TransAlta renewables inc.

**TRANSALTA RENEWABLES INC.**

**SECOND QUARTER REPORT FOR 2015**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") contains forward-looking statements. These statements are based on certain estimates and assumptions and involve risks and uncertainties. Actual results may differ materially. See the Forward-Looking Statements section of this MD&A for additional information.

This MD&A should be read in conjunction with the unaudited interim condensed consolidated financial statements of TransAlta Renewables Inc. as at and for the three and six months ended June 30, 2015 and 2014 and should also be read in conjunction with the annual audited consolidated financial statements and MD&A contained within our 2014 Annual Report. In this MD&A, unless the context otherwise requires, 'we', 'our', 'us', 'TransAlta Renewables', and the 'Corporation' refer to TransAlta Renewables Inc. and 'TransAlta' refers to TransAlta Corporation and its subsidiaries. All dollar amounts in the tables presented in this MD&A are in thousands of Canadian dollars, unless otherwise noted. The condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standard ("IFRS") IAS 34 *Interim Financial Reporting*. This MD&A is dated July 30, 2015. Additional information respecting the Corporation 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

TransAlta Renewables owns and operates 12 hydro facilities and 16 wind farms in Western and Eastern Canada and holds economic interests in TransAlta's Wyoming Wind Farm and Australian Assets (the "Australian Assets").

On May 7, 2015 we completed the investment in an economic interest of TransAlta's 425 megawatts ("MW") Australian gas-fired generation assets which are operational and contracted under long-term contracts, and the 150 MW South Hedland Power Station project, currently under construction, as well as the recently commissioned 270 kilometre gas pipeline. As we have an economic interest, and not direct ownership, the operational results of the Australian Assets will not be consolidated into our results; however, the finance income we receive on our Mandatory Redeemable Preferred Shares ("MRPS") and Tracking Preferred Shares ("TPS") will be included in our consolidated results. Refer to the Significant Events section of this MD&A for further details.

At June 30, 2015, our generating assets had 1,708 MW of gross generating capacity(1) in operation (1,680 MW net interest(1)). The full capacity of the facilities in which we have an interest is 1,856 MW.(1) TransAlta manages and operates these facilities on our behalf under the terms of a Management, Administrative and Operational Services Agreement.

## NON-IFRS MEASURES

We evaluate our performance using a variety of measures. Certain of these 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 net earnings attributable to common shareholders or cash flow from operating activities, as determined in accordance with IFRS, when assessing

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*(1) We measure capacity as Net Maximum Capacity (see Glossary of Key Terms for definition of this and other key terms), which is consistent with industry standards. 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.*

our financial performance or liquidity. 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.

## HIGHLIGHTS

### *Consolidated Highlights*

| | 3 months ended June 30 | | 6 months ended June 30 | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Renewable energy production (GWh)[1] | **698** | 743 | **1,656** | 1,724 |
| Revenues | **51,277** | 50,013 | **119,433** | 117,978 |
| Net earnings attributable to common shareholders | **7,167** | 5,890 | **26,817** | 27,024 |
| Comparable net earnings attributable to common shareholders[2] | **22,217** | 5,890 | **42,093** | 27,024 |
| Comparable EBITDA[2] | **51,680** | 35,194 | **105,520** | 90,856 |
| Funds from operations[2] | **43,402** | 26,950 | **88,001** | 73,304 |
| Cash flow from operating activities | **48,854** | 35,782 | **89,937** | 80,992 |
| Cash available for distribution[2] | **38,983** | 22,936 | **69,266** | 39,771 |
| Net earnings per share attributable to common shareholders, basic and diluted[3] | **0.04** | 0.05 | **0.19** | 0.24 |
| Comparable net earnings per share[2][3] | **0.14** | 0.05 | **0.31** | 0.24 |
| Funds from operations per share[2][3] | **0.27** | 0.23 | **0.64** | 0.64 |
| Cash available for distribution per share[2][3] | **0.24** | 0.20 | **0.50** | 0.35 |
| Dividends paid per common share[3] | **0.20** | 0.19 | **0.39** | 0.38 |

| As at | June 30, 2015 | Dec. 31, 2014 |
|---|---|---|
| Total assets | **3,198,631** | 1,964,157 |
| Total long-term liabilities | **996,399** | 682,005 |

### *Second Quarter Highlights*

- Comparable earnings before interest, taxes, depreciation, and amortization ("EBITDA") and funds from operations ("FFO") both increased $16.5 million in the quarter, compared to the same period last year, primarily due to the increase in finance income following the investment in TransAlta's Australian Assets.
- Renewable energy production decreased 45 gigawatt hours ("GWh") to 698 GWh compared to the same period in 2014, primarily due to lower wind volumes in Western Canada and the Wyoming Wind Farm, partially offset by higher wind volumes in Eastern Canada and fewer outages at the Western Canada hydro facilities. As Eastern Canada wind farms have contractually higher prices, the reduction in overall production did not have a significant financial impact.
- Comparable net earnings attributable to common shareholders increased by $16.3 million, primarily due to the increase in comparable EBITDA and lower income tax expense associated with an adjustment in respect of prior years, partially offset by foreign exchange losses due to the effect of the decreasing value of the Australian dollar on some of our investments in TransAlta's Australian Assets. Risks of changes in foreign currencies impacting our cash flows from this investment are mitigated in the period extending to June 30, 2020, and accordingly, this unrealized loss relates to investment balances anticipated to be outstanding after that date.

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*(1) Includes production from our economic interest in the Wyoming Wind Farm and excludes Australian gas-fired generation.*

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

*(3) Amounts in this and other tables are presented in whole numbers to the nearest two decimals.*

- Reported net earnings attributable to common shareholders increased by a lower amount, $1.3 million, as reported earnings were impacted by higher deferred tax charges and the mark-to-market losses from an economic hedge and liability-classified convertible shares.
- Cash available for distribution ("CAFD") increased $16.0 million in the quarter primarily due higher FFO, partially offset by higher sustaining capital expenditures.

***Year-To-Date Highlights***

- Comparable EBITDA and FFO both increased $14.7 million year-to-date, primarily due to the increase in finance income following the investment in TransAlta's Australian Assets, partially offset by the effects of lower renewable energy production.
- Renewable energy production decreased 68 GWh to 1,656 GWh compared to 2014, primarily due to lower wind volumes following above normal volumes last year at Wyoming Wind, closer to normal wind volumes, icing events, and an unplanned substation outage in the first quarter of 2015 in Eastern Canada, partially offset by higher wind volumes, and fewer outages at the Western Canada hydro facilities.
- Changes in reported and comparable net earnings attributable to common shareholders on a year-to-date basis are primarily due to the variances that arose in the second quarter.
- CAFD increased $29.5 million year-to-date, primarily due to higher FFO and an early payment on amortizing term debt in 2014, partially offset by higher sustaining capital expenditures.

## SIGNIFICANT EVENTS

***Investment in TransAlta's Western Australian Portfolio***

On May 7, 2015, we invested in an economic interest that is based on the cash flows of TransAlta's Australian assets (the "Transaction"). The Transaction was originally announced on March 23, 2015. TransAlta's Australia assets, held by TransAlta Energy (Australia) Pty Ltd. ("TEA"), presently consists of 425 MW of power generation from six gas-fueled operating facilities and the 150 MW South Hedland Power Station project, currently under construction, as well as the recently commissioned 270 kilometre gas pipeline (the "Australian Assets"). TransAlta will continue to own, manage, and operate the Australian Assets. The Transaction value was set at $1.78 billion, and consists of an initial investment and a commitment to fund the remaining construction costs for the South Hedland project. The investment agreement provides us with certain protections in relation to exchange rates, the cost to complete the construction of the South Hedland project, and the timing of the commencement of its commercial operation.

On closing, we immediately increased our dividend by 9 per cent, to an annualized rate of $0.84. In addition, we expect to realize the following benefits from the Transaction:

- An additional 6 to 7 per cent increase in the dividend once South Hedland is fully commissioned.
- Initial mid-teen per cent increase in CAFD per share. When South Hedland is fully commissioned, currently scheduled for mid-2017, we expect to increase our CAFD by approximately $127 million, or 140 per cent.
- Long-term, highly contracted cash flows.
- Increase in the scale and diversity of the Corporation.
- Provides a Right of First Offer on select potential growth initiatives in Australia.
- Increased the size of the public float by approximately 50 per cent.

*Initial investment*

Our initial investment was set at $1,284 million and consists of securities of TEA which provide us a priority return on invested capital MRPS, Class A TPS issued by another subsidiary of TransAlta, which provide an economic interest based on cash flows of the Australian Assets broadly equal to the underlying net distributable profits of TEA, and a return based on guarantees of TEA obligations indirectly assumed by the Corporation.

As consideration, we provided to TransAlta $216.9 million in cash, 58,270,933 Common Shares, and 26,086,956 Class B Shares. The Class B Shares provide voting rights equivalent to the Common Shares and are non-dividend paying, and will convert to Common Shares when the South Hedland project is fully commissioned. The number of Common Shares that TransAlta will receive on the conversion of the Class B Shares will be adjusted based on the actual amount that we fund for the construction and commissioning of the South Hedland project relative to the budgeted costs. In the event that the construction amount funded by us exceeds the budgeted costs, TransAlta will receive fewer Common Shares upon conversion and, comparably, TransAlta will receive more Common Shares in the event that we fund less than the budgeted costs.

We funded the cash proceeds through the public offering of 17,858,423 subscription receipts (each, a “Subscription Receipt”) at a price of $12.65 per Subscription Receipt. The offering closed in two parts on April 15 and 23, 2015. In total, we received approximately $226 million in gross proceeds, and incurred $8.2 million in share issue costs, net of $3.1 million income tax recovery thereon. Upon the closing of the Transaction, each holder of Subscription Receipts received one common share of the Corporation and a cash dividend equivalent payment of $0.06416 for each Subscription Receipt held. As a result, we issued 17,858,423 Common Shares and paid a total dividend equivalent of $1.1 million.

Upon closing of the Transaction, the Transaction values were revised to fair values on that day in accordance with IFRS requirements, as described further in the Financial Instruments section of this MD&A.

*Commitment to fund construction of the South Hedland project*

The remaining budgeted costs to be funded by us in connection with the construction and commissioning of the South Hedland project (through the “Contribution Agreement”) are estimated at approximately $491 million (AUD$507 million), and are expected to be funded through a combination of internally generated cash flow and borrowings under a credit facility. Under the Contribution Agreement, when funds are required by TEA for construction purposes, we will subscribe for and purchase preferred shares or MRPS, or other securities issued by TEA, all of which will be denominated and payable in Australian dollars. We expect to fund these costs over an approximate two year time period, until the anticipated commissioning of the South Hedland project in mid-2017. To protect against adverse fluctuations in the exchange rate between the Canadian and Australian dollars over this period, and the impact such fluctuations will have on the total Canadian dollar funding cost, we entered into a hedge agreement with TransAlta, whereby the cost of the Australian dollars has been fixed at $0.9684 Canadian per Australian dollar. The hedge on the contribution commitment is considered a held-for-trading derivative and accordingly it is accounted for as at fair value through profit and loss.

Additional information on the Transaction is available in the prospectus filed under the Corporation’s profile on SEDAR at www.sedar.com.

### *Alberta Specified Gas Emitters Regulation*

On June 29, 2015, the Alberta Government announced changes to its provincial greenhouse gas ("GHG") regulation, referred to as the Specified Gas Emitters Regulation ("SGER"). Specifically, the government announced a scheduled increase in the carbon levy as follows:

- On Jan 1, 2016, an increase in the GHG reduction obligation for large emitters from 12 per cent to 15 per cent of emissions, with the compliance price of the technology fund rising from $15 per tonne to $20 per tonne.
- On Jan. 1, 2017, a further increase to a 20 per cent reduction requirement and a $30 per tonne compliance price.

At the same time, the Alberta Government announced an intention to develop a broader climate change program which could result in greater emissions reductions over time. That program is to be developed by the fall of 2015 through consultations with Albertans and advice from an independent expert panel. It is not clear at this time if this broader climate change program will supplant the SGER framework, or be incremental to it.

The GHG offsets created by our Alberta wind facilities are expected to increase in value through 2017, as greenhouse gas emitters can use them as compliance instruments in place of contributing to the technology fund.

### *South Hedland Power Project*

Construction commenced in January 2015. In May 2015, bulk earthworks and soil remediation work was completed. Civil works have commenced and contractors were mobilized. Long lead equipment was ordered and manufacturing is underway with no reported delays in delivery. Factory acceptance testing was completed on various pieces of equipment. Detailed engineering of the power island is ongoing.

### *Bond Issuance*

On Feb. 11, 2015, we refinanced maturing debt at our Pingston hydro facility. Our share of gross proceeds was $45 million. The bonds bear interest at the annual fixed interest rate of 2.95 per cent, payable semi-annually with no principal repayments until maturity in May 2023. Proceeds were used to repay the $35 million secured debenture bearing interest at 5.28 per cent. Excess proceeds, net of transaction costs, are to be used for general corporate purposes.

## RESULTS OF OPERATIONS

The comparable results of operations are as follows:

| **3 months ended June 30, 2015** | **Gross installed capacity (MW)** | **Production (GWh)** | **Availability[1]** | **Revenues** | **Royalties and other costs of sales** | **Operating costs[2]** | **Comparable EBITDA** | **EBITDA per produced MWh[3]** |
|---|---|---|---|---|---|---|---|---|
| Western Canada wind | **418** | **165** | **96.45%** | **6,696** | **768** | **4,561** | **1,367** | **8.28** |
| Eastern Canada wind | **616** | **349** | **94.59%** | **36,420** | **1,415** | **4,482** | **30,523** | **87.46** |
| Hydro | **105** | **128** | **-** | **8,161** | **421** | **1,716** | **6,024** | **47.06** |
| Dividend income - Wyoming Wind Farm[4] | **144** | **56** | **98.51%** | **-** | **-** | **-** | **365** | **6.52** |
| **Total - Renewable energy** | **1,283** | **698** | **95.73%** | **51,277** | **2,604** | **10,759** | **38,279** | **54.84** |
| Finance income - Australian Assets[5] | **425** | **214** | **92.59%** | **-** | **-** | **-** | **16,653** | **77.82** |
| Corporate costs | **-** | **-** | **-** | **-** | **-** | **3,252** | **(3,252)** | **-** |
| **Total** | **1,708** | **912** | **95.17%** | **51,277** | **2,604** | **14,011** | **51,680** | **56.67** |

| 3 months ended June 30, 2014 | Gross installed capacity (MW) | Production (GWh) | Availability[1] | Revenues | Royalties and other costs of sales | Operating costs[2] | Comparable EBITDA | EBITDA per produced MWh[3] |
|---|---|---|---|---|---|---|---|---|
| Western Canada wind | 418 | 218 | 92.56% | 9,087 | 862 | 4,878 | 3,347 | 15.35 |
| Eastern Canada wind | 616 | 328 | 95.78% | 33,724 | 2,029 | 3,809 | 27,886 | 85.02 |
| Hydro | 105 | 118 | - | 7,202 | 604 | 1,485 | 5,113 | 43.33 |
| Dividend income - Wyoming Wind Farm[4] | 144 | 79 | 93.92% | - | - | - | 1,859 | 23.53 |
| Total - Renewable energy | 1,283 | 743 | 94.41% | 50,013 | 3,495 | 10,172 | 38,205 | 51.42 |
| Corporate costs | - | - | - | - | - | 3,011 | (3,011) | - |
| Total | 1,283 | 743 | 94.41% | 50,013 | 3,495 | 13,183 | 35,194 | 47.37 |

| **6 months ended June 30, 2015** | **Gross installed capacity (MW)** | **Production (GWh)** | **Availability[1]** | **Revenues** | **Royalties and other costs of sales** | **Operating costs[2]** | **Comparable EBITDA** | **EBITDA per produced MWh[3]** |
|---|---|---|---|---|---|---|---|---|
| Western Canada wind | **418** | **528** | **96.62%** | **24,522** | **2,061** | **9,600** | **12,861** | **24.36** |
| Eastern Canada wind | **616** | **806** | **94.51%** | **84,114** | **3,428** | **8,535** | **72,151** | **89.52** |
| Hydro | **105** | **168** | **-** | **10,797** | **801** | **2,873** | **7,123** | **42.40** |
| Dividend income - Wyoming Wind Farm[4] | **144** | **154** | **98.87%** | **-** | **-** | **-** | **3,399** | **22.07** |
| **Total - Renewable energy** | **1,283** | **1,656** | **95.79%** | **119,433** | **6,290** | **21,008** | **95,534** | **57.69** |
| Finance income - Australian Assets[5] | **425** | **214** | **92.59%** | **-** | **-** | **-** | **16,653** | **77.82** |
| Corporate costs | **-** | **-** | **-** | **-** | **-** | **6,667** | **(6,667)** | **-** |
| **Total** | **1,708** | **1,870** | **95.52%** | **119,433** | **6,290** | **27,675** | **105,520** | **56.43** |

| 6 months ended June 30, 2014 | Gross installed capacity (MW) | Production (GWh) | Availability[1] | Revenues | Royalties and other costs of sales | Operating costs[2] | Comparable EBITDA | EBITDA per produced MWh[3] |
|---|---|---|---|---|---|---|---|---|
| Western Canada wind | 418 | 504 | 93.46% | 22,715 | 2,157 | 9,812 | 10,746 | 21.32 |
| Eastern Canada wind | 616 | 839 | 96.51% | 86,424 | 4,496 | 7,669 | 74,259 | 88.51 |
| Hydro | 105 | 139 | - | 8,839 | 841 | 2,539 | 5,459 | 39.27 |
| Dividend income - Wyoming Wind Farm[4] | 144 | 242 | 95.28% | - | - | - | 6,224 | 25.72 |
| Total - Renewable energy | 1,283 | 1,724 | 95.27% | 117,978 | 7,494 | 20,020 | 96,688 | 56.08 |
| Corporate costs | - | - | - | - | - | 5,832 | (5,832) | - |
| **Total** | 1,283 | 1,724 | 95.27% | 117,978 | 7,494 | 25,852 | 90,856 | 52.70 |

### *Western Canada Wind*

Production for the three months ended June 30, 2015 decreased 53 GWh compared to the same period in 2014 due to lower wind volumes.

*(1) Availability includes generating assets, except hydro generation.*
*(2) Excludes depreciation and amortization.*
*(3) The amounts per MWh are presented in whole dollars to the nearest two decimals.*
*(4) Dividend income from investment in preferred shares.*
*(5) Quarterly production pro-rated from the date of Transaction.*

For the six months ended June 30, 2015, production increased 24 GWh compared to the same period in 2014 due to higher wind volumes in the first quarter of 2015.

Comparable EBITDA for the three months ended June 30, 2015 decreased $2.0 million compared to the same period in 2014, primarily due to lower revenue in relation to reduced production.

For the six months ended June 30, 2015, Comparable EBITDA increased $2.1 million compared to the same period in 2014, primarily due to higher production and higher emission reduction credit sales, offset by lower government incentives associated with the expiry of Summerview 1 government incentives in September 2014.

***Eastern Canada Wind***

Production for the three months ended June 30, 2015 increased 21 GWh compared to the same period in 2014, primarily due to higher wind resources.

For the six months ended June 30, 2015, production decreased 33 GWh compared to the same period in 2014, primarily due to lower and closer to normal wind volumes, icing events, and an unplanned substation outage in the first quarter of 2015.

Changes in comparable EBITDA for the three and six months ended June 30, 2015 are primarily due to changes in production. Price escalations have offset higher operating costs in the periods.

***Hydro***

Production for the three and six months ended June 30, 2015 increased 10 GWh and 29 GWh, respectively, compared to the same periods in 2014, primarily due to fewer outages in Western Canada, offsetting lower water resources.

Comparable EBITDA for the three and six months ended June 30, 2015 increased $0.9 million and $1.7 million, respectively, compared to the same periods in 2014, primarily due to higher production at our facilities in Western Canada, partially offset by an increase in operating costs due to major maintenance work in Western Canada.

***Economic Interest in Wyoming Wind Farm***

For the three and six months ended June 30, 2015, production at the Wyoming Wind Farm decreased 23 GWh and 88 GWh, respectively, compared to the same periods in 2014. The decrease is primarily due to lower wind volumes following above normal volumes in the first quarter last year.

Comparable EBITDA for the three and six months ended June 30, 2015 decreased $1.5 million and $2.8 million, respectively, compared to the same periods in 2014, primarily due to lower production and timing of the dividends received.

Dividends received on the preferred shares associated with the Wyoming Wind Farm during the second quarter of 2014 and 2015 are based on pre-tax earnings of TransAlta Wyoming Wind LLC during the months of March, April and May.

***Economic Interest in Australian Assets***

During the three months ended June 30, 2015, we have commenced earning finance income following the acquisition of the investment on May 7, 2015. Finance income includes interest income and guarantee fees earned from that date and the dividends earned following their declaration.

Availability of TEA power stations was 92.6 per cent in the period, which is in line with TransAlta's long-range forecasts for these assets.

Business operations and results of TEA have been in line with historical experience of TransAlta prior to our investment, except for the contribution from a full quarter of operation of the Fortescue Gas River Pipeline, following its commissioning on March 19, 2015. The project, TransAlta's first pipeline, was completed within a nine month time frame and now provides gas to TEA's Solomon power station.

***Corporate***

For the three and six months ended June 30, 2015 corporate costs increased $0.2 million and $0.8 million, respectively, primarily due to regulatory costs and the higher G&A Reimbursement Fee following the April 2014 rate adjustment related to the acquisition of an economic interest in the Wyoming Wind Farm and contractual cost escalation.

## OTHER CONSOLIDATED RESULTS

***Depreciation and Amortization***

During the first quarter, we recognized an adjustment to give effect to an indemnity from TransAlta for the benefit of the Corporation in respect of a dispute for final disbursements in relation to a construction project completed prior to the formation of the Corporation. As a result, as at June 30, 2015, we received $10.0 million from TransAlta, applied a reduction to property, plant & equipment ("PP&E") of $8.2 million, and recognized a liability of $1.2 million in excess of a previously recognized accounts payable amount.

***Net Interest Expense***

The components of net interest expense are shown below:

| | 3 months ended June 30 | | 6 months ended June 30 | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Interest on debt | **8,527** | 8,869 | **17,513** | 17,894 |
| Interest on letters of credit and guarantees pledged by TransAlta | **25** | 3 | **45** | 24 |
| Interest income | **(74)** | (2) | **(112)** | (5) |
| Accretion of provisions | **264** | 238 | **525** | 458 |
| **Net interest expense** | **8,742** | 9,108 | **17,971** | 18,371 |

For the three and six months ended June 30, 2015, net interest expense decreased compared to the same periods in 2014, primarily due to lower interest on the Amortizing Term Loan and higher interest income, partially offset by the higher interest costs on the Wyoming Wind Acquisition Loan due to unfavorable foreign exchange against the U.S. dollar.

***Class B Shares***

As at June 30, 2015, there are 26,086,956 Class B shares outstanding (Dec. 31, 2014 – nil), following closing of the Transaction. As Class B shares are convertible into common shares at a variable rate, they are classified as liabilities and their change in value is recognized in the statements of earnings. Changes in value of Class B shares are unrealized and relate to the change in value of underlying common shares during the period (net of the effect of estimated foregone dividends, as discounted using a risk-free rate for the period to conversion). Additional information on Class B shares is presented in Note 11 of our interim condensed consolidated financial statements

### *Income Taxes*

A reconciliation of income taxes and effective tax rates on earnings excluding non-comparable items is presented below:

| | 3 months ended June 30 | | 6 months ended June 30 | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Earnings before income taxes | **17,354** | 7,461 | **44,114** | 35,645 |
| Income attributable to non-controlling interest | **(854)** | (527) | **(1,927)** | (1,686) |
| Change in fair value of Class B shares | **1,742** | - | **1,742** | - |
| Economic hedge on South Hedland contribution commitment | **4,180** | - | **4,180** | - |
| **Comparable earnings attributable to TransAlta Renewables shareholders subject to tax** | **22,422** | 6,934 | **48,109** | 33,959 |
| **Comparable income tax adjustments:** | | | | |
| Income tax recovery related to economic hedge on South Hedland contribution commitment | **564** | - | **564** | - |
| Income tax expense related to writeoff of deferred income tax assets[1] | **(1,710)** | - | **(1,936)** | - |
| Income tax expense related to changes in corporate income tax rates[2] | **(3,782)** | - | **(3,782)** | - |
| Income tax expense related to Transaction fair value differences at initial recognition | **(4,200)** | - | **(4,200)** | - |
| **Total comparable income tax expense adjustments** | **(9,128)** | - | **(9,354)** | - |
| Income tax expense | **9,333** | 1,044 | **15,370** | 6,935 |
| **Comparable income tax expense** | **205** | 1,044 | **6,016** | 6,935 |
| **Comparable effective tax rate on earnings attributable to common shareholders (%)** | **1** | 15 | **13** | 20 |

(1) *Relates to the write down of the deferred tax assets on realized and unrealized foreign exchange capital losses as we do not expect to realize capital gains in the foreseeable future.*

(2) *Impact of increase in Alberta income tax rate from 10 per cent to 12 per cent.*

Comparable income tax expense for the three and six months ended June 30, 2015 decreased compared to the same periods in 2014, primarily due to an adjustment in respect of prior years, offset by higher comparable earnings.

The comparable effective tax rate on earnings attributable to common shareholders for the three and six months ended June 30, 2015 decreased compared to the same periods in 2014, due to an adjustment in respect of prior years and the effect of an increase in dividend income not subject to tax.

### *Non-Controlling Interest*

Natural Forces Technologies Inc. owns a 17 per cent interest in the Kent Hills 1 and 2 wind farms, which have 150 MW of gross generating capacity.

Net earnings attributable to the non-controlling interest for the three and six months ended June 30, 2015 increased $0.3 million and $0.2 million, respectively, compared to the same periods in 2014, primarily due to increased production.

### *Other Comprehensive Income ("OCI")*

As part of the acquisition of the economic interest in TransAlta's Australian Assets we acquired TPS issued by another subsidiary of TransAlta (see the Significant Events and Financial Instruments Sections of this MD&A). Under IFRS accounting requirements, we designated these shares as an available for sale financial asset with the result that changes in the fair value of these shares are recognized in OCI each period. During the three and six months ended June 30, 2015 we recognized a $14.9 million increase in fair value in OCI.

Changes in the fair value of TPS during the period from issuance to June 30, 2015 are primarily attributable to the increased value of the U.S. dollar.

## LIQUIDITY AND CAPITAL RESOURCES

Liquidity risk arises from our ability to meet general funding needs, engage in trading and 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 capital markets, cash generated from operations and funding from TransAlta. Our primary uses of funds are operational expenses, capital expenditures, distributions to non-controlling interest, interest and principal payments on debt, and dividends.

### *Financial Position*

The following chart highlights significant changes in the Condensed Consolidated Statements of Financial Position from Dec. 31, 2014 to June 30, 2015:

| | Increase/ (decrease) | Primary factors explaining change |
|---|---|---|
| Cash and cash equivalents | 26,849 | Timing of receipts and payments |
| Prepaid expenses | 5,766 | Annual insurance and property tax premiums, and long-term service agreement payments paid in the period |
| Property, plant, and equipment, net | (38,315) | Depreciation and adjustment with TransAlta, partially offset by additions |
| Intangible assets | (3,752) | Amortization |
| Investments in subsidiaries of TransAlta | 1,240,865 | Increase due to the acquisition of economic interest in the Australian Assets |
| Dividends payable | 11,997 | Issuance of common shares as part of the Transaction |
| Long-term debt (including current portion) | 7,710 | Refinancing of our Pingston facility and unfavourable changes in foreign exchange rates, partially offset by principal repayments on the Amortizing Term Loan |
| Class B shares liability | 278,786 | Issuance of Class B shares as part of the Transaction |
| Deferred income tax liabilities | 12,601 | Decreases in tax loss carryforwards and increases in taxable temporary differences |
| Risk management liabilities (current and long-term) | 17,334 | Derivative hedge liability on contribution commitment |
| Equity attributable to shareholders | 908,172 | Net earnings for the period, increase in fair value of available-for-sale financial assets recognized in other comprehensive income, and common shares issued, partly offset by dividends declared |

### *Cash Flows*

The following chart highlights significant changes in the Condensed Consolidated Statements of Cash Flows for the three and six months ended June 30, 2015 compared to the same periods in 2014:

| 3 months ended June 30 | 2015 | 2014 | Primary factors explaining change |
|---|---|---|---|
| Cash and cash equivalents, beginning of period | **37,288** | 11,945 | |
| Provided by (used in): | | | |
| Operating activities | **48,854** | 35,782 | Higher cash earnings of $16.5 million and unfavourable changes in working capital of $3.4 million |
| Investing activities | **(220,103)** | (1,991) | Increase in investment in subsidiaries of TransAlta of $216.9 million, unfavourable change in non-cash investing working capital balances of $0.8 million, and an increase in additions to property, plant and equipment of $0.5 million |
| Financing activities | **184,730** | (23,620) | Net proceeds on the issuance of common shares of $213.5 million, favourable change in non-cash financing working capital balances of $0.4 million, partially offset by an increase in dividends paid on common shares of $6.0 million |
| Translation of foreign currency cash | **(194)** | (22) | |
| Cash and cash equivalents, end of period | **50,575** | 22,094 | |

| 6 months ended June 30 | 2015 | 2014 | Primary factors explaining change |
|---|---|---|---|
| Cash and cash equivalents, net of bank overdraft, beginning of period | **23,726** | 18,365 | |
| Provided by (used in): | | | |
| Operating activities | **89,937** | 80,992 | Higher cash earnings of $14.7 million and unfavourable changes in working capital of $5.8 million |
| Investing activities | **(223,124)** | (3,043) | Increase in investment in subsidiaries of TransAlta of $216.9 million, increase in additions to plant, property and equipment of $1.6 million, a favourable change in non-cash investing working capital of $1.2 million, and a decrease in proceeds on the sale of assets of $0.3 million |
| Financing activities | **159,781** | (74,212) | Net proceeds on the issuance of common shares of $213.5 million, issuance of long-term debt of $45 million, and a favourable change in non-cash financing working capital balances of $0.4 million, partially offset by an increase in the repayment of long-term debt of $18.9 million, increase in dividends paid on common shares of $6.2 million |
| Translation of foreign currency cash | **255** | (8) | |
| Cash and cash equivalents, end of period | **50,575** | 22,094 | |

### *Debt*

Long-term debt, including amounts owing to TransAlta, totalled $666.2 million at June 30, 2015 compared to $658.5 million Dec. 31, 2014. Long-term debt increased from Dec. 31, 2014 primarily due to the refinancing of our Pingston facility and unfavorable changes in foreign exchange rates, partially offset by principal repayments on the Amortizing Term Loan.

At June 30, 2015, $274.9 million of our long-term debt was due to TransAlta (Dec. 31, 2014 - $279.3 million).

***Working Capital Credit Facility***

We have a $350 million unsecured Working Capital Credit Facility with TransAlta available to us. The facility is available for general corporate purposes, including financing ongoing working capital requirements. At June 30, 2015, no amounts were drawn on the facility. The Working Capital Credit Facility increased from $100 million following the close of the Transaction described in the Significant Events section of this MD&A.

***Share Capital***

On June 30, 2015 and July 30, 2015, we had 190.8 million common shares and 26.1 million Class B shares issued and outstanding.

During the three months ended June 30, 2015, 76.1 million common shares and 26.1 million Class B shares were issued. Information on issued shares is presented in the Significant Events section of this MD&A.

On July 30, 2015, we declared dividends of $0.07 per common share, payable on Sept. 30, 2015, Oct. 30, 2015 and Nov. 30, 2015.

## 2015 OUTLOOK

***Business Environment***

*Economic Environment*

We expect low growth in Western Canada in 2015. The slowdown in the oil and gas sector is expected to cut economic growth as a result of investment slowdown and lower consumer spending. Growth in Eastern Canada has not been as strong as expected, and as a result the Bank of Canada has lowered interest rates in the midst of two consecutive quarters of negative growth.

In West Australia, depressed commodity prices combined with the completion of the large iron ore expansion projects are driving a slowdown in the economy which we expect to continue for the balance of 2015. Unemployment rates are increasing, currently around 6.0 per cent nationally and expected to reach 6.5 per cent by year end. The prevailing theme is one of reduced spending (by companies and governments) and driving for operational efficiencies. Asset sales are expected to remain strong as companies evaluate and restructure their balance sheets to mitigate the impact of lower revenue forecasts. Forecasts for Australian GDP growth are in the range of 2.5 per cent to 3.0 per cent.

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 and continue to deal primarily with investment grade counterparties.

*Environmental Legislation*

As noted in the Significant Events section, Alberta's current greenhouse gas program has been renewed and expanded. We expect value realized from our environmental attributes generated in the province in 2015 to be consistent with prior years. Revenue from environmental attributes generated in Alberta amounted to $3.4 million year to date in 2015 and $7.5 million in the full year 2014.

On April 13, 2015, the Ontario Government announced that Ontario will be implementing a greenhouse gas cap-and-trade system in an effort to reduce emissions and fight climate change. The cap-and-trade system will impose a hard ceiling on the GHG emissions allowed in each sector of the economy. The details of the cap-and-trade system (such as specifics on a potential cap, covered sectors, or anticipated launch date) currently remain absent but are to be developed through stakeholder consultations.

***Operations***

*Production*

Including production from the Wyoming Wind Farm, we expect renewable energy production in 2015 to be in the range of 3,250 to 3,550 GWh. Australian gas-fired generation contracts primarily provide compensation for capacity, and accordingly, production is not a significant performance indicator of that business.

We expect wind and Australian Asset availability to be in the range of 95 to 97 per cent and 91 to 93 per cent, respectively, in 2015.

*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 capacity-weighted average contractual life remaining of 16 years. In addition, for 2015, approximately 75 per cent and 98 per cent of the environmental attributes from our wind and hydro facilities, respectively, have been sold.

The contract with respect to our 10 MW Akolkolex facility expired in April 2015, however the current contract terms are expected to remain in place until the buyer finalizes its renewal process.

*Government Incentives*

Certain of our wind and hydro facilities are eligible to receive incentives under the Wind Power Production Incentive or the ecoENERGY for Renewable Power incentive programs sponsored by the Canadian federal government to encourage the development of clean power generation projects in Canada. Qualifying facilities receive specified incentive payments for every kilowatt hour of energy production for a period of up to ten years from commissioning. We are expecting a reduction in revenues in 2015 associated with the expiry of the Summerview 1 incentives in September 2014. Incentives earned at Summerview 1 amounted to $1.0 million in the full year 2014.

*Operations, Maintenance, and Administration Costs ("OM&A")*

We expect OM&A costs for 2015 to remain consistent with 2014. We have long-term service agreements in place for many of our wind facilities, which allow us to stabilize costs.

*Economic Interest in Wyoming Wind Farm*

We expect declining dividends from our investment in the Wyoming Wind Preferred Shares in 2015 compared to 2014, due to lower than normal wind volumes in the first half of the year.

*Exposure to Fluctuations in Foreign Currencies*

We expect that we will be exposed to fluctuations in the exchange rate between the Canadian, Australian and U.S. dollars as a result of our economic interest in the Wyoming Wind Farm and TransAlta's Australian portfolio of assets, which includes our commitment to fund the remaining construction costs for the South Hedland Power Station in Australian dollars. U.S. dollar exposures related to the Wyoming Wind Farm are partially offset by the U.S.-denominated Wyoming Wind Acquisition Loan, our U.S.$20.0 million debenture, and the related payment of U.S.-denominated interest thereon. The Australian assets have cash flows in both Australian and U.S. dollars; however, the Corporation's near-term exposure to exchange rate fluctuations is limited, as TransAlta has agreed to set AUD/CAD and USD/CAD exchange rates for the first five years of cash flows from the Australian assets. TransAlta has also agreed to a set AUD/CAD exchange rate for the Corporation's Australian dollar commitment to fund the remaining construction costs for the South Hedland Power Station, which is expected to be completed in 2017. Any changes in foreign investments or foreign-denominated debt may change our exposure.

All of our other assets are located in Canada, and as a result, there is minimal additional exposure to fluctuations in foreign currencies. We may acquire equipment from foreign suppliers for future capital or unplanned maintenance projects, which could create exposure to fluctuations in the value of the Canadian dollar related to these currencies.

Our strategy is to minimize the impact, if any, of near-term fluctuations in the Canadian dollar against the Australian dollar, U.S. dollar, and other currencies by entering into foreign exchange contracts, to the extent that foreign denominated expenses and revenues do not offset.

*Net Interest Expense*

We are not exposed to interest rate risk from long-term debt as all instruments bear interest at a fixed rate. Net interest for 2015 is expected to be lower than 2014, primarily due to the lower carrying value and principal repayments on the Amortizing Term Loan and Wyoming Wind Acquisition Loan. However, changes in the value of the Canadian dollar relative to the U.S. dollar can affect the amount of interest expense incurred.

*Liquidity and Capital Resources*

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

The Corporation manages liquidity risk associated with debentures due in 2015 and beyond by preparing and revising long-term external financing plans reflecting business plans and market availability of capital. The Corporation anticipates refinancing its maturing debt based on reasonable commercial terms.

*Income Taxes*

The effective tax rate on earnings excluding non-comparable items for 2015 is expected to be approximately 9 to 14 per cent, which is lower than the statutory tax rate of 26 per cent, primarily due to certain earnings that are not subject to tax.

Our expectation of the effective tax rate has decreased from the prior quarter, as a result of the investment in Australian Assets currently generating finance income that is subject to tax at an average rate substantially lower than the statutory tax rate.

Dividends on TPS related to TEA are based on a value that is net of cash taxes paid by TEA. While we do not incur a tax expense for these cash taxes, they reduce finance income by an equivalent amount. For the period since May 7, 2015 to Dec. 31, 2015, TransAlta anticipates that TEA will pay no cash taxes that are attributable to our economic interest, as a result of deductions available to reduce taxable income.

***Capital Expenditures and Investments***

*Sustaining Capital*

Our sustaining capital is comprised of the ongoing capital costs associated with maintaining the existing generating capacity of our facilities.

For 2015, our estimate for total sustaining capital, net of any contributions received, is allocated among the following:

| Category | Description | Spend to date(1)(2) in 2015 | Expected spend in 2015 (2) |
|---|---|---|---|
| Routine capital | Expenditures to maintain our existing generating capacity | **0.8** | **1 - 2** |
| Planned maintenance | Regularly scheduled maintenance | **4.1** | **5 - 7** |
| **Total sustaining expenditures** | | **4.9** | **6 - 9** |

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 finance income we derive from our investments. For 2015, estimated sustaining capital expenditures of the facilities which we do not own, but in which we own economic interests, ranges from $8 to $10 million(3). As at June 30, 2015, $0.8 million(3) of this total has been spent.

*(1) As at June 30, 2015.*

*(2) Amounts reported in millions of dollars.*

(3) *Including pro-rata sustaining capital expenditures of TEA from the second quarter of 2015.*

*Investments*
During 2015, we anticipate investing $156 million in TEA towards the South Hedland project out of the estimated total contribution commitment of $491 million. We expect that the power station will be commissioned in the second quarter of 2017.

*Financing*
Financing for these capital expenditures and investments is expected to be provided by cash flow from operating activities and existing borrowing capacity through TransAlta.

## FINANCIAL INSTRUMENTS

Refer to Note 12 of our most recent annual consolidated financial statements and Note 8 of our interim condensed consolidated financial statements as at and for the three months ended June 30, 2015 for details on Financial Instruments. Also refer to the Financial Instruments section of our most recent annual MD&A for additional details.

Following the close of the Transaction, we acquired or issued the following financial instruments:

*Class B Common Shares*
We issued 26,086,956 Class B shares to TransAlta. Because the Class B shares are convertible into common shares at a variable rate, they are classified as a financial liability and not as equity. As explained in Note 8 of our interim condensed consolidated financial statements, we have chosen to designate the Class B shares as a *financial liability to be carried at fair value through profit and loss*. Under IFRS, a *financial liability to be carried at fair value through profit and loss* is measured at fair value initially and on an on-going basis, with changes in fair value recognized in net earnings. As a result, at every period end, the fair value of the Class B shares will be determined and the carrying amount of the financial liability will be adjusted, with the change in the fair value recognized in net earnings.

Changes in fair value of the Class B shares relate to the change in value of the underlying common shares during the period (net of the effect of estimated foregone dividends, discounted using a risk-free rate for the period to conversion). Estimates of the fair value of the Class B shares can vary based on the estimated cost of construction and commissioning of the South Hedland project by TEA, which can vary based on emergent or unforeseen capital needs of the project, or release of uncommitted planned contingency funds.

*Mandatory Redeemable Preferred Shares*
We acquired MRPS issued by TEA. The MRPS are non-voting and rank subordinate to all present and future secured and unsecured indebtedness of TEA, but senior to all other classes of issued and outstanding shares in the capital of TEA. We are entitled to receive cash dividends on the MRPS. The MRPS are subject to mandatory redemption in whole, on their maturity date or earlier at TEA's option. The MRPS are classified as a *loans and receivables* financial asset and are carried at amortized cost. The MRPS are denominated in Australian dollars and will be translated into their Canadian dollar equivalent at each period end except for earnings and redemptions of the period to June 30, 2020 which are hedged with TransAlta. We recognize the resulting foreign exchange gains or losses in net earnings.

*Tracking Preferred Shares*
We acquired Canadian dollar-denominated TPS issued by another subsidiary of TransAlta, which provide cumulative variable dividends, when declared, that are broadly equal to the underlying net distributable profits of TEA. As explained in Note 8 of our interim condensed consolidated financial statements, we have designated the TPS as an *available for sale financial asset*. Under IFRS, an *available for sale financial asset* is measured at fair value initially and on an on-going basis, with changes in fair value recognized in OCI. Accordingly, at every period end, the fair value of the TPS will be determined and the carrying amount of the TPS will be revised, with the resulting change in the fair value recognized in OCI. The initial fair value of the TPS is estimated by

reference to the net value of the other instruments at closing date. The period end fair value of the TPS is estimated using a discounted cash flow method, using estimates and assumptions about sales prices, production, capital expenditures, asset retirement costs, and other related cash inflows and outflows of the Australian Assets. Refer to Note 4 of our interim condensed consolidated financial statements for additional information.

*Hedge on Contribution Commitment*

As part of the Transaction, we entered into a Contribution Agreement with TEA and other TransAlta subsidiaries, related to our commitment to fund the remaining costs for the construction and commissioning of the South Hedland project, which at closing of the Transaction and at June 30, 2015 are estimated to be approximately $491 million. Under the Contribution Agreement, when funds are required by TEA for construction purposes, we will subscribe for and purchase Preferred Shares or MRPS, issued by TEA, both of which will be denominated and payable in Australian dollars. We expect to fund these costs over an approximate two year time period, until the anticipated commissioning of the South Hedland project in mid-2017. To protect against adverse fluctuations in the exchange rate between the Canadian and Australian dollars over this period, and the impact such fluctuations will have on our total Canadian dollar funding cost, we entered into a hedge agreement with TransAlta (the "Hedge on Contribution Commitment"), whereby we have fixed the cost of the Australian dollars we will need at $0.9684 Canadian per Australian dollar. The Hedge on Contribution Commitment is considered a held-for-trading derivative and accordingly we are required to account for this as *at fair value through profit and loss*. As a result, it was initially recognized at fair value and at every period end, the fair value is determined and the carrying amount adjusted, with the change in the fair value recognized in net earnings and included in foreign exchange gain (loss). On our statement of financial position, the fair value of the Hedge on Contribution Commitment is included in risk management assets or liabilities, as appropriate.

## RISK FACTORS

Risk is an inherent factor in doing business. Following the closing of the Transaction, some, but not all, additional risk factors that could affect our future results and our activities in mitigating those risks are outlined below. These risks do not occur in isolation, but must be considered in conjunction with each other.

*Nature of interests*

TransAlta indirectly retains legal title to the Australian Assets and we have no legal rights in respect of the Australian Assets. Rather, we own securities providing an economic interest based on the cash flows from TEA broadly equal to the underlying net distributable profits of TEA. 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 TPS issued by a subsidiary of TransAlta. 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 partnership owns are the Australian Assets along with other gas and renewables facilities. There can be no certainty that the Australian Assets, along with the additional assets within the limited partnership, will generate sufficient income, such that the distributions it pays will, in aggregate, be sufficient to satisfy the dividend payments in respect of the TPS.

*Dependence on financial performance of the Australian Assets*

The value of our common shares depends, in part, on the financial performance and profitability of TEA 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 Corporation, even if those liabilities arise from lawsuits, contracts or indebtedness that do not relate or are otherwise attributed to TEA or the Corporation.

*Income Taxes*

Our operations and investments are complex and located in several countries. 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 the information currently available.

*Construction of South Hedland facility*

While we have committed funding to TEA for the construction of the South Hedland power station, our risks associated thereto are mitigated by the adjustment mechanisms of the Class B shares, which provide a compensating effect to contributions above or below target through the issuance of fewer or more common shares upon conversion. We have obtained further protections with respect to the risk of the power station not being commissioned before June 1, 2017, through compensating features embedded in the terms of the TPS.

*Other financial risks*

- Credit risk: As at June 30, 2015, TEA had one below investment grade customer whose outstanding balances of $442.1 million accounted for 96 per cent of total trade accounts receivable and finance lease receivable outstanding. Risk of significant loss arising from this counterparty has been assessed as low, considering the counterparty's financial position, and how TEA provides its services in an area of the counterparty's lower-cost operations, and TransAlta's other credit risk management practices.
- Foreign currency risks: Refer to the 2015 Outlook section of this MD&A.
- Other market, credit and liquidity risks: Refer to Note 8 of our interim condensed consolidated financial statements.

## RELATED PARTY TRANSACTIONS AND BALANCES

Refer to the Related Party Transactions and Balances – Post-Acquisition Relationship with TransAlta section of our most recent annual MD&A for information about agreements and transactions with TransAlta.

### Related Party Transactions

Amounts recognized from transactions with TransAlta or subsidiaries of TransAlta, excluding those affected on May 7 at the close of the Transaction as described in the Significant Events section of this MD&A, are as follows:

| | 3 months ended June 30 | | 6 months ended June 30 | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Revenue from TransAlta PPAs | **6,037** | 7,055 | **16,606** | 15,006 |
| Royalty and other revenue-based costs adjustments | **(41)** | - | **(31)** | - |
| Revenue from emission reduction credits[1] | **80** | - | **2,320** | - |
| Finance income related to subsidiaries of TransAlta | **17,018** | 1,859 | **20,052** | 6,224 |
| G&A Reimbursement Fee | **2,657** | 2,619 | **5,285** | 5,142 |
| Interest expense on Amortizing Term Loan | **1,667** | 1,888 | **3,364** | 3,802 |
| Interest expense on letters of credit and guarantees | **25** | 3 | **45** | 24 |
| Interest expense on Wyoming Wind Acquisition Loan | **1,068** | 942 | **2,165** | 2,077 |

[1] For the six months ended June 30, 2015 the value of the emission reduction credits was $2,240, 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 of Directors.

### Related Party Balances

Related party balances include the following balances with TransAlta or subsidiaries of TransAlta:

| **As at** | **June 30, 2015** | Dec. 31, 2014 |
|---|---|---|
| Trade and other receivables | **16,490** | 7,136 |
| Trade accounts payable | **4,316** | 3,142 |
| Dividends payable | **19,944** | 10,345 |
| Interest payable | **2,602** | 2,795 |
| Investment in subsidiaries of TransAlta | **1,360,044** | 119,179 |
| Net risk management liabilities | **(17,444)** | (117) |
| Amortizing Term Loan | **167,188** | 178,364 |
| Wyoming Wind Acquisition Loan | **107,723** | 100,912 |
| Class B shares liability | **278,786** | - |
| Letters of credit issued by TransAlta on behalf of the Corporation | **5,167** | 4,503 |
| Guarantees provided by TransAlta on behalf of the Corporation | **226,500** | 226,500 |
| Indemnification guarantee provided by the Corporation to TransAlta | **939,492** | - |

### Indemnification Guarantee Provided by the Corporation to TransAlta

As part of the Transaction, 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 which 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.

## 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 Condensed Consolidated Statements of Earnings for the three months and six months ended June 30, 2015 and 2014. Presenting these line items provides management and investors with a measurement of ongoing operating performance that is readily comparable from period to period.

## NON-IFRS MEASURES

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

Typically, for comparability purposes, we exclude the impact of asset impairment charges and other adjustments to earnings, such as gains on sales of assets, as management believes these transactions are not representative of our business operations. Following completion of the Transaction, we also exclude the earnings impact of the mark-to-market change in fair value on the hedge of the South Hedland contribution commitment and the change in fair value of the Class B shares. These gains or losses are unrealized and are recognized in earnings as a result of applying IFRS requirements to these financial instruments. Refer to the Financial Instruments section of this MD&A for further information on these items. We also exclude the income tax expense related to the Transaction, to changes in corporate income tax rates and writedowns of deferred income tax assets as these amounts do not relate to tax impacts on current earnings.

Earnings on a comparable basis per share are calculated using the weighted average common shares outstanding during the period.

Comparable operating income and EBITDA also include the finance income related to subsidiaries of TransAlta. The finance income is used as a proxy for the EBITDA of the Wyoming Wind Farm and Australian Assets.

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, and income taxes.

A reconciliation of comparable results to reported results is as follows:

| | 3 months ended June 30, 2015 | | | 6 months ended June 30, 2015 | | |
|---|---|---|---|---|---|---|
| | **Reported** | **Comparable adjustments** | **Comparable total** | **Reported** | **Comparable adjustments** | **Comparable total** |
| Revenues | **51,277** | **-** | **51,277** | **119,433** | **-** | **119,433** |
| Royalties and other costs of sales | **2,604** | **-** | **2,604** | **6,290** | **-** | **6,290** |
| **Gross margin** | **48,673** | **-** | **48,673** | **113,143** | **-** | **113,143** |
| Operations, maintenance, and administration | **12,184** | **-** | **12,184** | **24,343** | **-** | **24,343** |
| Taxes, other than income taxes | **1,827** | **-** | **1,827** | **3,625** | **-** | **3,625** |
| Finance income related to subsidiaries of TransAlta | **-** | **(17,018)** (1) | **(17,018)** | **-** | **(20,052)** (1) | **(20,052)** |
| Insurance recovery | **-** | **-** | **-** | **(293)** | **-** | **(293)** |
| **Earnings before interest, taxes, depreciation, and amortization** | **34,662** | **17,018** | **51,680** | **85,468** | **20,052** | **105,520** |
| Depreciation and amortization | **18,230** | **-** | **18,230** | **36,492** | **-** | **36,492** |
| **Operating income** | **16,432** | **17,018** | **33,450** | **48,976** | **20,052** | **69,028** |
| Finance income related to subsidiaries of TransAlta | **17,018** | **(17,018)** (1) | **-** | **20,052** | **(20,052)** (1) | **-** |
| Change in fair value of Class B shares | **(1,742)** | **1,742** (2) | **-** | **(1,742)** | **1,742** (2) | **-** |
| Foreign exchange loss | **(5,612)** | **4,180** (3) | **(1,432)** | **(5,201)** | **4,180** (3) | **(1,021)** |
| **Earnings before interest and taxes** | **26,096** | **5,922** | **32,018** | **62,085** | **5,922** | **68,007** |
| Net interest expense | **8,742** | **-** | **8,742** | **17,971** | **-** | **17,971** |
| Income tax expense | **9,333** | **(9,128)** (4) | **205** | **15,370** | **(9,354)** (4) | **6,016** |
| **Net earnings** | **8,021** | **15,050** | **23,071** | **28,744** | **15,276** | **44,020** |
| Non-controlling interest | **854** | **-** | **854** | **1,927** | **-** | **1,927** |
| **Net earnings attributable to common shareholders** | **7,167** | **15,050** | **22,217** | **26,817** | **15,276** | **42,093** |
| Weighted average number of common shares outstanding in the period (millions) | **160.7** | **160.7** | **160.7** | **137.8** | **137.8** | **137.8** |
| **Net earnings per share attributable to common shareholders** | **0.04** | **0.10** | **0.14** | **0.19** | **0.12** | **0.31** |

| | 3 months ended June 30, 2014 | | | 6 months ended June 30, 2014 | | |
|---|---|---|---|---|---|---|
| | Reported | Comparable adjustments | Comparable total | Reported | Comparable adjustments | Comparable total |
| Revenues | 50,013 | - | 50,013 | 117,978 | - | 117,978 |
| Royalties and other | 3,495 | - | 3,495 | 7,494 | - | 7,494 |
| **Gross margin** | 46,518 | - | 46,518 | 110,484 | - | 110,484 |
| Operations, maintenance, and administration | 11,364 | - | 11,364 | 22,228 | - | 22,228 |
| Taxes, other than income taxes | 1,819 | - | 1,819 | 3,624 | - | 3,624 |
| Finance income related to subsidiaries of TransAlta | - | (1,859) (1) | (1,859) | - | (6,224) (1) | (6,224) |
| **Earnings before interest, taxes, depreciation, and amortization** | 33,335 | 1,859 | 35,194 | 84,632 | 6,224 | 90,856 |
| Depreciation and amortization | 18,475 | - | 18,475 | 36,614 | - | 36,614 |
| **Operating income** | 14,860 | 1,859 | 16,719 | 48,018 | 6,224 | 54,242 |
| Finance income related to subsidiaries of TransAlta | 1,859 | (1,859) (1) | - | 6,224 | (6,224) (1) | - |
| Foreign exchange loss | (150) | - | (150) | (226) | - | (226) |
| **Earnings before interest and taxes** | 16,569 | - | 16,569 | 54,016 | - | 54,016 |
| Net interest expense | 9,108 | - | 9,108 | 18,371 | - | 18,371 |
| Income tax expense | 1,044 | - | 1,044 | 6,935 | - | 6,935 |
| **Net earnings** | 6,417 | - | 6,417 | 28,710 | - | 28,710 |
| Non-controlling interest | 527 | - | 527 | 1,686 | - | 1,686 |
| **Net earnings attributable to common shareholders** | 5,890 | - | 5,890 | 27,024 | - | 27,024 |
| Weighted average number of common shares outstanding in the period (millions) | 114.7 | - | 114.7 | 114.7 | - | 114.7 |
| **Net earnings per share attributable to common shareholders** | 0.05 | - | 0.05 | 0.24 | - | 0.24 |

*(1) The finance income related to subsidiaries of TransAlta is used as a proxy for operating income and EBITDA thereof.*
*(2) Class B shares are treated as liabilities at fair value through profit and loss for accounting purposes.*
*(3) Revaluation of the economic hedge on contribution commitment.*
*(4) Income tax expense comparable adjustments are detailed in the income taxes section of "Other Consolidated Results".*

***Funds from Operations***

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

| | 3 months ended June 30 | | 6 months ended June 30 | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Cash flow from operating activities | **48,854** | 35,782 | **89,937** | 80,992 |
| Change in non-cash operating working capital balances | **(5,452)** | (8,832) | **(1,936)** | (7,688) |
| **Funds from operations** | **43,402** | 26,950 | **88,001** | 73,304 |
| Weighted average number of common shares outstanding in the period (millions) | **160.7** | 114.7 | **137.8** | 114.7 |
| **Funds from operations per share** | **0.27** | 0.23 | **0.64** | 0.64 |

***Cash Available for Distribution***

CAFD represents the amount of cash generated from operations by our business, before changes in working capital and after non-discretionary payments. CAFD can be used to invest in growth initiatives, make early principal repayments of debt, pay additional common share dividends, or repurchase common shares.

Sustaining capital for the three and six months ended June 30, 2015 represent total additions to PP&E and intangibles per the Consolidated Statements of Cash Flows.

The reconciliation between cash flow from operating activities and CAFD is outlined below:

| | 3 months ended June 30 | | 6 months ended June 30 | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Cash flow from operating activities | **48,854** | 35,782 | **89,937** | 80,992 |
| Add (deduct): | | | | |
| Changes in non-cash operating working capital | **(5,452)** | (8,832) | **(1,936)** | (7,688) |
| Sustaining capital expenditures | **(3,086)** | (2,465) | **(4,918)** | (3,273) |
| Distributions paid to subsidiaries' non-controlling interest | **(1,333)** | (1,549) | **(2,641)** | (2,985) |
| Principal repayments of amortizing debt | **-** | - | **(11,176)** | (27,275) |
| **Cash available for distribution** | **38,983** | 22,936 | **69,266** | 39,771 |
| Weighted average number of common shares outstanding in the period (millions) | **160.7** | 114.7 | **137.8** | 114.7 |
| **Cash available for distribution per share** | **0.24** | 0.20 | **0.50** | 0.35 |

We seek to maintain sufficient cash balances and Working Capital Credit Facilities to fund periodic net cash outflows related to our business. We maintain the ability to decide on when within the year or half-year periods amortizing term debt principal repayments are made, and optimize our cash balances accordingly. This factor explains the decrease in repayments between 2014 and 2015.

## CURRENT ACCOUNTING CHANGES

There were no IFRS or other accounting policy changes adopted in the period.

## FUTURE ACCOUNTING CHANGES

Accounting standards that have been previously issued by the International Accounting Standards Board ("IASB") but not yet effective, and which we have not yet applied include IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*. Refer to the Future Accounting Changes section of our most recent annual MD&A for information regarding the requirements of IFRS 9 and IFRS 15.

IFRS 9 is effective for annual periods beginning on or after Jan. 1, 2018 and IFRS 15 is effective for annual periods beginning on or after Jan. 1, 2017. Early application is permitted for both.

In May 2015 the IASB proposed a deferral of the effective date of IFRS 15 by one year to Jan. 1, 2018, and on July 22, 2015, the IASB voted to confirm the one year deferral.

We continue to assess the impact of adopting these standards on the consolidated financial statements.

## SELECTED QUARTERLY INFORMATION

| | **Q3 2014** | **Q4 2014** | **Q1 2015** | **Q2 2015** |
|---|---|---|---|---|
| Revenue | **42,596** | **72,870** | **68,156** | **51,277** |
| Net earnings (loss) attributable to common shareholders | **(31)** | **21,665** | **19,650** | **7,167** |
| Net earnings per share attributable to common shareholders, basic and diluted | **-** | **0.19** | **0.17** | **0.04** |
| Comparable earnings per share | **-** | **0.19** | **0.17** | **0.14** |
| Cash available for distribution per share | **0.05** | **0.38** | **0.26** | **0.24** |

| | Q3 2013 | Q4 2013 | Q1 2014 | Q2 2014 |
|---|---|---|---|---|
| Revenue | 43,535 | 69,949 | 67,965 | 50,013 |
| Net earnings attributable to common shareholders | 1,207 | 15,535 | 21,134 | 5,890 |
| Net earnings per share attributable to common shareholders, basic and diluted | 0.01 | 0.13 | 0.18 | 0.05 |
| Comparable earnings per share | 0.03 | 0.15 | 0.18 | 0.05 |
| Cash available for distribution per share | 0.17 | 0.36 | 0.15 | 0.20 |

Our business results fluctuate with seasonal variations, with the first and fourth quarters seeing largest wind volumes and the second and third 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. The third quarter of 2013 benefited from the higher merchant prices in Western Canada than the lower prices under the TransAlta PPAs established in August 2013 as part of the initial public offering. In December 2013, we acquired an economic interest in the 144 MW Wyoming Wind Farm through the purchase of preferred shares and started receiving dividends from it in Q1 2014. In May 2015, we acquired an economic interest in the Australian Assets, and approximately doubled our capitalization. The earnings of the second quarter of 2015 include various effects arising from financial instruments and deferred taxes, however, most of those have been eliminated on a comparable basis.

## FORWARD-LOOKING STATEMENTS

This MD&A, the documents incorporated herein by reference, 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 assumption was 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 financial performance including, but not limited to, for example: spending on growth and sustaining capital and productivity projects, including sustaining capital expenditures of subsidiaries of TransAlta in which we have an economic interest; expectations in terms of the cost of operations, capital spending, and maintenance, including maintenance performed by third parties, and including the variability of those costs; expectations related to future earnings and cash flow from operating and contracting activities; incentive levels from government assistance; the recontracting of our Akolkolex Facility; the anticipated dividend from our economic interest in the Wyoming Wind Farm preferred shares on CAFD; the payment of future dividends; expectations for demand for electricity in both the short term and long term, and the resulting impact on electricity prices; expectations in respect of generation availability, capacity, and production; expectations and plans for future growth, including expansion into existing and new markets and other forms of power generation and acquisition activities, including acquisition activities involving TransAlta; expectations regarding the Transaction (as defined herein); the effect, results and perceived benefits of the Transaction, including forecasts of CAFD and expected CAFD per share accretion, the expected increase to the dividend following the South Hedland project being fully commissioned; and the timing and completion and commissioning of projects under development, including the South Hedland project and the costs thereof; expected governmental regulatory regimes and legislation such as Alberta's greenhouse gas program and their expected impact on us, as well as the cost of complying with resulting regulations and laws; estimates of future tax rates, future tax expense, cash taxes of TEA and the adequacy of tax provisions; accounting estimates; anticipated growth rates in our markets; potential legal and contractual claims; expectations for the ability to access capital markets at reasonable terms; the estimated or potential impact of changes in interest rates and changes in the value of the Canadian dollar relative to the U.S. dollar and the Australian dollar; the monitoring of our exposure to liquidity risk; expectations regarding entering into additional financial instruments; expectations in respect to the global economic environment; estimated cash flow required to settle decommissioning and restoration activities; and expectations regarding borrowing rates and our credit practices.

Factors that may adversely impact our forward-looking statements include risks relating to: changes in general economic conditions, including interest rates; operational risks involving our facilities, including unplanned outages at such facilities; including risks pertaining to the Transaction, the timing and cost of the construction and commissioning of the South Hedland project; disruptions in the transmission and distribution of electricity; the effects of weather; disruptions in the source of water or wind 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; 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 development projects and acquisitions. The foregoing risk factors, among others, are described in further detail in the Risk Factors section of our 2015 AIF for the year ended Dec. 31, 2014 and our 2014 Annual MD&A. Additional risks related to the Transaction are described in the prospectus associated with the offering. All documents are 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. 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.

**TRANSALTA RENEWABLES INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS**

*(in thousands of Canadian dollars, except as otherwise noted)*

| | 3 months ended June 30 | | 6 months ended June 30 | |
|---|---|---|---|---|
| Unaudited | **2015** | 2014 | **2015** | 2014 |
| Revenues | **39,582** | 40,516 | **94,337** | 94,605 |
| Government incentives | **4,245** | 4,619 | **10,201** | 11,165 |
| Lease revenue | **7,450** | 4,878 | **14,895** | 12,208 |
| **Total revenue** | **51,277** | 50,013 | **119,433** | 117,978 |
| Royalties and other costs of sales | **2,604** | 3,495 | **6,290** | 7,494 |
| **Gross margin** | **48,673** | 46,518 | **113,143** | 110,484 |
| Operations, maintenance, and administration | **12,184** | 11,364 | **24,343** | 22,228 |
| Depreciation and amortization | **18,230** | 18,475 | **36,492** | 36,614 |
| Taxes, other than income taxes | **1,827** | 1,819 | **3,625** | 3,624 |
| Insurance recovery | **-** | - | **(293)** | - |
| **Operating income** | **16,432** | 14,860 | **48,976** | 48,018 |
| Finance income related to subsidiaries of Transalta *(Note 4)* | **17,018** | 1,859 | **20,052** | 6,224 |
| Net interest expense *(Note 5)* | **(8,742)** | (9,108) | **(17,971)** | (18,371) |
| Change in fair value of Class B shares *(Note 11)* | **(1,742)** | - | **(1,742)** | - |
| Foreign exchange loss | **(5,612)** | (150) | **(5,201)** | (226) |
| **Earnings before income taxes** | **17,354** | 7,461 | **44,114** | 35,645 |
| Income tax expense *(Note 6)* | **9,333** | 1,044 | **15,370** | 6,935 |
| **Net earnings** | **8,021** | 6,417 | **28,744** | 28,710 |
| | | | | |
| **Net earnings attributable to:** | | | | |
| Common shareholders | **7,167** | 5,890 | **26,817** | 27,024 |
| Non-controlling interest *(Note 7)* | **854** | 527 | **1,927** | 1,686 |
| | **8,021** | 6,417 | **28,744** | 28,710 |
| | | | | |
| **Weighted average number of common shares outstanding in the period** *(millions) (Note 12)* | **160.7** | 114.7 | **137.8** | 114.7 |
| **Net earnings per share attributable to common shareholders, basic and diluted** *(Note 12)* | **0.04** | 0.05 | **0.19** | 0.24 |

*See accompanying notes.*

**TRANSALTA RENEWABLES INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

*(in thousands of Canadian dollars)*

| | **3 months ended June 30** | | **6 months ended June 30** | |
|---|---|---|---|---|
| Unaudited | **2015** | 2014 | **2015** | 2014 |
| **Net earnings** | **8,021** | 6,417 | **28,744** | 28,710 |
| Losses on derivatives designated as cash flow hedges, net of tax(1) | **(2)** | (89) | **(100)** | (29) |
| **Total items that will not be reclassified subsequently to net earnings** | **(2)** | (89) | **(100)** | (29) |
| Gains (losses) on derivatives designated as cash flow hedges, net of tax(2) | **(11)** | (309) | **-** | 288 |
| Reclassification of (gains) losses on derivatives designated as cash flow hedges to net earnings, net of tax(3) | **-** | 427 | **(5)** | (202) |
| Available-for-sale financial assets - net change in fair value *(Note 4)* | **14,938** | - | **14,938** | - |
| **Total items that will be reclassified subsequently to net earnings** | **14,927** | 118 | **14,933** | 86 |
| **Other comprehensive income** | **14,925** | 29 | **14,833** | 57 |
| **Total comprehensive income** | **22,946** | 6,446 | **43,577** | 28,767 |
| | | | | |
| **Total comprehensive income attributable to:** | | | | |
| Common shareholders | **22,092** | 5,919 | **41,650** | 27,081 |
| Non-controlling interest *(Note 7)* | **854** | 527 | **1,927** | 1,686 |
| | **22,946** | 6,446 | **43,577** | 28,767 |

*(1) Net of income tax expense of 20 and recovery 16 for the three and six months ended June 30, 2015 (2014 - 30 and 10 recovery), respectively.*

*(2) Net of income tax recovery of 4 and nil for the three and six months ended June 30, 2015 (2014 - 109 recovery and 99 expense), respectively.*

*(3) Net of income tax of nil and expense 2 for the three and six months ended June 30, 2015 (2014 - 187 recovery and 30 expense), respectively.*

*See accompanying notes.*

**TRANSALTA RENEWABLES INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**
*(in thousands of Canadian dollars)*

| Unaudited | **June 30, 2015** | Dec. 31, 2014 |
|---|---|---|
| Cash and cash equivalents | **50,575** | 23,726 |
| Trade and other receivables | **37,375** | 35,667 |
| Prepaid expenses | **7,161** | 1,395 |
| Risk management assets *(Note 8)* | **27** | 15 |
| Income taxes receivable | **143** | - |
| | **95,281** | 60,803 |
| Property, plant, and equipment *(Note 9)* | | |
| Cost | **2,023,215** | 2,029,682 |
| Accumulated depreciation | **(411,250)** | (379,402) |
| | **1,611,965** | 1,650,280 |
| Intangible assets | **94,908** | 98,660 |
| Risk management assets *(Note 8)* | **-** | 5 |
| Other assets | **2,942** | 2,981 |
| Investments in subsidiaries of TransAlta *(Note 4)* | **1,360,044** | 119,179 |
| Deferred income tax assets | **33,491** | 32,249 |
| **Total assets** | **3,198,631** | 1,964,157 |
| | | |
| Accounts payable and accrued liabilities | **31,810** | 30,893 |
| Risk management liabilities *(Note 8)* | **6,482** | 9 |
| Income taxes payable | **10** | 405 |
| Dividends payable *(Note 12)* | **26,711** | 14,714 |
| Current portion of deferred revenue | **425** | 425 |
| Current portion of long-term debt *(Note 10)* | **188,581** | 194,951 |
| | **254,019** | 241,397 |
| Long-term debt *(Note 10)* | **477,584** | 463,504 |
| Class B shares liability *(Note 11)* | **278,786** | - |
| Decommissioning provisions | **14,565** | 16,287 |
| Deferred revenues | **6,340** | 6,552 |
| Deferred income tax liabilities | **208,135** | 195,534 |
| Risk management liabilities *(Note 8)* | **10,989** | 128 |
| **Total liabilities** | **1,250,418** | 923,402 |
| **Equity** | | |
| Common shares *(Note 12)* | **2,152,505** | 1,223,845 |
| Deficit | **(256,496)** | (221,175) |
| Accumulated other comprehensive income | **15,071** | 238 |
| **Equity attributable to shareholders** | **1,911,080** | 1,002,908 |
| Non-controlling interest *(Note 7)* | **37,133** | 37,847 |
| **Total equity** | **1,948,213** | 1,040,755 |
| **Total liabilities and equity** | **3,198,631** | 1,964,157 |

Commitments and contingencies *(Note 13)*

*See accompanying notes.*

**TRANSALTA RENEWABLES INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

*(in thousands of Canadian dollars)*

| Unaudited | Common shares | Deficit | Accumulated other comprehensive income | Attributable to shareholders | Attributable to non-controlling interest | Total |
|---|---|---|---|---|---|---|
| Balance, Dec. 31, 2014 | 1,223,845 | (221,175) | 238 | 1,002,908 | 37,847 | 1,040,755 |
| Net earnings | - | 26,817 | - | 26,817 | 1,927 | **28,744** |
| Other comprehensive income: | | | | | | |
| Net losses on derivatives designated as cash flow hedges, net of tax | - | - | (105) | (105) | - | **(105)** |
| Net change in fair value available-for-sale financial assets | - | - | 14,938 | 14,938 | - | **14,938** |
| Total comprehensive income | - | 26,817 | 14,833 | 41,650 | 1,927 | **43,577** |
| Common shares issued to TransAlta | 712,070 | - | - | 712,070 | - | **712,070** |
| Public offering | 216,590 | - | - | 216,590 | - | **216,590** |
| Common share dividends | - | (62,138) | - | (62,138) | - | **(62,138)** |
| Distributions to non-controlling interest | - | - | - | - | (2,641) | **(2,641)** |
| **Balance, June 30, 2015** | **2,152,505** | **(256,496)** | **15,071** | **1,911,080** | **37,133** | **1,948,213** |

| Unaudited | Common Shares | Deficit | Accumulated other comprehensive income | Attributable to shareholders | Attributable to non-controlling interest | Total |
|---|---|---|---|---|---|---|
| Balance, Dec. 31, 2013 | 1,223,845 | (196,263) | 187 | 1,027,769 | 39,290 | 1,067,059 |
| Net earnings | - | 27,024 | - | 27,024 | 1,686 | 28,710 |
| Other comprehensive income: | | | | | | |
| Net gains on derivatives designated as cash flow hedges, net of tax | - | - | 57 | 57 | - | 57 |
| Total comprehensive income | - | 27,024 | 57 | 27,081 | 1,686 | 28,767 |
| Common share dividends | - | (29,428) | - | (29,428) | - | (29,428) |
| Distributions to non-controlling interest | - | - | - | - | (2,985) | (2,985) |
| Balance, June 30, 2014 | 1,223,845 | (198,667) | 244 | 1,025,422 | 37,991 | 1,063,413 |

*See accompanying notes.*

**TRANSALTA RENEWABLES INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

*(in thousands of Canadian dollars)*

| | 3 months ended June 30 | | 6 months ended June 30 | |
|---|---|---|---|---|
| Unaudited | **2015** | 2014 | **2015** | 2014 |
| **Operating activities** | | | | |
| Net earnings | **8,021** | 6,417 | **28,744** | 28,710 |
| Depreciation and amortization | **18,229** | 18,475 | **36,492** | 36,614 |
| Accretion of provisions *(Note 5)* | **264** | 238 | **525** | 458 |
| Deferred income tax expense *(Note 6)* | **8,952** | 1,031 | **14,478** | 6,350 |
| Change in fair value of Class B shares | **1,742** | - | **1,742** | - |
| Unrealized foreign exchange loss | **5,924** | 520 | **5,506** | 580 |
| Unrealized (gain) loss from risk management activities | **27** | (9) | **14** | 37 |
| Other non-cash items | **243** | 278 | **500** | 555 |
| Cash flow from operations before changes in working capital | **43,402** | 26,950 | **88,001** | 73,304 |
| Change in non-cash operating working capital balances | **5,452** | 8,832 | **1,936** | 7,688 |
| **Cash flow from operating activities** | **48,854** | 35,782 | **89,937** | 80,992 |
| **Investing activities** | | | | |
| Additions to property, plant, and equipment *(Note 9)* | **(3,086)** | (2,519) | **(4,918)** | (3,351) |
| Additions to intangibles | **-** | (16) | **-** | (16) |
| Proceeds on sale of assets | **3** | - | **3** | 312 |
| Investment in subsidiaries of TransAlta | **(216,873)** | - | **(216,873)** | - |
| Realized risk management gain (loss) | **16** | (100) | **(123)** | - |
| Change in non-cash investing working capital balances | **(162)** | 645 | **(1,213)** | 13 |
| Other | **(1)** | (1) | **-** | (1) |
| **Cash flow used in investing activities** | **(220,103)** | (1,991) | **(223,124)** | (3,043) |
| **Financing activities** | | | | |
| Issuance of long-term debt *(Note 10)* | **-** | - | **45,000** | - |
| Long-term debt repayments *(Note 10)* | **-** | - | **(46,176)** | (27,275) |
| Net proceeds on issuance of common shares | **213,533** | - | **213,533** | - |
| Dividends paid on common shares *(Note 11)* | **(28,070)** | (22,071) | **(50,141)** | (43,952) |
| Distributions to non-controlling interest | **(1,333)** | (1,549) | **(2,641)** | (2,985) |
| Change in non-cash financing working capital balances | **440** | - | **440** | - |
| Other | **160** | - | **(234)** | - |
| **Cash flow from (used in) financing activities** | **184,730** | (23,620) | **159,781** | (74,212) |
| **Cash flow from operating, investing, and financing activities** | **13,481** | 10,171 | **26,594** | 3,737 |
| **Effect of translation on foreign currency cash** | **(194)** | (22) | **255** | (8) |
| **Increase in cash and cash equivalents** | **13,287** | 10,149 | **26,849** | 3,729 |
| **Cash and cash equivalents, net of bank overdraft, beginning of period** | **37,288** | 11,945 | **23,726** | 18,365 |
| **Cash and cash equivalents, end of period** | **50,575** | 22,094 | **50,575** | 22,094 |
| Cash income taxes paid | **330** | 270 | **1,024** | 862 |
| Cash interest paid | **8,563** | 10,313 | **16,787** | 17,521 |

*See accompanying notes.*

## 1. BACKGROUND AND ACCOUNTING POLICIES

### A. The Corporation

TransAlta Renewables Inc. ("TransAlta Renewables" or the "Corporation") holds a portfolio of renewable and natural gas power generation facilities, and other infrastructure assets. The Corporation owns 12 hydroelectric ("hydro") facilities and 16 wind farms in Canada, and holds economic interests in a wind farm in the United States (U.S.) and a portfolio of gas-fired generation and related infrastructure assets in Australia. The Corporation's head office is located in Calgary, Alberta.

### B. Basis of Preparation

These unaudited interim condensed consolidated financial statements have been prepared by management in compliance with International Accounting Standard ("IAS") 34 *Interim Financial Reporting* using the same accounting policies as those used in the Corporation's most recent annual consolidated financial statements. These unaudited interim condensed consolidated financial statements do not include all of the disclosures included in the Corporation's annual consolidated financial statements. Accordingly, these should be read in conjunction with the Corporation's most recent annual consolidated financial statements which are available on SEDAR at www.sedar.com.

The unaudited interim condensed consolidated financial statements include the accounts of the Corporation and the subsidiaries that it controls.

The unaudited interim condensed consolidated financial statements have been prepared on a historical cost basis, except for derivative financial instruments, which are stated at fair value.

The unaudited interim condensed consolidated financial statements reflect all adjustments that consist of normal recurring adjustments and accruals that are, in the opinion of management, necessary for a fair presentation of results. The Corporation's results are partly seasonal due to the nature of electricity, which is generally consumed as it is generated; and the nature of wind and run-of-river hydro resources, which fluctuate based on both seasonal patterns and annual 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. Inversely, wind speeds are historically greater during the cold winter months and lower in the warm summer months.

These unaudited interim condensed consolidated financial statements were authorized for issue by the Board of Directors on July 30, 2015.

### C. Use of Estimates and Significant Judgments

The preparation of these unaudited interim condensed consolidated financial statements in accordance with IAS 34 requires management to use judgment and make estimates and assumptions that could affect the reported amounts of assets, liabilities, revenues, and expenses, and disclosures of contingent assets and liabilities. These estimates are subject to uncertainty. Actual results could differ from these 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. Refer to Note 2(Q) of the Corporation's most recent annual consolidated financial statements for a more detailed discussion of the significant accounting judgments and key sources of estimation uncertainty. Additional significant judgments are described in the following Note 2(A).

## 2. ACCOUNTING CHANGES

### A. Current Accounting Changes

During the three month period ended June 30, 2015, the Corporation entered into financial instruments and derivatives that are accounted for at fair value, with the initial and subsequent changes in fair value affecting earnings in the period the change occurs. The fair values of financial instruments and derivatives are classified within three levels, with Level III fair values determined using inputs for the asset or liability that are not readily observable. These fair value levels are outlined and discussed in more detail in Note 8. Some of the Corporation's fair values are included in Level III because they require the use of internal valuation techniques or models to determine fair value. The determination of the fair value of these contracts can be complex and relies on judgments and estimates concerning operating revenue, costs, discount rates and business alternatives, among other factors. These fair value estimates may not necessarily be indicative of the amounts that could be realized or settled, and changes in these assumptions could affect the reported fair value of financial instruments. Fair values can fluctuate significantly and can be favourable or unfavourable depending on current market conditions.

### B. Future Accounting Changes

Accounting standards that have been previously issued by the International Accounting Standards Board but are not yet effective, and have not been applied by the Corporation include IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*. Refer to Note 3 of the Corporation's most recent annual consolidated financial statements for information regarding the requirements of IFRS 9 and IFRS 15.

IFRS 9 is effective for annual periods beginning on or after Jan. 1, 2018 and IFRS 15 is effective for annual periods beginning on or after Jan. 1, 2017. Early application is permitted for both.

In May 2015 the IASB proposed a deferral of the effective date of IFRS 15 by one year to Jan. 1, 2018, and on July 22, 2015, the IASB voted to confirm the one year deferral.

The Corporation continues to assess the impact of adopting these standards on its consolidated financial statements.

## 3. SIGNIFICANT EVENTS

### Investment in TransAlta Corporation's ("TransAlta") Western Australian Portfolio

On May 7, 2015, the Corporation invested in an economic interest that is based on the cash flows of TransAlta's Australian assets (the “Transaction”). The Transaction was originally announced on March 23, 2015. TransAlta’s Australia assets, held by TransAlta Energy (Australia) Pty Ltd. (“TEA”), presently consists of 425 MW of power generation from six gas-fueled operating facilities and the 150 MW South Hedland Power Station project, currently under construction, as well as the recently commissioned 270 kilometre gas pipeline (the “Australian Assets”). TransAlta will continue to own, manage, and operate the Australian Assets. The Transaction was set at $1.78 billion, and consists of an initial investment and a commitment to fund the remaining construction costs for the South Hedland project. The investment agreement provides the Corporation with certain protections in relation to exchange rates, the cost to complete the construction of the South Hedland project, and the timing of the commencement of its commercial operation.

*Initial investment*

The Corporation’s initial investment was set at $1,284 million and consists of securities of TEA which provide the Corporation a priority return on invested capital (mandatory redeemable preferred shares or “MRPS”), Class A Preferred shares (tracking preferred shares) issued by another subsidiary of TransAlta, which provide an economic interest based on cash flows of the Australian Assets broadly equal to the underlying net distributable profits of TEA, and a return based on guarantees of TEA obligations indirectly assumed by the Corporation.

As consideration, the Corporation provided to TransAlta $216.9 million in cash, 58,270,933 Common Shares, and 26,086,956 Class B Shares. The Class B Shares provide voting rights equivalent to the Common Shares and are non-dividend paying, and will convert to Common Shares when the South Hedland project is fully commissioned. The number of Common Shares that TransAlta will receive on the conversion of the Class B Shares will be adjusted based on the actual amount that the Corporation funds for the construction and commissioning of the South Hedland project relative to the budgeted costs. In the event that the construction amount funded by the Corporation exceeds the budgeted costs, TransAlta will receive fewer Common Shares upon conversion and, comparably, TransAlta will receive more Common Shares in the event that the Corporation funds less than the budgeted costs.

The Corporation funded the cash proceeds through the public issuance of 17,858,423 subscription receipts (each, a “Subscription Receipt”) at a price of $12.65 per Subscription Receipt. The offering closed in two parts on April 15 and 23, 2015. In total, the Corporation received approximately $226 million in gross proceeds, and incurred $8.2 million in share issue costs, net of $3.1 million income tax recovery. Upon the closing of the Transaction, each holder of Subscription Receipts received one common share of the Corporation and a cash dividend equivalent payment of $0.06416 for each Subscription Receipt held. As a result, the Corporation issued 17,858,423 Common Shares and paid a total dividend equivalent of $1.1 million.

Upon closing of the Transaction, the Transaction values were revised to fair values on that day in accordance with IFRS requirements, as described in Note 8.

*Commitment to fund construction of the South Hedland project*

The remaining budgeted costs to be funded by the Corporation in connection with the construction and commissioning of the South Hedland project (through the “Contribution Agreement”) are estimated at approximately $491 million (AUD$507 million), and are expected to be funded through a combination of internally generated cash flow and borrowings under a credit facility. Under the Contribution Agreement, when funds are required by TEA for construction purposes, the Corporation will subscribe for and purchase preferred shares, MRPS, or other securities issued by TEA, all which will be denominated and payable in Australian dollars. The Corporation expects to fund these costs over an approximate two year time period, until the anticipated commissioning of the South Hedland project in mid-2017. To protect against adverse fluctuations in the exchange rate between the Canadian and Australian dollars over this period, and the impact such fluctuations will have on the total Canadian dollar funding cost, the Corporation entered into a hedge agreement with TransAlta, whereby the cost of the Australian dollars has been fixed at $0.9684 Canadian per Australian dollar. The hedge on contribution commitment is considered a held-for-trading derivative and accordingly it is accounted for as at fair value through profit and loss.

## 4. FINANCE INCOME RELATED TO SUBSIDIARIES OF TRANSALTA

Finance income related to subsidiaries of TransAlta is comprised of income from various interests that in aggregate and over time indirectly provide the Corporation with cash flows based on those of TEA and TransAlta Wyoming Wind LLC, respectively.

| | 3 months ended June 30 | | 6 months ended June 30 | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Interest income from investment in mandatory redeemable preferred shares of TEA | **4,608** | - | **4,608** | - |
| Fee income from indirect guarantee of TEA obligations | **2,845** | - | **2,845** | - |
| Dividend income from investment in preferred shares tracking adjusted TEA amounts | **9,200** | - | **9,200** | - |
| **Total finance income related to TEA** | **16,653** | - | **16,653** | **-** |
| Dividend income from investment in preferred shares tracking earnings and distributions of TransAlta Wyoming Wind LLC | **365** | 1,859 | **3,399** | 6,224 |
| **Total** | **17,018** | 1,859 | **20,052** | 6,224 |

Finance income is recognized in cash flows from operating activities in the Condensed Consolidated Statements of Cash Flows. Foreign exchange gains and losses related to monetary investments in subsidiaries of TransAlta are recognized within foreign exchange gains or loss in the Condensed Consolidated Statements of Earnings.

Summary of investments in subsidiaries of TransAlta:

| **As at** | **June 30, 2015** | Dec. 31, 2014 |
|---|---|---|
| Investment in mandatory redeemable preferred shares of TEA | **421,899** | - |
| Investment in preferred shares tracking adjusted TEA amounts | **810,921** | - |
| **Total investments in subsidiaries related to TEA** | **1,232,820** | **-** |
| Investment in preferred shares tracking earnings and distributions of TransAlta Wyoming Wind LLC | **127,224** | 119,179 |
| **Total investment in subsidiaries of TransAlta** | **1,360,044** | 119,179 |

### A. Finance income related to TEA

Interest income from the investment in MRPS of TEA represents income realized from the average coupon rates. The Corporation also receives a fee for providing the guarantees disclosed in Note 13. Ultimately, these cash flows are deducted from the TEA amounts that form the basis for dividends payable. That basis is broadly comprised of earnings before interest, income taxes, depreciation, and amortization, plus net cash interest, less cash taxes, sustaining capital expenditures and other adjustments. Income from all sources is fixed in Canadian dollars at the following exchange rates:

| | **2015** | **2016** | **2017** | **2018** | **2019** | **Thereafter until June 30, 2020** |
|---|---|---|---|---|---|---|
| Income denominated in AUD | 0.98 | 0.96 | 0.96 | 0.94 | 0.94 | 0.94 |
| Income denominated in USD | 1.24 | 1.24 | 1.24 | 1.24 | 1.24 | 1.20 |

Changes in the investments in subsidiaries of TransAlta that relate to TEA are detailed as follows:

| | Mandatory Redeemable Preferred Shares of TEA(1) | Preferred Shares Tracking TEA Amounts |
|---|---|---|
| Issuance *(Note 8)* | **423,152** | **795,983** |
| Unrealized foreign exchange losses recognized in earnings | **(1,253)** | **-** |
| Net change fair value available-for-sale financial instrument recognized in OCI | **-** | **14,938** |
| **Investment balance at June 30, 2015** | **421,899** | **810,921** |

*(1) Principal amount at the date of issuance on May 7th, 2015 and at June 30, 2015 was AUD $443,527.*

Summarized consolidated financial information relating to TEA is as follows:

| **3 months ended June 30** | **2015** |
|---|---|
| **Results of operations** | |
| Revenues | **29,029** |
| Depreciation and amortization | **5,165** |
| Operating income | **13,165** |
| Finance lease income | **11,659** |
| Net earnings | **17,762** |
| Total comprehensive income | **10,042** |
| **Cash flows** | |
| Additions to PP&E: | |
| South Hedland | **23,065** |
| Sustaining Capital | **848** |

The dividend basis of the period was pro-rated to the number of days of ownership of the tracking preferred shares.

| **As at** | **June 30, 2015** | Dec. 31, 2014 |
|---|---|---|
| **Financial position** | | |
| Current assets | **49,228** | 49,862 |
| Long-term assets | **767,881** | 668,759 |
| Current liabilities | **(81,565)** | (26,881) |
| Long-term liabilities | **(483,252)** | (460,614) |
| Equity | **(252,292)** | (231,126) |

The Corporation estimated the fair value of the preferred shares tracking adjusted TEA amounts utilizing significant unobservable inputs such as TEA's long-range forecast as part of a discounted cash flow model, as outlined in Note 8(B)(I)(c).

Key assumptions in respect of significant unobservable inputs used in the fair value measurement include the discount rate and the quarterly cash flows from the instrument and guarantee fees. The model extends over 32 years. The table below summarizes quantitative data regarding these unobservable inputs:

| **Unobservable input** | **Inception date (May 7, 2015)** | **June 30, 2015** |
|---|---|---|
| Discount rate | **7.2 per cent** | **7.2 per cent** |
| Quarterly cash flows | **Average of 15,500** | **Average of 15,800** |

The increase in the quarterly cash flows and overall changes in the fair value of the tracking preferred shares during the period from issuance to June 30, 2015 are primarily attributable to the increased value of the U.S. dollar relative to the Canadian dollar.

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

| Unobservable input | Alternative assumption | Change in fair values as at June 30, 2015 |
|---|---|---|
| Basis point change in discount rates | **-10 basis points decrease** | **8,254** |
| | **+10 basis points increase** | **(8,118)** |
| Quarterly cash flows | **+1% increase** | **8,100** |
| | **- 1% decrease** | **(8,100)** |

**B. Finance income related to TransAlta Wyoming Wind LLC**

Dividend income from the investment in preferred shares tracking earnings and distributions of TransAlta Wyoming Wind LLC for the three and six months ended June 30, 2015 and June 30, 2014 was fully based on pre-tax earnings of TransAlta Wyoming Wind LLC.

Summarized financial information relating to TransAlta Wyoming Wind LLC is as follows:

| | 3 months ended June 30 | | 6 months ended June 30 | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| **Results of operations** | | | | |
| Revenues | **2,961** | 3,620 | **8,227** | 11,166 |
| Net earnings and total comprehensive income | **(534)** | 1,254 | **1,836** | 3,762 |
| **Cash flows** | | | | |
| Additions to PP&E | **8** | 586 | **277** | 586 |

| As at | June 30, 2015 | Dec. 31, 2014 |
|---|---|---|
| **Financial position** | | |
| Current assets | **9,105** | 4,867 |
| Long-term assets | **125,456** | 120,315 |
| Current liabilities | **(1,096)** | (1,487) |
| Long-term liabilities | **(3,404)** | (3,577) |
| Equity | **(130,061)** | (120,118) |

The investment in preferred shares as at June 30, 2015 and Dec. 31, 2014 is comprised of the U.S.$102.7 million investment in Class A preferred shares of a subsidiary of TransAlta, and represents the Corporation’s economic interest in TransAlta Wyoming Wind LLC., whose only operation is the Wyoming Wind Farm. The preferred shares entitle the holder to receive monthly, cumulative cash dividends that are based on, and track to, the pre-tax earnings and distributions of TransAlta Wyoming Wind LLC.

## 5. NET INTEREST EXPENSE

The components of net interest expense are as follows:

| | 3 months ended June 30 | | 6 months ended June 30 | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Interest on long-term debt | **8,527** | 8,869 | **17,513** | 17,894 |
| Interest on letters of credit and guarantees pledged by TransAlta | **25** | 3 | **45** | 24 |
| Interest income | **(74)** | (2) | **(112)** | (5) |
| Accretion of provisions | **264** | 238 | **525** | 458 |
| **Net interest expense** | **8,742** | 9,108 | **17,971** | 18,371 |

## 6. INCOME TAXES

The components of income tax expense are as follows:

| | 3 months ended June 30 | | 6 months ended June 30 | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Current income tax expense | **538** | 145 | **1,049** | 717 |
| Adjustments in respect of current income tax of previous years | **(157)** | (132) | **(157)** | (132) |
| Adjustments in respect of deferred income tax of previous years | **(1,373)** | 83 | **(1,373)** | 176 |
| Deferred income tax expense arising from the writedown of deferred tax assets(1) | **1,710** | - | **1,936** | - |
| Deferred income tax expense related to the origination and reversal of temporary differences(2) | **4,833** | 948 | **10,133** | 6,174 |
| Deferred income tax expense resulting from changes in tax rates(3) | **3,782** | - | **3,782** | **-** |
| **Income tax expense** | **9,333** | 1,044 | **15,370** | 6,935 |

*(1) Relates to the write down of the deferred tax assets on realized and unrealized foreign exchange capital losses as we do not expect to realize capital gains in the foreseeable future.*

*(2) The three and six month ended June 30, 2015 include a $4,200 impact of fair value differences at initial recognition in the Transaction.*

*(3) Impact of increase in Alberta corporate income tax rate from 10 per cent to 12 per cent.*

Presented in the Condensed Consolidated Statements of Earnings as follows:

| | 3 months ended June 30 | | 6 months ended June 30 | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Current income tax expense | **381** | 13 | **892** | 585 |
| Deferred income tax expense | **8,952** | 1,031 | **14,478** | 6,350 |
| **Income tax expense** | **9,333** | 1,044 | **15,370** | 6,935 |

## 7. NON-CONTROLLING INTEREST

The Corporation's non-controlling interest is comprised of Natural Forces Technologies Inc.'s 17 per cent interest in Kent Hills 1 and 2 ("Kent Hills") wind farms. Summarized financial information relating to 100 per cent of Kent Hills is as follows:

| | 3 months ended June 30 | | 6 months ended June 30 | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| **Results of operations** | | | | |
| Revenues | **8,870** | 7,159 | **19,236** | 17,998 |
| Net earnings and total comprehensive income | **5,022** | 3,099 | **11,337** | 9,917 |

| As at | June 30, 2015 | Dec. 31, 2014 |
|---|---|---|
| **Financial position** | | |
| Current assets | **5,886** | 6,654 |
| Long-term assets | **214,719** | 218,950 |
| Current liabilities | **(1,690)** | (2,452) |
| Long-term liabilities | **(481)** | (520) |
| Total equity | **(218,434)** | (222,632) |

## 8. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

### A. Financial Assets and Liabilities – Measurement

Financial assets and financial liabilities are measured on an ongoing basis at fair value or amortized cost.

Following the close of the Transaction described in Note 3, the Corporation is party to new financial instruments. The MRPS of TEA have been classified as loans and receivable, the preferred shares tracking adjusted TEA amounts have been classified as available-for-sale, and the Class B shares issued have been classified as a financial liability at fair value through profit or loss. The hedge on contribution commitments has been classified as a held-for-trade derivative.

### B. Fair Value of Financial Instruments

#### I. Level I, II, and III Fair Value Measurements

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.

**a. Level I**

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

**b. 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.

The Corporation's 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 measured and carried at fair value, the Corporation uses 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, the Corporation relies on similar interest or currency rate inputs and other third-party information such as credit spreads.

**c. Level III**

Fair values are determined using inputs for the asset or liability that are not readily observable.

In estimating the fair value of the preferred shares tracking adjusted TEA amounts, the Corporation uses a discounted cash flow method, and makes 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, management uses 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. Additional disclosures on this measurement are presented in Note 4.

Estimates of the fair value of the Class B shares liability can vary based on the estimated cost of construction and commissioning of the South Hedland project by TEA, which can vary based on emergent or unforeseen capital needs of the project, or release of uncommitted planned contingency funds. Additional disclosures on this measurement are presented in Note 11.

TransAlta enters into commodity risk management contracts on behalf of the Corporation. These contracts may include commodity transactions for which market-observable data is not available or contracts with terms that extend beyond a liquid trading period where forward price forecasts are not available for the full period of the contract. In these cases, Level III fair values are determined by TransAlta personnel using valuation techniques such as the mark-to-forecast model with inputs that are based on historical data such as unit availability, transmission congestion, demand profiles for individual non-standard deals and structured products, volatilities and correlations between products derived from historical prices, and/or a combination of external and internal fundamental modelling, including discounting. The policies and procedures that TransAlta has established for its own risk management activities and for the determination of Level III fair values are applied to the transactions TransAlta undertakes for the Corporation. Additional disclosures on Level III measurements are presented in the following section.

**II. Fair values at initial recognition – Transaction**

Financial instruments exchanged in the Transaction were initially recognized at fair value on May 7th, 2015. Usually, transaction prices are the best evidence of fair value. Because the terms of the Transaction were finalized on March 23, 2015, valuation differences from the originally estimated initial investment value of $1,284 million have arisen. These changes result from variations in foreign exchange rates and equity prices in the intervening period. Further changes arose from the recognition of the benefit to the Corporation of the non-participation feature of Class B shares.

Fair value of the least observable financial instrument exchanged at that date, the tracking preferred shares, was determined by reference to the net value of other instruments at closing date, as follows:

| Instrument | Fair value level | Primary valuation basis | Value |
|---|---|---|---|
| Common shares issued to TransAlta | I | Closing common share price on May 7th, 2015 | **712,071** |
| Class B shares issued to TransAlta | III | Closing common share price on May 7th, 2015, minus the present value of estimated $0.07 per share monthly dividend, discounted using a risk free rate for the period to conversion, assuming South Hedland on schedule and costs at target | **277,043** |
| Cash consideration to TransAlta | I | Cash value | **216,873** |
| Derivative hedge liability on contribution commitment | II | Currency rates | **13,148** |
| Mandatory redeemable preferred shares | II | Yield to maturity and currency rates | **(423,152)** |
| Tracking preferred shares | III | Net value | **795,983** |

**III. Financial Instruments – Risk Management Assets and Liabilities Measured at Fair Value**

The Corporation's commodity-based risk management assets and liabilities relate to trading activities and certain contracting activities. Other risk management assets and liabilities include risk management assets and liabilities that are used in hedging foreign currency exposures, including those related to the Contribution Agreement described in Note 3.

The following table summarizes the net risk management assets (liabilities) as at June 30, 2015 and Dec. 31, 2014:

| | Cash flow hedges | Non-hedges | Non-hedges | Total | | |
|---|---|---|---|---|---|---|
| | Level II | Level II | Level III | Level II | Level III | Total |
| **Net risk management assets (liabilities) at June 30, 2015** | **14** | **(17,316)** | **(142)** | **(17,302)** | **(142)** | **(17,444)** |
| Net risk management assets (liabilities) at Dec. 31, 2014 | 14 | (3) | (128) | 11 | (128) | (117) |

The change in non-hedge liabilities is primarily attributable to the hedge on contribution commitments.

**IV. Financial Instruments – Not Measured at Fair Value**

The fair value of the MRPS of TEA and long-term debt is as follows:

| | Fair value | | | | Total carrying |
|---|---|---|---|---|---|
| | Level I | Level II | Level III | Total | value |
| **Mandatory redeemable preferred shares of TEA - June 30, 2015** | **-** | **-** | **421,899** | **421,899** | **421,899** |
| **Long-term debt(1) - June 30, 2015** | **-** | **675,620** | **-** | **675,620** | **666,165** |
| Long-term debt(1) - Dec. 31, 2014 | - | 682,121 | - | 682,121 | 658,455 |

*(1) Includes current portion*

The fair value of the Corporation's debentures is determined using prices observed in secondary markets. The fair value of the MRPS and other long-term debt is determined by calculating an implied price based on a current assessment of the yield to maturity.

The book value of other short-term financial assets and liabilities (cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and dividends payable) approximates fair value due to the liquid nature of the asset or liability.

The Corporation's investment in the preferred shares tracking earnings and distributions of TransAlta Wyoming Wind LLC continues to be measured at cost under similar conditions as described in the Corporation's most recent annual financial statements.

**C. Nature and Extent of Risks Arising from Financial Instruments and Derivatives**

The following discussion is limited to specific risk measures, which are more fully discussed in Note 12(C) of the Corporation's most recent annual consolidated financial statements.

**I. Foreign Currency Rate Risk**

Following the closing of the Transaction, the Corporation is now exposed to changes in the value of the Australian dollar. The Corporation has mitigated the anticipated incremental exposure to the Australian and U.S. dollar denominated cash flows arising from the Transaction for the period through June 30, 2020 through the use of contractual agreements with TransAlta. As at June 30, 2015, a four cent increase or decrease in Australian dollar relative to the Canadian dollar would increase or decrease net earnings of the Corporation by $25.5 million, and result in an increase or decrease in OCI, including underlying valuation impacts of non-monetary available-for-sale securities, of $28 million.

Non-monetary available-for-sale securities further contain embedded U.S.-denominated cash flows. A four cent increase or decrease in U.S. dollar relative to the Canadian dollar relative to this indirect exposure would increase or decrease OCI of the Corporation by $16 million.

**II. Credit Risk**

The Corporation's maximum exposure to credit risk at June 30, 2015, without taking into account collateral held or right of set-off, and including indirect exposure arising from the Corporation's investment in preferred shares tracking adjusted TEA amounts, is detailed as follows:

| **Component** | **Amount** | **Key risk assessment factors** |
|---|---|---|
| *Direct exposure* | | |
| Accounts receivable and risk management assets | **37,402** | All of the Corporation's counterparties were considered investment grade. At June 30, 2015, the Corporation had two unrelated customers whose outstanding balances each accounted for greater than 10 per cent of the total third party trade accounts receivable outstanding. The Corporation has evaluated the risk of default related to these customers to be minimal.<br><br>The outstanding balance also includes dividends receivable of $9.2 million on the tracking preferred shares from a subsidiary of TransAlta. As the dividend declaration was made while considering the sufficiency of funds available, the risk of default has been assessed as minimal. |
| MRPS | **421,899** | The MRPS form TEA's least subordinate significant form of long-term financing, which benefits from TEA's contract and counterparty profile. |
| **Total - Direct exposure** | **459,301** | |
| *Indirect exposure* | | |
| Accounts receivable and finance lease receivable of TEA | **442,081** | TEA had one unrelated below investment grade customer whose outstanding balances accounted for 96% of total trade accounts receivable and finance lease receivable outstanding. Risk of significant loss arising from this counterparty has been assessed as low, considering the counterparty's financial position, and how TEA provides its services in an area of the counterparty's lower-cost operations, and TransAlta's other credit risk management practices. |
| **Total** | **901,382** | |

The Corporation uses external credit ratings, as well as internal ratings in circumstances where external ratings are not available, to establish credit limits for counterparties. In certain cases, the Corporation will require security instruments such as parental guarantees, letters of credit, cash collateral or third party credit insurance to reduce overall credit risk. As at June 30, 2015, no significant component of the amounts forming part of the Corporation's exposure to credit risk were either past due or impaired.

**III. Other Market Risks**

Following the closing of the Transaction, the Corporation is exposed to additional market risks, based on changes in the fair value of the Class B shares and the preferred shares tracking adjusted TEA amount. A one per cent increase (decrease) in the value of these securities would result in a $2.8 million decrease (increase) in net income, and an $8.1 million increase (decrease) in OCI, respectively.

### IV. Liquidity Risk

The following table presents the contractual maturities of the Corporation's financial liabilities as at June 30, 2015 and also include, committed contributions under the terms of the Contribution Agreement:

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 and thereafter | Total |
|---|---|---|---|---|---|---|---|
| Accounts payable and accrued liabilities | 31,810 | - | - | - | - | - | **31,810** |
| Long-term debt | 149,972 | 69,040 | 24,413 | 297,240 | 26,422 | 101,088 | **668,175** |
| Net risk management liabilities | 3,864 | 4,014 | 9,440 | 10 | 10 | 106 | **17,444** |
| Interest on long-term debt (1) | 15,890 | 23,939 | 21,525 | 13,647 | 3,958 | 6,414 | **85,373** |
| Dividends payable | 26,711 | - | - | - | - | - | **26,711** |
| Contribution commitment(1) | 156,106 | 123,568 | 211,305 | - | - | - | **490,979** |
| **Total** | **384,353** | **220,561** | **266,683** | **310,897** | **30,390** | **107,608** | **1,320,492** |

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

The Corporation manages liquidity risk associated with debentures and committed contributions through preparing and revising long-term external financing plans reflecting business plans and market availability of capital.

The Class B shares liability will be settled by the issuance of common shares, and accordingly, do not give rise to liquidity risk.

## 9. PROPERTY, PLANT, AND EQUIPMENT

A reconciliation of the changes in the carrying amount of property, plant & equipment ("PP&E") is as follows:

| | Hydro generation | Wind generation | Capital spares and other | Total |
|---|---|---|---|---|
| As at Dec. 31, 2014 | 191,057 | 1,450,287 | 8,936 | 1,650,280 |
| Additions | **453** | **4,403** | **62** | **4,918** |
| Depreciation | **(3,382)** | **(28,660)** | **-** | **(32,042)** |
| Adjustment with TransAlta | **-** | **(8,242)** | **-** | **(8,242)** |
| Revisions and additions to decommissioning costs | **(1,445)** | **(802)** | **-** | **(2,247)** |
| Retirements | **(77)** | **(625)** | **-** | **(702)** |
| Transfers | **-** | **608** | **(608)** | **-** |
| **As at June 30, 2015** | **186,606** | **1,416,969** | **8,390** | **1,611,965** |

During the first quarter of 2015, the Corporation recognized an adjustment to give effect to an indemnity from TransAlta for the benefit of the Corporation in respect to a dispute for final disbursements in relation to a construction project completed prior to the formation of the Corporation. As a result, as at June 30, 2015, the Corporation received $10.0 million from TransAlta, applied a reduction to PP&E of $8.2 million, and recognized a liability of $1.2 million in excess of a previously recognized accounts payable amount.

## 10. LONG-TERM DEBT

### A. Amounts Outstanding

| As at | June 30, 2015 | | | Dec. 31, 2014 | | |
|---|---|---|---|---|---|---|
| | **Carrying value** | **Face value** | **Interest(1)** | Carrying value | Face value | Interest(1) |
| Unsecured debentures(2) | **346,478** | **348,264** | **5.91%** | 344,201 | 346,698 | 5.91% |
| Secured debenture | **44,776** | **45,000** | **2.95%** | 34,978 | 35,000 | 5.28% |
| Amortizing Term Loan | **167,188** | **167,188** | **4.00%** | 178,364 | 178,364 | 4.00% |
| Wyoming Wind Acquisition Loan(3) | **107,723** | **107,723** | **4.00%** | 100,912 | 100,912 | 4.00% |
| | **666,165** | **668,175** | | 658,455 | 660,974 | |
| Less: current portion | **(188,581)** | **(188,581)** | | (194,951) | (194,951) | |
| **Total long-term debt** | **477,584** | **479,594** | | 463,504 | 466,023 | |

*(1) Interest rate reflects the stipulated rate or the average rate weighted by principal amounts outstanding.*

*(2) Includes U.S.$20.0 million (2014 - U.S.$20.0 million).*

*(3) U.S.$87.0 million (2014 - U.S.$87.0 million).*

On Feb. 11, 2015, the Corporation and its partner refinanced maturing debt at the Pingston hydro facility. The Corporation's share of gross proceeds was $45 million. The bonds bear interest at the annual fixed interest rate of 2.95 per cent, payable semi-annually with no principal repayments until maturity in May 2023. Proceeds were used to repay the $35 million secured debenture bearing interest at 5.28 per cent.

The Corporation has a $350 million working capital credit facility with TransAlta (Dec. 31, 2014 - $100 million). As at June 30, 2015 and Dec. 31, 2014, no amounts were drawn on this facility.

The Corporation anticipates refinancing its maturing debt based on reasonable commercial terms.

### B. Restrictions

Unsecured debentures include restrictive covenants requiring the proceeds received from the sale of certain assets to be reinvested into similar renewable assets.

## 11. CLASS B SHARES

As at June 30, 2015, there are 26,086,956 Class B shares outstanding (Dec. 31, 2014 – nil), following closing of the Transaction. The characteristics of Class B shares are described in Note 3. As the Class B shares are convertible into common shares at a variable rate, they are classified as liabilities and their change in value is recognized in net earnings. Changes in the value of the Class B shares are unrealized and relate to the change in value of underlying common shares during the period, net of the effect of estimated foregone dividends, as discounted using a risk-free rate for the period to conversion.

Estimated commissioning date and total costs for the construction of the South Hedland project represent significant unobservable inputs to the valuation. At inception and on June 30, 2015, commissioning is anticipated as scheduled and costs were estimated to be at target. A one per cent increase or decrease in costs would have resulted in a $4 million corresponding decrease or increase in fair value, respectively. A one month delay or acceleration in achieving commissioning would have resulted in a corresponding $2 million decrease or increase in fair value, respectively.

## 12. COMMON SHARES

### A. Authorized and Outstanding

The Corporation is authorized to issue an unlimited number of common shares without nominal or par value and an unlimited number of preferred shares. The common shares entitle the holders thereof to one vote per share at meetings of shareholders. The preferred shares are issuable in series and have such rights, restrictions, conditions, and limitations as the Board of Directors (the "Board") may from time to time determine. No preferred shares have been issued.

The change in issued and outstanding common shares during the six months ended June 30, 2015 and the year ended Dec. 31, 2014, respectively, are as follows:

| As at | **June 30, 2015** | | Dec. 31, 2014 | |
|---|---|---|---|---|
| | **Common shares** *(millions)* | **Amount** *(thousands)* | Common shares *(millions)* | Amount *(thousands)* |
| Issued and outstanding, beginning of period | **114.7** | **1,223,845** | 114.7 | 1,223,845 |
| Issued to TransAlta | **58.2** | **712,070** | - | - |
| Public offering | **17.9** | **216,590** | - | - |
| **Issued and outstanding, end of period** | **190.8** | **2,152,505** | 114.7 | 1,223,845 |

### B. Dividends

The declaration of dividends on the Corporation's common shares is at the discretion of the Board.

The following table summarizes the common share dividends declared within the six months ended June 30, 2015 and 2014, excluding dividend equivalent payments described in Note 3.

| Dividends declared | Total dividends per share | Total dividends | TransAlta | Other shareholders |
|---|---|---|---|---|
| **Period ended June 30, 2015** | **0.40248** | **62,138** | **44,682** | **17,456** |
| Period ended June 30, 2014 | 0.25664 | 29,428 | 20,688 | 8,740 |

On July 30, 2015, the Corporation declared dividends of $0.07 per common share, payable on Sept. 30, 2015, Oct. 30, 2015 and Nov. 30, 2015.

### C. Earnings per Share

Basic earnings per share is based on net earnings attributable to the common shareholders and is calculated based upon the weighted average number of common shares outstanding during the periods presented. The Corporation has no dilutive or potentially dilutive instruments. Class B shares are excluded from the calculation.

## 13. COMMITMENTS AND CONTINGENCIES

### A. Litigation

In the normal course of business, the Corporation may become party to litigation claims. There are currently no known claims that the Corporation has determined as significant enough to require disclosure.

### B. Guarantees

As part of the Transaction, the Corporation 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"). The Corporation has 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 which occur on or after May 7, 2015. As at June 30, 2015 the total amounts guaranteed by the Corporation were $939.5 million.

As consideration for this indemnity, TransAlta is required to pay the Corporation the Canadian dollar equivalent of the guarantor fees it receives from TEA in respect of any of the TEA Guarantees, subject to the fixed rate conversion as described in Note 4.

### C. Contribution Commitment

As described in Note 3, the Corporation entered into a Contribution Agreement to fund the remaining costs for the construction and commissioning of the South Hedland project, which at June 30, 2015 are estimated to be approximately $491 million (AUD$507 million).

## 14. RELATED PARTY TRANSACTIONS AND BALANCES

The Corporation has entered into certain agreements and transactions with TransAlta which are discussed in more detail in Note 24 of the Corporation's most recent annual consolidated financial statements.

### A. Related Party Transactions

Related party transactions include the finance income related to subsidiaries of TransAlta, the changes in fair value of Class B shares liability and the interest on letters of credit and guarantees pledged by TransAlta disclosed in Note 5.

Significant related party transactions that are not otherwise presented elsewhere consist of the following:

| | 3 months ended June 30 | | 6 months ended June 30 | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Revenue from TransAlta PPAs | **6,037** | 7,055 | **16,606** | 15,006 |
| Royalty and other revenue-based costs adjustment | **(41)** | - | **(31)** | - |
| Revenue from emission reduction credits[1] | **80** | - | **2,320** | - |
| G&A Reimbursement Fee | **2,657** | 2,619 | **5,285** | 5,142 |
| Interest expense on Amortizing Term Loan | **1,667** | 1,888 | **3,364** | 3,802 |
| Interest expense on Wyoming Wind Acquisition Loan | **1,068** | 942 | **2,165** | 2,077 |
| Foreign exchange loss on hedge contribution commitment | **4,180** | - | **4,180** | - |

[1] For the six months ended June 30, 2015 the value of the emission reduction credits was $2,240, 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 of Directors.

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

**B. Related Party Balances**

Related party balances include the investments in subsidiaries of TransAlta, the risk management assets and liabilities, as well as the Amortizing Term Loan, Wyoming Wind Acquisition Loan, and credit facility disclosed in Note 10, the Class B shares liability, and the guarantees provided by the Corporation on behalf of TransAlta and TEA disclosed in Note 13.

Significant related party balances that are not otherwise presented elsewhere consist of the following:

| **As at** | **June 30, 2015** | Dec. 31, 2014 |
|---|---|---|
| Trade and other receivables | **16,490** | 7,136 |
| Trade accounts payable | **4,316** | 3,142 |
| Interest payable | **2,602** | 2,795 |
| Dividends payable | **19,944** | 10,345 |
| Letters of credit issued by TransAlta on behalf of the Corporation | **5,167** | 4,503 |
| Guarantees provided by TransAlta on behalf of the Corporation | **226,500** | 226,500 |

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

## GLOSSARY OF KEY TERMS

**Amortizing Term Loan** - An unsecured, Amortizing Term Loan from TransAlta, with an initial amount in 2013 of $200 million.

**Capacity** - The rated continuous load-carrying ability, expressed in megawatts, of generation equipment.

**G&A Reimbursement Fee –** The fee payable to TransAlta under the Management, Administrative and Operational Services Agreement to compensate TransAlta for the provision of all the general administrative services as may be required or advisable for the management of the affairs of the Corporation.

**Gigawatt** - A measure of electric power equal to 1,000 megawatts.

**Gigawatt Hour (GWh)** - A measure of electricity consumption equivalent to the use of 1,000 megawatts of power over a period of one hour.

**Greenhouse Gas (GHG)** - Gases having potential to retain heat in the atmosphere, including water vapour, carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, and perfluorocarbons.

**Mandatory Redeemable Preferred Shares (MRPS) –** An investment in the Mandatory Redeemable Preferred Shares of TransAlta Energy (Australia) Pty Ltd. We are entitled to receive cash dividends on the MRPS.

**Megawatt (MW)** - A measure of electric power equal to 1,000,000 watts.

**Megawatt Hour (MWh)** - A measure of electricity consumption equivalent to the use of 1,000,000 watts of power over a period of one hour.

**Net Maximum Capacity** - The maximum capacity or effective rating, modified for ambient limitations, that a generating unit or power plant can sustain over a specific period, less the capacity used to supply the demand of station service or auxiliary needs.

**PPA –** A power purchase and sale agreement between a power generator and a third-party acquirer of electricity.

**Renewable Power** - Power generated from renewable terrestrial mechanisms including wind, hydro, geothermal, and solar with regeneration.

**Tracking Preferred Shares (TPS) –** An investment in the Tracking Preferred Shares of a TransAlta subsidiary, which provide cumulative variable dividends broadly equal to the underlying net distributable profits of TransAlta Energy (Australia) Pty Ltd.

**TransAlta PPAs –** PPAs between TransAlta and the Corporation providing for the purchase by TransAlta, for a fixed price, all of the power produced by certain wind and hydro facilities. The initial price payable in 2013 by TransAlta for output was $30.00/MWh for wind facilities and $45.00 per MWh for hydro facilities, which amounts are adjusted annually for changes in the Consumer Price Index.

**Unplanned Outage** - The shutdown of a generating unit due to an unanticipated breakdown.

**Working Capital Credit Facility -** A $350 million unsecured Working Capital Credit Facility with TransAlta. The facility is available for general corporate purposes including financing ongoing working capital requirements.

**Wyoming Wind Acquisition Loan** – An unsecured loan from TransAlta to fund the acquisition of the economic interest in the 144 MW wind farm in Wyoming with an initial amount in 2013 of U.S. $102 million.

**Wyoming Wind Preferred Shares** – A U.S.$102.7 million investment in Class A Preferred Shares of a TransAlta subsidiary to acquire the economic interest in the 144 MW wind farm in Wyoming.

**TransAlta Renewables Inc.**

110 - 12th Avenue S.W.

Box 1900, Station “M”

Calgary, Alberta Canada T2P 2M1

**Phone**

403.267.7110

**Website**

www.transaltarenewables.com

**CST Trust Company**

P.O. Box 700 Station “B”

Montreal, Québec

H3B 3K3

**Phone**

Toll-free in North America: 1.800.387.0825

Toronto/outside North America: 416.682.3860

**E-mail**

inquiries@canstockta.com

**Fax**

514.985.8843

**Website**

www.canstockta.com

**Additional Information**

Requests can be directed to:

**Investor Inquiries**

**Phone**

1.800.387.3598 in Canada and United States

or 403.267.2520

**E-mail**

investor_relations@transalta.com

**Media Inquiries**

Toll-free 1.855.255.9184

or 403.267.2540