taxes	2	—	—	2
Finance income	(18)	18	—	—
Foreign exchange gain	(12)	12	—	—
Impairment of investment	23	(23)	—	—
Earnings before interest, taxes, depreciation and amortization	91	(7)	34	118

(1) Amounts related to economic interests include finance lease income adjusted for change in finance lease receivable amount.

(2) Commencing in the third quarter of 2017, amounts related to economic interests include interest earned on the prepayment of certain transmission costs.

(3) Amounts related to economic interests include the effect of contractually fixed management costs.

Three months ended Dec. 31, 2016

	Reported	Adjustments	Economic interests ⁽³⁾	Comparable total
Revenues ⁽¹⁾	94	—	85	179
Fuel, royalties and other costs of sales	15	—	16	31
Gross margin	79	—	69	148
Operations, maintenance and administration ⁽²⁾	14	—	11	25
Taxes, other than income taxes	1	—	1	2
Finance income	(39)	39	—	—
Change in fair value of Class B shares	13	(13)	—	—
Foreign exchange gain	22	(22)	—	—
Earnings before interest, taxes, depreciation and amortization	68	(4)	57	121

(1) Amounts related to economic interests include finance lease income adjusted for change in finance lease receivable amount.

(2) Amounts related to economic interests include the effect of contractually fixed management costs.

(3) Includes results for the Canadian Assets, which were acquired on Nov. 30, 2016.

The table below reconciles our finance income to Comparable EBITDA of the facilities in which we hold an economic interest:

Three months ended Dec. 31	2017			2016					
	US Wind	Australian Gas	Total	Canadian Wind ⁽¹⁾	Canadian Hydro ⁽¹⁾	US Wind	Canadian Gas ⁽¹⁾	Australian Gas	Total
Comparable EBITDA	5	29	34	2	1	5	15	34	57
Sustaining capital	—	(2)	(2)	(1)	—	—	(2)	(2)	(5)
Change in long-term receivable	—	6	6	—	—	—	—	—	—
Current income tax expense	—	—	—	—	—	—	(2)	—	(2)
Unrealized risk management gain	—	—	—	—	—	—	(1)	—	(1)
Reserves and other	—	5	5	—	(1)	—	(2)	—	(3)
Currency adjustment	—	(1)	(1)	—	—	—	—	(1)	(1)
AFFO	5	37	42	1	—	5	8	31	45
Return of capital	(3)	(14)	(17)	—	—	—	(3)	—	(3)
Effects of changes in working capital and other timing on finance income	(2)	(5)	(7)	—	—	(4)	4	(3)	(3)
Finance income	—	18	18	1	—	1	9	28	39

(1) On Nov. 30, 2016, we acquired the Canadian Assets.

Reconciliation of Comparable EBITDA to AFFO

Three months ended Dec. 31	2017			2016		
	Owned assets	Economic interests	Total	Owned assets	Economic interests	Total
Comparable EBITDA	84	34	118	64	57	121
Interest expense	(12)	—	(12)	(12)	—	(12)
Change in long-term receivable	—	6	6	—	—	—
Sustaining capital expenditures	(6)	(2)	(8)	(4)	(5)	(9)
Current income tax expense	(1)	—	(1)	(1)	(2)	(3)
Distributions paid to subsidiaries' non-controlling interest	1	—	1	—	—	—
Unrealized risk management (gain) loss	1	—	1	(1)	(1)	(2)
Realized foreign exchange gain (loss)	(1)	—	(1)	1	—	1
Reserves and other	—	5	5	—	—	—
Currency adjustment	—	(1)	(1)	—	(1)	(1)
Other	3	—	3	(1)	(3)	(4)
AFFO	69	42	111	46	45	91

Discussion of Comparable EBITDA and Operational Results

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 interest, income taxes and the impacts of timing and sustaining capital expenditures on finance income from subsidiaries of TransAlta.

Three months ended Dec. 31	Long-term average renewable energy production (GWh) ⁽¹⁾	Production (GWh)		Comparable EBITDA	
		2017	2016	2017	2016
Canadian Wind	891	938	783	73	59
Canadian Hydro	83	58	84	2	4
US Wind	107	127	108	5	5
Total - Renewable energy	1,081	1,123	975	80	68
Canadian Gas		341	321	15	23
Australian Gas		457	397	29	34
Corporate		—	—	(6)	(4)
Total		1,921	1,693	118	121

(1) Long-term average is calculated on an annualized basis from the average annual energy yield predicted from our simulation model based on historical resource data performed over a period of typically 15 years for wind and 30 years for hydro.

- Canadian Wind: Comparable EBITDA increased \$14 million over the prior year due to higher wind resource, contract price escalation and lower operating costs arising from long-term service contracts renegotiated in the third quarter of 2016, and lower blade maintenance.
- Canadian Hydro: Comparable EBITDA decreased \$1 million from 2016 due to lower hydro resource.
- US Wind: Higher wind resource increased production for the fourth quarter of 2017 compared to the prior year, but was offset by an increase in royalty and operating costs, which resulted in Comparable EBITDA remaining consistent with the prior year.
- Canadian Gas: Comparable EBITDA decreased \$9 million from 2016 mainly due to the unfavourable non-cash impact of unrealized mark-to-market, timing of planned outages and equipment issues.
- Australian Gas: The Australian Assets performed in line with the Corporation's expectations, although they provided lower Comparable EBITDA of \$5 million compared to the prior year. Comparable EBITDA generated from the South Hedland Power Station was more than offset by lower finance lease income due to FMG completing its acquisition of the Solomon Power Station on Nov. 1, 2017.

- **Corporate:** Consistent with the annual results, Corporate costs are slightly higher compared to last year due to the development fee paid to TransAlta upon signing the PPA with NB Power for Kent Hills 3.

Selected Quarterly Information

	Q1 2017	Q2 2017	Q3 2017	Q4 2017
Revenue ⁽¹⁾	124	110	91	134
Net earnings (loss) attributable to common shareholders	27	22	(73)	33
Cash flow from operating activities	100	73	87	30
AFFO	83	64	70	111
CAFD	83	43	70	88
Net earnings (loss) per share attributable to common shareholders, basic and diluted	0.12	0.10	(0.30)	0.13
CAFD per share	0.37	0.19	0.29	0.35

	Q1 2016	Q2 2016	Q3 2016	Q4 2016
Revenue	68	52	45	94
Net earnings attributable to common shareholders	(36)	(15)	23	26
Cash flow from operating activities	81	70	62	69
AFFO	82	55	55	91
CAFD	82	38	55	69
Net earnings per share attributable to common shareholders, basic and diluted	(0.16)	(0.07)	0.10	0.12
CAFD per share	0.37	0.17	0.25	0.31

(1) Q1, Q2, and Q3 2017 revised to reflect netting of intercompany gas sales with purchases. This adjustment had no effect on net earnings (loss) attributable to common shareholders or any other measures presented in this table.

Our business results fluctuate with seasonal variations, with the first and fourth quarters seeing the largest wind volumes and the second and third quarters recording higher hydro volumes. As wind forms a larger part of our renewable fleet, higher revenues and earnings are expected in the first and fourth quarters. On Jan. 6, 2016, we acquired an economic interest in the Canadian Assets, adding 611 MW to our existing capacity and subsequently on Nov. 30, 2016 we acquired ownership of the Canadian Assets. In May 2015, we acquired an economic interest in the Australian Assets, and approximately doubled our capitalization. The earnings after this investment include various effects arising from financial instruments:

- Favourable changes in the fair value of the Class B shares liability in the third quarter of 2017, with unfavourable changes in all other previous quarters. The Class B shares were converted to common shares on Aug. 1, 2017.
- Foreign exchange gains on Australian-dollar-denominated instruments in the first and fourth quarters of 2017, and the third quarter of 2016, with losses in the second and third quarters of 2017 and the first, second and fourth quarters of 2016.
- In the third and fourth quarters of 2017, we recognized an impairment on the Australian Tracking Preferred Shares.

Controls and Procedures

Management has evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our report is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding our required disclosure. In designing and evaluating our disclosure controls and procedures, management is required to apply its judgment in evaluating and implementing possible controls and procedures.

There has been no change in the internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Based on the foregoing evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of Dec. 31, 2017, the end of the period covered by this report, our disclosure controls and procedures and our internal controls over financial reporting were effective.