



# **PRIMARY ENERGY RECYCLING CORPORATION**

**Management's Discussion and  
Analysis of Financial Condition and Results of Operations  
(In US Dollars)**

**Three Months and Nine Months Ended September 30, 2011 and 2010**

**Primary Energy Recycling Corporation**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL**  
**CONDITION AND RESULTS OF OPERATIONS**

*The following management's discussion and analysis of the financial condition and results of operations ("MD&A") of Primary Energy Recycling Corporation ("we" or the "Company") dated November 8, 2011 should be read in conjunction with the unaudited interim consolidated financial statements of the Company for the three months and nine months ended September 30, 2011 and 2010. The Company's financial statements are presented to comply with International Financial Reporting Standards ("IFRS"). The comparative periods for 2010 that were previously reported in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") have been presented to comply with IFRS for comparative purposes. See note 4 to the Company's interim consolidated financial statements for a reconciliation of the comparative periods from Canadian GAAP to IFRS. All amounts in this MD&A are in U.S. dollars, unless otherwise stated. Rounding adjustments have been made to certain financial information in this MD&A. As a result, numerical figures shown as totals may not be exact arithmetic aggregations of their component parts.*

**Forward-Looking Statements**

Certain statements in this MD&A, including statements regarding the expected completion date of the North Lake upgrade, the repayment of debt under the Company's Credit Facility (as defined below), capital expenditures for the North Lake renewal project, the expected capital costs of the Portside facility renewal and the potential buyout of the management agreement and the non-controlling interest, may constitute "forward-looking statements", which reflect the expectations of management regarding future growth, results of operations, performance and business prospects and opportunities of the Company. Such forward-looking statements reflect current expectations regarding future events and operating performance and speak only as of the date hereof. These forward-looking statements involve significant risks and uncertainties, and should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not or the times at or by which such performance or results will be achieved.

A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements, including, but not limited to, the factors discussed under "Risk Factors" in this MD&A and in the Company's most recent annual information form. Additional information relating to the Company, including its annual information form, is available on SEDAR at [www.sedar.com](http://www.sedar.com). Although the forward-looking statements contained in this MD&A are based on what are believed to be reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward-looking statements, and the differences may be material. These forward-looking statements are made as of the date of this MD&A and, except as required by applicable securities laws, the Company assumes no obligation to update or revise them to reflect new events or circumstances.

**Non-IFRS Measures**

***Definition of EBITDA, Adjusted EBITDA and Free Cash Flow***

References to "EBITDA" are to earnings before interest, taxes and depreciation and amortization.

References to "Adjusted EBITDA" are to EBITDA as adjusted for certain non-recurring adjustments for major maintenance/outage work expenses and non-cash stock based compensation that represent recorded expenses based on specific circumstances and are not expected to be part of the Company's ongoing business activity.

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References to "Free Cash Flow" are to cash provided by operating activities as adjusted for capital expenditures.

EBITDA, Adjusted EBITDA and Free Cash Flow are not recognized measures under IFRS and do not have standardized meanings prescribed by IFRS. Therefore, EBITDA, Adjusted EBITDA and Free Cash Flow may not be comparable to similar measures presented by other issuers. Management believes that EBITDA, Adjusted EBITDA and Free Cash Flow are important measures in evaluating the Company's performance and allow for comparison of operating performance on a consistent basis. However, EBITDA and Adjusted EBITDA should not be construed as an alternative to net earnings or loss determined in accordance with IFRS and Free Cash Flow should not be construed as an alternative to net cash provided by operating activities determined in accordance with IFRS as indicators of the Company's performance or cash flows from operating, investing and financing activities or as measures of liquidity and cash flows.

**Overview**

**General**

The Company owns a majority interest in Primary Energy Recycling Holdings LLC ("PERH") which is headquartered in Oak Brook, Illinois. PERH indirectly owns and operates three recycled energy projects, one clean heat and power project and a 50% interest in a pulverized coal facility ("Harbor Coal") (collectively, the "Projects"). The Projects have a combined electrical generating capacity of 283 megawatts and a combined steam generating capacity of 1.8 MMBtu/hour. PERH creates value for its customers by recycling recoverable heat and byproduct fuels from industrial and electric generation processes and converting it into reliable and economical electricity and thermal energy for resale back to its customers.

The Company owns 85.7% of the common membership interests of PERH. CPI USA Ventures LLC (the "Manager") indirectly holds the remaining 14.3% of the common membership interests of PERH.

**Review of Facility Operations**

*Availability and Production*

The Projects had an average availability of 99% during the three months ended September 30, 2011. North Lake had a scheduled outage to accommodate site host operations and no facility experienced any significant unplanned outage. Production of electricity during the third quarter of 2011 was at the highest quarterly levels in the past four years. One of the main contributors was Ironside, which produced higher quarterly levels of electricity than it has historically because of the site host's strong blast furnace operation and reduced alternate uses for the resulting steam production. Harbor Coal had high pulverized coal deliveries during the quarter in response to blast furnace demand. The Portside facility performed well during the quarter with no outages and no major maintenance or capital improvement requirements.

*Upgrade*

Work on Phase II of the North Lake plant upgrade continues as planned. The transmission tower and line has been completed and is now in service. The installation of the cooling tower basin has begun with piles being driven and excavation substantially complete. The North Lake upgrade is expected to be completed in the second or third quarter of 2012, depending on the site host's outage plans for its blast furnace.

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*Maintenance and Repair Activity*

Work at Cokenergy continued with the planned outage of one boiler for major retubing work which was completed in the quarter. Cokenergy elected to retube a second boiler starting in the fourth quarter of 2011. While the boilers are out of service for the retubing work, a portion of the gases from the coke plant is vented rather than being treated in Cokenergy's flue gas desulfurization system and baghouse. Cokenergy has notified the Indiana Department of Environmental Management that the venting during the retubing work may cause the 2011 annual emission limit to be exceeded for particulate matter of a specific size defined as (PM10). The retube work minimizes emissions over the longer term and is the correct approach for environmental stewardship. Retubing work is expected to occur once during a boiler's lifetime, if at all.

**Environmental Matters**

*Cokenergy*

*Notice of Violation (NOV)*

There is a meeting scheduled February 2012 with the United States Environmental Protection Agency (USEPA) regarding its June 21, 2010 NOV issued to Cokenergy. The timing and nature for resolution of the NOV remains uncertain.

*Indiana Department of Environmental Management (IDEM) Notification*

In addition, on October 20, 2011 IDEM notified Cokenergy that three emergency occurrence reports submitted for the first and second quarters of 2011, each for a one day event during which sulfur dioxide (SO<sub>2</sub>) limitations are alleged, have been deemed as violations and referred to USEPA for further consideration.

*Cross State Air Pollution Rule (CSAPR)*

In July 2011, the USEPA finalized CSAPR, which requires Indiana and 26 other states to improve air quality by reducing power plant emissions that allegedly contribute to ground-level ozone and fine particle pollution in other downwind states. This rule, which replaces Clean Air Interstate Rule (CAIR), mandates emission reductions beginning in 2012.

The combustion turbine (CT) at Portside Energy is the only Primary Energy equipment falling under the guidance of CSAPR. We are currently seeking a non-applicability determination from USEPA that would preclude the CT from CSAPR because the source is not connected to a "utility power distribution system" and the source qualifies for an exemption as a "cogeneration unit". In the event we are unsuccessful in obtaining the non-applicability determination, CSAPR allowances awarded to the facility from USEPA for 2012 and 2013 are sufficient to match emissions from the facility's operations. IDEM has indicated they will submit a State Implementation Plan (SIP) for 2014 and beyond which will likely redistribute CSAPR allowances.

*National Ambient Air Quality Standards (NAAQS)*

On June 2, 2010, the USEPA finalized a revision to the primary SO<sub>2</sub> NAAQS. The new SO<sub>2</sub> standard is a 75 parts per billion over a one hour period. IDEM has been delegated the authority to implement this standard on behalf of the USEPA. IDEM will initiate a rulemaking process beginning in January 2012 to implement the revised SO<sub>2</sub> standard, which will likely result in revised emission limits for larger sources of SO<sub>2</sub> emissions throughout Indiana. The revised emission limits are expected to be finalized by IDEM in the Spring of 2013 and IDEM will be required to attain the revised SO<sub>2</sub> standards within Indiana by the Summer of 2017. While the outcome or impact of these matters cannot be predicted at this time, the Cokenergy facility may be required to install additional emission controls to maintain compliance with IDEM's implementation plan.

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**Major Maintenance and Capital Expenditures**

We are entering into a multiyear period where cash expenditures on plant major maintenance and capital expenditures will exceed historical levels, primarily due to contract renewal investments and environmental compliance. As previously disclosed, the renewal contract for the North Lake facility will be upgraded from its current rating of 75 MW to 90 MW. The capital investment associated with this project is projected to be \$11 to \$12 million and the work started earlier this year. \$0.1 million was expended on the project in the third quarter of 2011 for a total of \$3.3 million in the first nine months of 2011. An additional \$2.6 million is anticipated in the fourth quarter of 2011. Timing of actual cash flow is uncertain because some vendors have exhibited slow billing practices. We are nearing completion of the long term contract renewal for the Portside facility. Like North Lake, we expect capital upgrades included with the renewal that are intended to improve efficiency, reduce fuel usage and improve existing boiler reserve capacity. Once the contract is renewed further details regarding the terms of the contract and the capital required for upgrading the plant will be provided. We expect the capital cost to be less than North Lake. If the contract is signed this year additional costs may be incurred this year to order equipment. As we prepare for the upcoming Cokenergy contract renewal negotiations and to help ensure ongoing environmental compliance, we have elected to perform major maintenance on several of the Cokenergy boilers and the ductwork connecting them to the facility's flue gas desulfurization system to improve the plant's reliability and availability. While the full scope of the repairs have not been finalized, we are planning to retube two boilers this year (one completed and one in-progress as noted above), two in 2012 and possibly another two or three in 2013. One boiler retubing was completed in 2010, thus by the end of 2013 we expect to have at least seven boilers retubed. Each retubing is estimated to cost approximately \$1.3 million. It is also possible that an additional retubing may be required during the life of any contract extension but the timing, scope and cost cannot be predicted at this time. Subsequent to the end of the third quarter, one of the large motors used to induce draft for the coking operations at Cokenergy failed as a result of an electrical outage at the mill. This motor will be repaired or replaced in the fourth quarter 2011. In addition, one time ductwork repairs are being planned for the fourth quarter of 2011 and into 2012. There are other potential capital enhancement programs which could arise from the Cokenergy re-contracting process but at this point no capital has been assigned for any upgrades. There are no current plans for any capital programs for the Harbor Coal or Ironside facilities.

**Sale of Manager to Atlantic Power**

The planned sale of Capital Power Income LP, the Manager, to Atlantic Power is scheduled to close in November 2011. The Company has met with Atlantic Power to discuss termination of the Management Agreement and a potential purchase of the Manager's minority ownership of PERH that Atlantic Power will acquire in conjunction with the acquisition of Capital Power Income LP. No agreement has been reached on this matter to date and there can be no assurances that an agreement will be reached. The Company expects that any transaction will be financed with debt.

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**Results of Operations**

(in 000's of US\$, except share and per share data)

	<u>Three Months Ended September 30,</u>	
	<u>2011</u>	<u>2010</u>
<b>Revenue:</b>		
Capacity	\$ 9,018	\$ 9,018
Energy service	4,790	3,729
	<u>13,808</u>	<u>12,747</u>
<b>Expenses:</b>		
Operations and maintenance	3,159	3,656
General and administrative	2,438	2,237
Employee benefits	510	3,767
Depreciation and amortization	5,428	7,578
	<u>11,535</u>	<u>17,238</u>
<b>Equity in earnings of Harbor Coal joint venture</b>	<u>1,028</u>	<u>1,228</u>
<b>Operating income (loss)</b>	3,301	(3,263)
<b>Other expense:</b>		
Interest expense	(1,518)	(2,400)
Realized and unrealized loss on derivative contracts	-	(8)
	<u>1,783</u>	<u>(5,671)</u>
<b>Income (loss) before income taxes</b>	1,783	(5,671)
Income tax expense	(1,533)	(175)
<b>Net income (loss) and comprehensive income (loss)</b>	<u>\$ 250</u>	<u>\$ (5,846)</u>
<b>Net income (loss) and comprehensive income (loss) attributable to:</b>		
Owners of the Company	\$ 745	\$ (4,759)
Non-controlling interest	(495)	(1,087)
	<u>\$ 250</u>	<u>\$ (5,846)</u>
<b>Net income (loss) per share attributable to owners of the Company:</b>		
Weighted average number of shares outstanding - basic	44,706,187	44,706,187
Weighted average number of shares outstanding - diluted	45,128,828	44,706,187
<b>Basic and diluted net income (loss) per share attributable to owners of the Company</b>	<u>\$ 0.02</u>	<u>\$ (0.10)</u>

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**Three Months Ended September 30, 2011 compared to Three Months Ended September 30, 2010**

The Company's revenue of \$13.8 million in the third quarter of 2011 increased \$1.1 million, or 8.3%, compared with revenue of \$12.7 million for the third quarter of 2010. The increase is related to the variable portion of Energy Service revenue. North Lake's revenue increased by \$0.6 million during the third quarter primarily due to increased host operations resulting in higher steam delivery to the North Lake facility. The Ironside facility operated during the third quarter of 2011, but was out of service during the same period in 2010 which positively impacted revenue by \$0.2 million. Revenue was also positively impacted by increased host operating levels at the other facilities and by energy credit revenue of \$0.1 million recorded by the Cokenergy facility.

Operations and maintenance expense for the third quarter of 2011 was \$3.2 million compared to \$3.6 million for the third quarter of 2010, a decrease of \$0.4 million or 13.5%. During the third quarter of 2011, the Company incurred periodic expenditures of \$0.4 million for boiler re-tubing work. Periodic costs for the same period in 2010 were comprised of \$0.9 million for boiler re-tubing, \$0.4 million for air filtration and bag house expenditures and \$0.3 million for a turbine generator repair. Costs associated with boiler re-tubing work are specific to individual boilers. The Company views periodic costs as unique expenditures that are not anticipated to recur. Additionally, the Company had increased operating expenses during the third quarter of 2011 for boiler repair work of \$0.4 million, contractor labor of \$0.2 million, water chemical treatments of \$0.1 million and general maintenance of \$0.1 million.

General and administrative expense for the third quarter of 2011 was \$2.4 million compared to \$2.2 million for the third quarter of 2010, an increase of \$0.2 million or 9.0%. The increase is due to additional professional fees of \$0.1 million and plant and liability insurance of \$0.1 million.

Employee benefits for the third quarter of 2011 were \$0.5 million compared to \$3.8 million for the third quarter of 2010, a decrease of \$3.3 million. The decrease is the amount of the stock based compensation recorded in the third quarter of 2010.

Depreciation and amortization expense for the third quarter of 2011 was \$5.4 million compared to \$7.6 million for the third quarter of 2010, a decrease of \$2.2 million. During the second quarter of 2011, the North Lake contract intangible was fully amortized resulting in reduced amortization expense for the third quarter of 2011 compared to the same prior period in 2010.

Equity in earnings of Harbor Coal joint venture for the third quarter of 2011 was \$1.0 million compared to \$1.2 million for the third quarter of 2010, a decrease of \$0.2 million. The decrease is due to a reduction in billing rate as specified in the amended PCI Partnership Agreement for the Company's investment in PCI Associates.

Operating income for the third quarter of 2011 was \$3.3 million compared to an operating loss of \$3.3 million for the third quarter of 2010, an increase of \$6.6 million. The increase is primarily due to reductions in depreciation and amortization and stock based compensation.

Interest expense for the third quarter of 2011 was \$1.5 million compared to \$2.4 million for the third quarter of 2010, a decrease of \$0.9 million. This decrease is due to the reduced level of debt outstanding under the Company's Credit Facility partially offset by increased amortization of deferred finance fees during the third quarter of 2011.

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Realized and unrealized loss on derivative contracts for the third quarter of 2011 and 2010 were de minimis amounts.

Income tax expense for the third quarter of 2011 was \$1.5 million compared to \$0.2 million for the third quarter of 2010, an increase of \$1.3 million. The amount of expense recorded in each period is primarily due to the change in value of future tax assets and liabilities.

Net income and comprehensive income for the third quarter of 2011 was \$0.3 million compared to a net loss and comprehensive loss \$5.9 million for the third quarter of 2010, an improvement of \$6.2 million. The improvement is the result of the net effect of the items discussed above.

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**Results of Operations**

(in 000's of US\$, except share and per share data)

	Nine Months Ended September 30,	
	2011	2010
<b>Revenue:</b>		
Capacity	\$ 27,054	\$ 27,054
Energy service	12,849	12,194
	39,903	39,248
<b>Expenses:</b>		
Operations and maintenance	10,025	9,010
General and administrative	6,917	6,873
Employee benefits	1,676	4,690
Depreciation and amortization	19,232	22,710
	37,850	43,283
<b>Equity in earnings of Harbor Coal joint venture</b>	3,132	3,029
<b>Operating income (loss)</b>	5,185	(1,006)
<b>Other expense:</b>		
Interest expense	(5,053)	(7,772)
Realized and unrealized loss on derivative contracts	(4)	(184)
Loss on derecognition	(500)	-
	(5,557)	(8,036)
<b>Loss before income taxes</b>	(372)	(8,962)
Income tax expense	(2,429)	(1,400)
<b>Net loss and comprehensive loss</b>	\$ (2,801)	\$ (10,362)
<b>Net loss and comprehensive loss attributable to:</b>		
Owners of the Company	\$ (536)	\$ (7,349)
Non-controlling interest	(2,265)	(3,013)
	\$ (2,801)	\$ (10,362)
<b>Net loss per share attributable to owners of the Company:</b>		
Weighted average number of shares outstanding - basic and diluted	44,706,187	44,706,187
<b>Basic and diluted net loss per share attributable to owners of the Company</b>	\$ (0.01)	\$ (0.16)

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**Nine Months Ended September 30, 2011 compared to Nine Months Ended September 30, 2010**

The Company's revenue of \$39.9 million in the first nine months of 2011 increased \$0.7 million, or 1.7%, compared with revenue of \$39.2 million for the first nine months of 2010. The increase is related to the variable portion of Energy Service revenue. The Ironside facility was fully operational during the first nine months of 2011 and was out of service during the same period in 2010 which had a positive impact on revenue of \$0.7 million.

Operations and maintenance expense for the first nine months of 2011 was \$10.0 million compared to \$9.0 million for the first nine months of 2010, an increase of \$1.0 million or 11.3%. Periodic expenditures for the nine month period ended September 2011 for boiler re-tubing work totaled \$1.1 million. Periodic costs for the same period in 2010 were comprised of \$1.1 million for boiler re-tubing work, \$0.7 million for air filtration and bag house expenditures and \$0.3 million for a turbine generator repair. Costs associated with boiler re-tubing work are specific to individual boilers. The Company views periodic costs as unique expenditures that are not anticipated to recur. Additionally, the Company had increased operating expenses during the nine month period ended September 30, 2011 for boiler repair work of \$0.9 million, contractor labor of \$0.6 million, water chemical treatments of \$0.2 million, environmental control system repairs of \$0.2 million and general maintenance of \$0.1 million.

General and administrative expense totaled \$6.9 million for the first nine months of 2011 and is flat when compared to the first nine months of 2010.

Employee benefits for the first nine months of 2011 were \$1.6 million compared to \$4.7 million for the first nine months of 2010, a decrease of \$3.1 million. The decrease is due to the amount of the stock based compensation recorded in the third quarter of 2010.

Depreciation and amortization expense for the first nine months of 2011 was \$19.2 million compared to \$22.7 million for the first nine months of 2010, a decrease of \$3.5 million. During the second quarter of 2011, the North Lake contract intangible was fully amortized resulting in a reduced amount of amortization expense for the first nine months of 2011 compared to the first nine months of 2010.

Equity in earnings of Harbor Coal joint venture for the first nine months of 2011 was \$3.1 million compared to \$3.0 million for the first nine months of 2010, an increase of \$0.1 million. The net increase is the result of reduced operating expenses of \$0.4 million offset by reduced revenue of \$0.3 million based on a reduction in the billing rate specified in the amended PCI Partnership Agreement for the Company's investment in PCI Associates.

Operating income for the first nine months of 2011 was \$5.2 million compared to an operating loss of \$1.0 million for the first nine months of 2010, an increase of \$6.2 million. The increase is primarily due to reductions in depreciation and amortization and stock based compensation.

Interest expense for the first nine months of 2011 was \$5.0 million compared to \$7.8 million for the first nine months of 2010, a decrease of \$2.8 million. This decrease is due to the reduced level of debt outstanding under the Company's Credit Facility partially offset by increased amortization of deferred finance fees during the first nine months of 2011.

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Realized and unrealized loss on derivative contracts for the first nine months of 2011 was a de minimis amount and was \$0.2 million for the first nine months of 2010.

Loss on derecognition for the first nine months of 2011 was \$0.5 million and represents the write-off of the undepreciated costs associated with the prior overhaul at North Lake.

Income tax expense for the first nine months of 2011 was \$2.4 million compared to \$1.4 million for the first nine months of 2010, an increase of \$1.0 million. The amount of expense recorded in each period is primarily due to the change in value of future tax assets and liabilities.

Net loss and comprehensive loss for the first nine months of 2011 was \$2.8 million compared to \$10.4 million for the first nine months of 2010, an improvement of \$7.6 million. The improvement is the result of the net effect of the items discussed above.

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**Adjusted EBITDA and Free Cash Flow**

The Company believes that Adjusted EBITDA is an important measure as it allows for the assessment of the operating performance of the business on a consistent basis from period to period. For the three months ended September 30, 2011 and 2010 the Company generated Adjusted EBITDA of \$10.1 million and \$10.2 million, respectively. For the nine months ended September 30, 2011 and 2010 the Company generated Adjusted EBITDA of \$28.5 million and \$30.1 million, respectively. EBITDA and Adjusted EBITDA are reconciled to net income (loss) and comprehensive income (loss) in the table below.

**Reconciliation of Net Income (Loss) and Comprehensive Income (Loss) to Adjusted EBITDA**

(in 000's of US\$)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net income (loss) and comprehensive income (loss)	\$ 250	\$ (5,846)	\$ (2,801)	\$ (10,362)
Adjustment to net income (loss) and comprehensive income (loss):				
Depreciation and amortization	5,428	7,578	19,232	22,710
Depreciation and amortization included in equity in earnings of Harbor Coal joint venture	1,009	1,009	3,027	3,027
Interest expense	1,518	2,400	5,053	7,772
Realized and unrealized loss on derivative contracts	-	8	4	184
Loss on derecognition	-	-	500	-
Income tax expense	1,533	175	2,429	1,400
<b>EBITDA</b>	<b>\$ 9,738</b>	<b>\$ 5,324</b>	<b>\$ 27,444</b>	<b>\$ 24,731</b>
Adjustments to EBITDA:				
Major maintenance	400	1,600	1,100	2,122
Non-cash stock based compensation	-	3,262	-	3,262
<b>Adjusted EBITDA</b>	<b>\$ 10,138</b>	<b>\$ 10,186</b>	<b>\$ 28,544</b>	<b>\$ 30,115</b>

The Company believes that Free Cash Flow is an important measure as it allows for the evaluation of the amount of cash generated by the business on a consistent basis from period to period. For the three months ended September 30, 2011 and 2010 the Company generated Free Cash Flow of \$6.7 million and \$8.4 million, respectively. For the nine months ended September 30, 2011 and 2010 the Company generated Free Cash Flow of \$19.2 million and \$24.1 million, respectively. Free Cash Flow is reconciled to net cash provided by operating activities in the table below.

**Reconciliation of Net Cash Provided By Operating Activities to Free Cash Flow**

(in 000's of US\$)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net cash provided by operating activities	\$ 7,012	\$ 8,566	\$ 23,610	\$ 24,787
Less: capital expenditures	(296)	(186)	(4,424)	(676)
<b>Free Cash Flow</b>	<b>\$ 6,716</b>	<b>\$ 8,380</b>	<b>\$ 19,186</b>	<b>\$ 24,111</b>

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Summary of Quarterly Results

(In 000's of US\$, except per share data)

	4th Quarter 2009 (1), (2)	1st Quarter 2010 (2)	2nd Quarter 2010 (2)	3rd Quarter 2010 (2)	4th Quarter 2010 (2)	1st Quarter 2011 (2)	2nd Quarter 2011	3rd Quarter 2011
Revenues	\$ 15,329	\$ 13,260	\$ 13,241	\$ 12,747	\$ 13,535	\$ 12,782	\$ 13,313	\$ 13,808
Operating income (loss)	\$ 2,290	\$ 1,582	\$ 675	\$ (3,263)	\$ 1,418	\$ 601	\$ 1,283	\$ 3,301
Net income (loss) and comprehensive income (loss) attributable to the owners of the Company	\$ (2,824)	\$ (770)	\$ (1,820)	\$ (4,759)	\$ 20,221	\$ (1,281)	\$ -	\$ 745
Net income (loss) per share (basic and diluted) attributable to the owners of the Company	\$ (0.06)	\$ (0.02)	\$ (0.04)	\$ (0.10)	\$ 0.45	\$ (0.03)	\$ -	\$ 0.02

(1) Results for 2009 have been prepared using Canadian GAAP. Results for 2010 and 2011 have been prepared using IFRS.

(2) All per share amounts have been retrospectively restated to give effect to the Share Consolidation in the consolidated financial statements.

### Outstanding Share Data

As of May 5, 2011, the Company completed a three-to-one Common Share consolidation (the "Share Consolidation"). Under the Share Consolidation, the Company consolidated all of its outstanding Common Shares on the basis of one post-consolidation Common Share for three existing Common Shares and all resulting fractional Common Shares were cancelled. Accordingly, the 134,118,561 Common Shares previously issued and outstanding were consolidated into 44,706,187 Common Shares, all of which are outstanding as of the date of this MD&A. All Common Share and per share amounts have been retrospectively restated to give effect to the Share Consolidation in the consolidated financial statements. Additionally, the number of Common Shares reserved for issuance under the Company's stock option plan and the number of Common Shares into which the outstanding options will be exercisable has been proportionally reduced to reflect the three-to-one consolidation ratio and the applicable exercise price has been proportionally increased.

On August 24, 2010, the Board of Directors awarded a total of 5,500,000 options to Mr. John Prunkl, the President and Chief Executive Officer of the Company, subject to approval of the Stock Option Plan by the Company's shareholders. The Company's shareholders approved the plan on October 15, 2010. All of the options granted to Mr. Prunkl vested immediately and are defined as incentive stock options for U.S. tax purposes. The stock price at date of award was Cdn\$0.94 (Cdn\$2.82 after adjustment to give effect to the Share Consolidation). The exercise price of the first option to acquire 5,000,000 Common Shares was Cdn\$1.00 with a fair value at the date of measurement of \$0.61. The exercise price of the second option to acquire 500,000 Common Shares was Cdn\$1.20 with a fair value at the date of measurement of \$0.56. For each of the nine months ended September 30, 2010 and the year ended December 31, 2010, the Company recognized a total of \$3.3 million in non-cash stock based compensation expense associated with the grants issued under the Stock Option Plan, based on the estimated fair value of the options on the grant date. As a result of the Share Consolidation, Mr. Prunkl's 5,500,000 options were consolidated into 1,833,332 options with the respective exercise price increasing by three times. As a result, the first option is to acquire 1,666,666 Common Shares at an exercise price of Cdn\$3.00. The second option is to acquire 166,666 Common Shares at an exercise price of Cdn\$3.60. At September 30, 2011 there were 1,833,332 options currently exercisable with a weighted average exercise price of \$3.03.

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As of the grant date, the options had a weighted average fair value measurement of \$0.61. The fair value of the respective options was determined by the Black-Scholes option pricing model using the assumptions noted in the following table.

Stock price at date of fair value measurement	Cdn\$1.09
Volatility	40%
Risk-free rate	2.79%
Expected term (in years)	10
Dividend yield	0%

**Basic and Diluted Net Income (Loss) Per Share Attributable to Owners of the Company**

Basic net income (loss) per share is computed by dividing the net income (loss) for the period attributable to the owners of the Company by the weighted average number of Common Shares outstanding during the period. Diluted net income (loss) per share is computed by dividing the net income (loss) for the period, by the weighted average number of Common Shares outstanding and, when dilutive, adjusted for the effect of all potentially dilutive shares, including stock options, on an as-if-converted basis.

The following table sets forth the computation for basic and diluted net loss per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<b>Numerator:</b>				
Net income (loss) attributable to owners of the Company	\$ 745	\$ (4,759)	\$ (536)	\$ (7,349)
<b>Denominator:</b>				
Denominator for basic - weighted average number of Common Shares outstanding (i)	44,706,187	44,706,187	44,706,187	44,706,187
Denominator for diluted - weighted average number of Common Shares outstanding (i)	45,128,828	44,706,187	44,706,187	44,706,187
<b>Basic and diluted income (loss) per share:</b>				
Basic and diluted net income (loss) per share (i)	\$ 0.02	\$ (0.10)	\$ (0.01)	\$ (0.16)

(i) All Common Share and per share amounts have been retrospectively restated to give effect to the Share Consolidation in the consolidated financial statements.

Options to purchase 1,833,332 Common Shares were outstanding at the end of the period ending September 30, 2011. For the three months and nine months ended September 30, 2011, basic net income (loss) per share have been calculated using the weighted average number of Common Shares outstanding of 44,706,187. For the three months ended September 30, 2011, diluted net income per share has been calculated using the weighted average number of Common Shares outstanding of 45,128,828. For the nine months ended September 30, 2011, there were no differences in the weighted average number of Common Shares outstanding used for diluted net loss per share as the effect of all potentially dilutive Common Shares outstanding was anti-dilutive. For the three months and nine months ended September 30, 2010, there were no differences in the weighted average number of Common Shares outstanding used for basic and diluted net loss per share as the effect of all potentially dilutive Common Shares outstanding was anti-dilutive.

**Liquidity and Capital Resources**

For the three months ended September 30, 2011, the Company recorded a decrease in cash and cash equivalents of \$0.9 million. As of September 30, 2011, the Company's cash balance was \$21.6 million. The Company's primary source of capital has historically been cash flows from operations. Available capital is now primarily used for repayment of debt principal, capital expenditures, payment of interest and operating expenses. The Company believes that available cash funds, in addition to cash flows to be generated from future operations, will be sufficient to finance the Company's anticipated operating and maintenance requirements associated with the

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Company's facilities in the near term, its planned capital expenditures and its debt service requirements under its Credit Facility. The Company expects to spend approximately \$11.0 to \$12.0 million on capital improvements for its North Lake facility to meet the upgrade requirements specified under the new Tolling Agreement. Approximately \$6.0 million will be spent during 2011 with the balance in 2012. The upgrade is expected to be completed in mid 2012. For the first nine months of 2011, the Company incurred \$3.3 million of capital expenditures for equipment and services in support of the North Lake upgrade. Additionally, the Company expects to pay off its outstanding debt balance early in 2013, if the Company does not re-finance prior thereto. The Company is exploring re-financing at the present time but no decisions have been made to proceed at this time.

*Cash Flows for the Three Months and Nine Months Ended September 30, 2011*

Net cash provided by operating activities for the three months ended September 30, 2011 was \$7.0 million, which resulted from net income and comprehensive income of \$0.3 million, plus \$6.4 million of net non-cash items charged to the Consolidated Statement of Comprehensive Income, plus \$2.0 million of distributions received from the Company's investment in joint venture, less \$1.7 million representing the net change in the Company's operating assets and liabilities. The net non-cash items consisted primarily of depreciation of property, plant and equipment and amortization of intangible assets, equity in earnings of joint venture, interest expense and income tax expense. The net change in operating assets and liabilities resulted primarily from increases in accrued property taxes and amounts due to affiliates and a decrease in inventory and other assets offset by decreases in accounts payable and accrued expenses and increases in accounts receivable. Net cash used in investing activities for the three months ended September 30, 2011 was \$0.1 million comprised of \$0.3 million of capital expenditures offset by a \$0.2 million change in restricted cash. Net cash used in financing activities for the three months ended September 30, 2011 was \$7.8 million and represents repayment of debt outstanding under the Credit Facility.

Net cash provided by operating activities for the nine months ended September 30, 2011 was \$23.6 million, which resulted from net loss and comprehensive loss of \$2.8 million, plus \$20.8 million of net non-cash items charged to the Consolidated Statement of Comprehensive Income, plus \$5.6 million of distributions received from the Company's investment in joint venture. The net non-cash items consisted primarily of depreciation of property, plant and equipment and amortization of intangible assets, loss on derecognition, equity in earnings of joint venture, interest expense and income tax expense. The net change in operating assets and liabilities resulted primarily from increases in accounts payable, accrued expenses, amounts due to affiliates and a decrease in inventory and other assets offset by decreases in accrued property taxes and increases in accounts receivable. Net cash used in investing activities for the nine months ended September 30, 2011 was \$3.7 million comprised of \$4.4 million of capital expenditures offset by a \$0.7 million change in restricted cash. Net cash used in financing activities for the nine months ended September 30, 2011 was \$20.7 million and represents repayment of debt outstanding under the Credit Facility.

*Cash Flows for the Three Months and Nine Months Ended September 30, 2010*

Net cash provided by operating activities for the three months ended September 30, 2010 was \$8.6 million, which resulted from a net loss and comprehensive loss of \$5.9 million, plus \$10.9 million of net non-cash items charged to the Consolidated Statement of Operations, plus \$2.2 million of distributions received from the Company's investment in joint venture, plus \$1.4 million representing the net change in the Company's operating assets and liabilities. The net non-cash items consisted primarily of depreciation of property, plant and equipment and amortization of intangible assets, equity in earnings of joint venture, interest expense, stock based compensation expense and income tax expense. The net change in operating assets and liabilities resulted primarily from increases in

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accounts payable, amounts due to affiliates, accrued property taxes and accrued expenses offset by increases in accounts receivable and inventory and other assets. Net cash provided by investing activities for the three months ended September 30, 2010 was \$0.1 million comprised of a \$0.3 million change in restricted cash offset by \$0.2 million of capital expenditures. Net cash used in financing activities for the three months ended September 30, 2010 was \$8.4 million and represents repayment of debt outstanding under the Credit Facility.

Net cash provided by operating activities for the nine months ended September 30, 2010 was \$24.8 million, which resulted from a net loss and comprehensive loss of \$10.4 million, plus \$27.7 million of net non-cash items charged to the Consolidated Statement of Operations, plus \$6.3 million of distributions received from the Company's investment in joint venture, plus \$1.2 million representing the net change in the Company's operating assets and liabilities. The net non-cash items consisted primarily of depreciation of property, plant and equipment and amortization of intangible assets, equity in earnings of joint venture, interest expense, stock based compensation expense and income tax expense. The net change in operating assets and liabilities resulted primarily from increases in accrued expenses and accounts payable offset by decreases in accrued property taxes and amounts due to affiliates and increases in accounts receivable and inventory and other assets. Net cash used in investing activities for the nine months ended September 30, 2010 was \$0.3 million comprised of \$0.7 million of capital expenditures offset by a \$0.4 million change in restricted cash. Net cash used in financing activities for the nine months ended September 30, 2010 was \$26.1 million comprised of \$25.5 million of repayment of debt outstanding under the Credit Facility, \$0.3 million paid in financing costs and \$0.3 million of payments for stock issuance costs incurred in 2009.

*Long-Term Debt and Credit Facility*

**Credit Facility**

On October 23, 2009, PERH, through its subsidiary Primary Energy Operations LLC ("PEO"), entered into a \$105.0 million secured term loan facility (the "Credit Facility"). On November 13, 2009, the Company borrowed the \$105.0 million available under the Credit Facility. As of September 30, 2011, \$50.6 million remains outstanding.

The Credit Facility has a five-year term and accrues interest at an interest rate equal to, at PEO's option, an adjusted LIBOR rate (subject to a 2.0% minimum) plus 4.5% or an alternate base rate (subject to a 3.0% minimum) plus 3.5%. The loan is subject to 0.25% quarterly mandatory amortization payments and quarterly mandatory prepayments of principal equal to 100% of PEO's excess cash flow (as defined in the Credit Facility) for the period. The Company has classified approximately \$33.1 million (exclusive of \$1.4 million of deferred finance fees) of borrowings under the Credit Facility as short-term debt at September 30, 2011. This amount represents approximately \$0.4 million of required principal repayments and approximately \$32.7 million of estimated principal prepayments based upon anticipated excess cash flow (as defined in the Credit Facility). To the extent the Company's excess cash flow is more or less than anticipated, the amount of quarterly prepayment of principal under the terms of the Credit Facility may be different than the amount currently classified as short term debt. The debt outstanding under the Credit Facility is guaranteed by PERH and PEO's wholly-owned subsidiaries (collectively, the "Guarantors") and secured by a pledge of substantially all of PEO's and the Guarantors' real and personal property. The Credit Facility also contains financial covenants requiring PEO to meet certain maximum leverage and minimum fixed charge coverage ratios, as well as other covenants. These covenants may limit the Company's ability to, among other things, incur additional secured or unsecured debt, pay dividends, make acquisitions or other investments, make capital expenditures, sell or otherwise dispose of certain assets, enter into sale and leaseback transactions and enter into mergers or consolidations.

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The cost of borrowing (including fees) for the Company is approximately 6.9% based on current LIBOR. As of September 30, 2011, the Company was in compliance with all covenants under the Credit Facility.

*Net Operating Loss Carryforward*

As of September 30, 2011, the Company has recorded a deferred tax asset relating to its U.S. net operating loss carryforward of approximately \$46.4 million that will start to expire in 2026. As of December 31, 2010 the Company increased the value of its deferred tax asset related to its U.S. net operating losses as it is more likely than not that the tax benefit of the net operating loss carryforward will be utilized. The increase was primarily based on the expectation of future taxable income due to the reduction in interest expense as a result of the Company's recapitalization in 2009.

Additionally, during 2010, the Company determined that \$32.6 million of income recognized upon the cancellation of debt in 2009 is not taxable for U.S. purposes. This determination served to increase the Company's net operating loss carryforward by \$32.6 million. However, the Company has not recorded a corresponding deferred tax asset as it is not probable that the asset would be realized.

The Company has net operating losses of approximately Cdn\$49.1 million for Canadian tax purposes that will begin to expire in 2028. A deferred tax asset associated with these net operating losses has not been recognized as the Company does not anticipate realizing a benefit. At September 30, 2011 and December 31, 2010, the net long-term deferred tax asset balance was \$2.6 million and \$4.9 million, respectively.

**Interest Rate Cap Contract**

On November 12, 2009 the Company entered into an interest rate cap contract for \$0.3 million pursuant to provisions of the Credit Facility. The interest rate cap contract has a three-year term. The interest rate cap contract establishes a series of quarterly interest rate caps with the notional amount of each quarterly cap based upon the amount of anticipated debt outstanding under the Credit Facility. The quarterly interest rate increases from 2.25% to 5.00% during the last year of the three-year term of the contract. The notional amounts reduce over time based upon anticipated debt reductions. The contract does not qualify as a cash flow hedge for accounting purposes and the change in fair value is recorded in income. As of September 30, 2011 and December 31, 2010, the fair value of the interest rate cap contract was a de minimis amount.

**Commitments and Contractual Obligations**

The following table reflects the Company's contractual obligations and commitments related to outstanding indebtedness as of September 30, 2011, including payments due for each of the next five years and thereafter. The Credit Facility requires the Company to make mandatory quarterly prepayments of principal equal to 100% of PEO's excess cash flow (as determined in accordance with the terms of the Credit Facility) for the period. The figures included in the table below reflect management's current estimates of its excess cash flow during the term of the Credit Facility. Based on management's current estimates, the Company expects to repay all indebtedness under the Credit Facility in 2013. However, there can be no assurance that management's current estimates of the Company's excess cash flow will be met or that the Credit Facility will be repaid in advance of its maturity as set forth below.

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Maturities of debt are based upon quarterly mandatory payments and projections of excess cash flow, which are subject to change based on results of operations and other factors, including those identified under "Risk Factors". In 2011, the projected timing of debt repayment has been impacted by additional operational expenditures related to boiler repairs and duct work activity and projected capital expenditures as allowed under the Credit Facility. The estimated principal payments are as follows (in 000's):

	<b>September 30, 2011</b>						
	<b>Balance</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>Thereafter</b>
Credit Facility	\$ 50,626	\$ 9,356	\$ 30,855	\$ 10,415	\$ -	\$ -	\$ -
Total	\$ 50,626	\$ 9,356	\$ 30,855	\$ 10,415	\$ -	\$ -	\$ -

The Company pays a management fee under a management agreement with the Manager dated August 24, 2009 ("the Management Agreement") which continues through August 2025. See "Transactions with Related Parties".

As of September 30, 2011, the Company has outstanding commitments of \$8.3 million to purchase equipment and services in support of the North Lake upgrade. Approximately \$2.6 million will be spent for the remainder of 2011 with the balance in 2012.

The Company has no off-financial position debt or similar obligations.

**Transactions with Related Parties**

The Manager provides accounting, tax, administrative and operational services to the Company and its subsidiaries pursuant to the terms of the Management Agreement for which it earns a fixed fee that is adjusted annually for inflation. The Management Agreement has an initial term ending in 2025.

For 2011 the annual management fee is \$3.2 million and any incremental additional costs incurred by the Manager as a result of any acquisitions made by PERH or its subsidiaries. In addition, there are certain costs paid by the Manager that the Company manages. If the amount of these costs exceeds \$1.3 million, subject to annual adjustment for inflation, the excess costs will be incurred by the Company. A copy of the Management Agreement is available for review on SEDAR at [www.sedar.com](http://www.sedar.com).

**Critical Accounting Estimates**

The preparation of financial statements requires the Company to make estimates and assumptions concerning the future that affect the reported amounts of assets and liabilities and by definition will seldom equal actual results. The estimates and judgments that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

***Property plant and equipment***

Management estimates the useful lives of property, plant and equipment based on the period during which the assets are expected to be available for use. The amounts and timing of recorded expenses for amortization of property, plant and equipment for any period are affected by these estimated useful lives. The estimates are reviewed at least annually and are updated if expectations change as a result of physical wear and tear, technical or commercial obsolescence and legal or other limits to use. It is possible that changes in these factors may cause significant changes in the estimated useful lives of the Company's property, plant and equipment in the future.

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***Asset retirement obligations***

Provisions for asset retirement obligations require the assessment of the amounts that the Company will have to pay and assumptions in terms of timing and discount rate.

***Income Taxes***

Estimation of income taxes included an evaluation of the recoverability of deferred tax assets based on an assessment of the Company's ability to utilize the underlying future tax deductions against future taxable income before they expire. The Company's assessment is based upon existing tax laws and estimates of future taxable income. If the assessment of the Company's ability to utilize the underlying future tax deductions changes, the Company would be required to recognize more or fewer of the tax deductions as assets, which would decrease or increase the income tax expense in the period in which the determination is made.

***Risk Factors***

The Company's future performance and financial condition involves a number of risks and uncertainties. Any of these risks and uncertainties could have a material adverse effect on the results of operations, business prospects and financial condition of the Company or on the market price or value of the Common Shares. The following is a list of some of the risks facing the Company. Additional risks are discussed in the Company's most recent annual information form which is available for review on SEDAR at [www.sedar.com](http://www.sedar.com).

***The Company Derives its Revenues From Only Two Steel Industry Customers***

All of PERH's revenues are generated from providing services to entities controlled by only two underlying customers. The percentage of PERH's revenues generated by each major customer for the year ended December 31, 2010 was approximately 86% and 14%, respectively. In addition, both of PERH's customers are participants in the U.S. steel industry and, as such, their businesses are affected by risks relating to the steel industry. In particular, the steel industry is cyclical in nature and may be affected by prevailing economic conditions in major world economies. A recession in the United States, Canada or globally (or concerns that a recession could continue for a prolonged period) could substantially decrease the demand for steel products and adversely affect the financial condition, production and business of our customers. The steel industry is particularly sensitive to trends in cyclical industries such as non-residential construction, appliance, machinery and equipment, and transportation industries. A disruption or downturn in any of these industries or markets could materially adversely impact the financial condition, production and business of PERH's customers. A material adverse impact to the business of either of our customers may adversely affect the Projects and the financial condition of PERH.

***Projects May Not Operate as Planned***

The revenue produced by the Projects is dependent, in whole or in part, on the amount of electric energy and thermal energy generated by them. With respect to each of the Projects, there is a risk of equipment failure (of both Project equipment and equipment operated by the host) for various reasons including, without limitation, component failures, latent defect, design error, operator error, weather conditions or force majeure which could adversely affect revenues or operating and maintenance expenses. For Project equipment, it is possible that annual major maintenance expenditures may increase above historical spending levels as equipment ages and it is expected that these costs will be funded from cash generated from operations. To the extent that maintenance spending exceeds historical requirements, there may be a negative impact on net income. To the extent that such equipment requires either longer than anticipated down times for maintenance and

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repair, or suffers disruptions of energy generation for other reasons, the amount of revenue may be adversely affected.

Neither PERH nor its subsidiaries control, or have contractual rights in respect of, the operations of its customers. The host steel mills have the ability to run their plants at their discretion. Since some of the Projects are affected by the level of production at these host steel mills, a Project's performance may be impacted by its host's operational decisions. Such operational decisions include, without limitation, production levels and which blast furnaces the host steel mills choose to run.

***Dependence on the Manager, Dedicated Employees, CEO and the Management Agreement***

PERH and the Company are currently dependent on the Manager and Capital Power Operations (US) Inc. ("Capital Power US") to provide accounting, tax, administrative and operational services. On August 24, 2009, amendments were made to the Management Agreement so that the Company will have the right to terminate the Management Agreement for an initial termination fee of \$8.0 million, which fee shall decline on a pro rata monthly basis over a four year period to \$5.0 million provided that the Manager agrees to the sale, transfer, assignment or redemption of its interests in PERH. As of September 30, 2011, the termination fee is \$6.5 million. Upon termination of the Management Agreement, PERH and the Company will be required to establish replacement management arrangements. If PERH and the Company are not able to obtain or internally replace such management arrangements with a similar cost structure, the financial condition of the Company may be negatively affected.

Following the amendments to the Management Agreement, certain Capital Power US employees became dedicated employees required to devote their full-time efforts to managing the business of PERH. In addition, PERH hired John D. Prunkl as its President and Chief Executive Officer. These dedicated employees or the CEO may terminate their employment and the loss of any of their services could materially harm PERH's business and financial condition. The Manager or PERH may also not be able to locate or employ on acceptable terms qualified replacements for such dedicated employees or the CEO if their services were no longer available.

***The Projects are Subject to Significant Environmental and Other Regulations***

The Projects, facilities and operations are subject to extensive and increasingly stringent federal, state and local laws, regulations, guidance and other requirements governing or relating to, among other things: air emissions and climate change; discharges into water; the storage, handling, use and transportation of materials; the prevention of releases of hazardous substances into the environment; the prevention, presence and remediation of hazardous substances in soil and groundwater, both on and off site; land use and zoning matters; and workers health and safety matters. As such, the operation of the Projects carries an inherent risk of environmental, health and safety liabilities (including potential civil actions, compliance or remediation orders, injunctive relief, fines and other penalties), and may result in the Projects being involved from time to time in administrative and judicial proceedings relating to such matters. In addition, the Projects operate on real estate owned by others that may be contaminated. Although management believes that existing indemnities provide appropriate protection against claims related to contamination not caused by the Projects, there can be no assurance that future claims will not be made against the Projects in respect of such contamination that may be material.

The Projects have obtained environmental permits and other approvals that are required for their operations. Compliance with applicable laws and regulations and future changes to them is material to the Issuer's businesses. Although management believes that the operations of the Projects are

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currently in material compliance with applicable environmental laws, licenses, permits and other authorizations required for the operation of the Projects and although there are environmental monitoring and reporting systems in place with respect to all the Projects, there is no guarantee that more stringent laws and regulations will not be imposed, that there will not be more stringent enforcement of applicable laws or regulations, or that such monitoring and reporting systems may not fail, which may result in material expenditures. Failure by the Projects to comply with any environmental, health or safety requirements, or increases in the cost of such compliance, including as a result of unanticipated liabilities or expenditures for investigation, assessment, remediation or prevention, could result in additional expense, capital expenditures, restrictions, temporary or permanent cessation of operations, or delays in the Projects' activities, the extent of which cannot be predicted.

In June of 2010, the Cokenergy facility received a Notice of Violation and Finding of Violation ("NOV/FOV") from the USEPA alleging violations of its Title V permit under the Clean Air Act. The Company currently has a meeting scheduled with the USEPA in February 2012. The timing and nature for resolution of the NOV remains uncertain. While management does not anticipate that this matter will have a significant adverse impact to the Company, the ultimate outcome cannot be assured and it may have a material adverse impact on the Cokenergy facility and the financial position of the Company. On October 20, 2011 IDEM notified Cokenergy that three emergency occurrence reports submitted for the first and second quarters of 2011, each for a one day event during which sulfur dioxide (SO<sub>2</sub>) limitations are alleged, have been deemed as violations and referred to USEPA for further consideration.

***Transition to International Financial Reporting Standards***

Effective January 1, 2011, IFRS replaced Canadian GAAP for all Canadian publicly traded companies for annual and interim financial statements. IFRS is premised on a conceptual framework similar to Canadian GAAP; however, significant differences exist in certain matters of recognition, measurement and disclosure. The transition required the conversion, for comparative purposes, of previously reported balance sheets as at December 31, 2009 and December 31, 2010 and interim and annual consolidated statements of income and cash flow for 2010 from Canadian GAAP to IFRS.

***New Accounting Standards Issued but not yet Effective***

Certain new accounting standards and IFRS Interpretation Committee (IFRIC) interpretations have been published that are mandatory for accounting periods beginning on or after January 1, 2011. The Company's assessment of the impact of these new standards and interpretations is set out below.

IFRS 7, *Financial Instruments – Disclosures* (IFRS 7), has been amended and will be effective for financial periods beginning on or after July 1, 2011. The amendments increase the disclosure requirements for transactions involving transfers of financial assets, for example using receivables, investments or equity to settle transactions. These amendments are intended to provide greater transparency around risk exposures of transactions when a financial asset is transferred and the transferor retains some level of continuing exposure in the asset. The amendments also require disclosures where transfers of financial assets are not evenly distributed throughout the period. It is not anticipated that these amendments to IFRS 7 will have a significant effect on the Company's disclosures as it is the Company's practice to settle transactions in cash. However, if the Company enters into other types of transfers of financial assets in the future, disclosure regarding those transfers may be affected.

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IFRS 9, *Financial Instruments* (IFRS 9), was issued by the IASB on November 12, 2009 and will replace IAS 39, *Financial Instruments: Recognition and Measurement*. IFRS 9 is effective for annual periods beginning on or after January 1, 2013. The Company is currently evaluating the impact of IFRS 9; however it is not expected to have a material effect on the consolidated financial statements of the Company.

On May 13, 2011, the IASB issued IFRS 10, *Consolidated Financial Statements* (IFRS10), IFRS 11, *Joint Arrangements* (IFRS 11) and IFRS 12, *Disclosure of Interests in Other Entities* (IFRS 12). IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 replaces IAS 27, *Consolidated and Separate Financial Statements* and SIC-12, *Consolidation – Special Purpose Entities*. IFRS 11 establishes principles for the financial reporting by parties to a joint arrangement. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures* and SIC-13, *Jointly Controlled Entities – Non-monetary Contributions by Venturers*. IFRS 12 combines, enhances and replaces the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities. As a consequence of these new standards, the IASB also issued amended and retitled IAS 27, *Separate Financial Statements* and IAS 28, *Investments in Associates and Joint Ventures*. The new requirements are effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. Management anticipates that these standards will be adopted in the Company's consolidated financial statements for the relevant period, however these standards are not expected to have a material effect on the consolidated financial statements of the Company.

In addition to the issuance of new standards as detailed above, there have also been amendments to existing standards, including IAS 1, *Presentation of Financial Statements* (IAS 1) and IAS 19, *Employee Benefits* (IAS 19). The amendments to IAS 1 will require that entities group items presented in other comprehensive income (OCI) based on an assessment of whether such items may, or may not, be reclassified to earnings at a subsequent date. Amendments to IAS 1 are applicable to annual periods beginning on or after July 1, 2012, with early adoption permitted. Amendments to IAS 19 eliminate an entity's option to defer the recognition of certain gains and losses related to postemployment benefits and require remeasurement of associated assets and liabilities in OCI. Amendments to IAS 19 are applicable on a modified retrospective basis to annual periods beginning on or after January 1, 2013, with early adoption permitted. Management anticipates that these amended standards will be adopted in the Company's consolidated financial statements for the relevant period, however these standards are not expected to have a material effect on the consolidated financial statements of the Company.

### **International Financial Reporting Standards**

Effective January 1, 2011 Canadian publicly listed entities were required to prepare their financial statements in accordance with IFRS. Due to the requirement to present comparative financial information, the effective transition date is January 1, 2010. The three months ended March 31, 2011 was the Company's first reporting period under IFRS.

The Company's IFRS conversion project is comprised of four phases: diagnostic assessment, evaluation and development, implementation and post implementation review. The IFRS conversion project is complete through the implementation phase. The post-implementation review phase will continue in future periods, as outlined below.

Note 4 to the Company's interim consolidated financial statements for the three months and six months ended June 30, 2010 provides more detail on the key differences between Canadian GAAP

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and IFRS, accounting policy decisions adopted by the Company, the application of IFRS 1 – *First time adoption of IFRS* to the Company for significant or potentially significant areas that have had an impact on the Company's financial statements on transition to IFRS or that may have an impact in future periods.

***Transitional Financial Impact***

The table below outlines the impact of adjustments to equity upon adoption of IFRS at September 30, 2010 and December 31, 2010 for comparative purposes.

	<u>December 31, 2010</u>	<u>September 30, 2010</u>
Equity as reported under Canadian GAAP	\$ 170,730	\$ 149,679
IFRS adjustments increase (decrease):		
Restatement of property, plant and equipment to reflect impact of IFRS requirements	(338)	(199)
Impact of IFRS conversion on long-term incentive compensation	(35)	-
Impact of recognizing deferred tax in accordance with IAS 12	(399)	228
Pro-rata allocation of IFRS adjustments to non-controlling interest	53	28
Reclassification of non-controlling interests	<u>82,028</u>	<u>82,847</u>
Total equity under IFRS	<u>\$ 252,039</u>	<u>\$ 232,583</u>

Additional disclosure of the IFRS conversion impact on prior period net income and statement of financial position is provided in Note 4 to the Company's financial statements.

***Cash Flow Impact***

The main IFRS transition adjustment that impacted the cash balance in 2010 was due to the accounting policy determination to reflect the Company's investment in the PCI Associates joint venture using the equity method, which resulted in the Company's proportionate share of PCI Associates' assets (including cash) and liabilities being reflected as investment in PCI Associates on the statement of financial position. The change did not have a material impact on cash balances. None of the other IFRS transition adjustments noted had significant impact on cash balances during 2010.

***Financial Statement Presentation Changes***

The transition to IFRS has resulted in numerous presentation changes in the financial statements.

The changes to our cash flow statement are outlined above. The following is a summary of the significant changes to our consolidated statement of comprehensive income:

- Revenue and expenses of the Company's investment in the PCI Associates joint venture have been reclassified into equity in earnings of joint venture.
- Expenses by function and nature – the consolidated statements of comprehensive income present expenses by nature with a separate expense line for employee benefits that had previously been

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reflected in operations and maintenance and general and administrative expenses. Depreciation and amortization expense has been adjusted to reflect the changes associated with componentization as required under IFRS.

- Interest expense – under IFRS, interest expense includes interest on debt, accretion expense for asset retirement costs and amortization of deferred financing fees. Accretion expense was previously included in general and administration expense.

- Income tax expense – has been adjusted to reflect the impact of additional IFRS depreciation expense due to componentization, capitalization of overhead related expenditures and the deferred tax impact to stock based compensation as required under IFRS. These changes and the corresponding tax impact serve to change the amount of income or loss reported under IFRS compared to Canadian GAAP for the respective period in 2010.

Other adjustments noted in the reconciliations are reclassifications within the statement of comprehensive income and do not impact net income/loss.

The changes to the statement of financial position primarily relate to the reclassification of the Company's share of PCI Associates' assets and liabilities into investment in joint venture and the reclassification of non controlling interest into equity.

***Control Activities***

For all changes to policies and procedures that have been identified, the effectiveness of internal controls over financial reporting and disclosure controls and procedures has been assessed and any changes have been implemented. In addition, controls over the IFRS changeover process have been implemented, as necessary. The required accounting process changes that resulted from the application of IFRS accounting policies were not significant. The design, implementation and documentation of the internal controls over accounting process changes resulting from the application of IFRS accounting policies has been completed. The existing control framework was applied to the IFRS changeover process. All accounting policy changes and transitional financial position impacts were subject to review by senior management and the Audit Committee of the Board of Directors.

***Business Activities and Key Performance Measures***

We have assessed the impact of the IFRS transition project on our financial covenants and key ratios in the Credit Facility. The transition did not impact our covenants as they are based on U.S. GAAP requirements and key ratios that have an equity component.

***Information Technology and Systems***

The IFRS transition project did not have a significant impact on our information systems for the convergence periods. We also do not expect significant changes in the post-convergence periods.

***Post-Implementation***

The post-implementation phase of the IFRS conversion project will involve continuous monitoring of changes in IFRS in future periods. It is noted that the standard-setting bodies that determine IFRS have significant ongoing projects that could impact the IFRS accounting policies that the Company selected. In particular, there may be additional new or revised IFRSs or IFRICs in relation to consolidation, joint ventures, financial instruments, hedge accounting, discontinued operations, leases, employee benefits and revenue recognition. Processes are in place to ensure that potential

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changes are monitored and evaluated. The impact of any new IFRSs and IFRIC interpretations will be evaluated as they are drafted and published.

**Internal Control over Financial Reporting**

The objective of the internal control over financial reporting designed by management is to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. Other than changes related to our IFRS transition plan, there have been no changes to the Company's internal control over financial reporting that have occurred during the nine months ended September 30, 2011, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Additional Information**

Additional information relating to the Company, including the unaudited interim consolidated financial statements for the three months and nine months ended September 30, 2011 and 2010 and the Company's most recent annual information form, is available on SEDAR at [www.sedar.com](http://www.sedar.com).