TRANSALTA CORP
Form 40-F
March 16, 2007

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 40-F**

[Check one]

o REGISTRATION STATEMENT PURSUANT TO SECTION 12 OF THE SECURITIES EXCHANGE ACT OF 1934

OR

x ANNUAL REPORT PURSUANT TO SECTION 13(a) OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006 Commission file number 001-15214

**TRANSALTA CORPORATION**

(Exact name of Registrant as specified in its charter)

**Not applicable**

(Translation of Registrant s name into English (if applicable))

**Canada**

(Province or other jurisdiction of incorporation or organization)

**4911**

(Primary Standard Industrial Classification Code Number (if applicable))

**Not Applicable**

(I.R.S Employer Identification Number (if applicable))

**110-12th Avenue S.W., Box 1900, Station M ,**

**Calgary, Alberta, Canada, T2P 2M1,**

**(403) 267-7110**

(Address and telephone number of Registrant s principal executive offices)

**CT Corporation System, 111 8th Avenue, 13th Floor,**

**New York, New York, 10011, (212) 894-8400**

(Name, address (including zip code) and telephone number (including area code)

of agent for service in the United States)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Shares, no par value | New York Stock Exchange |
| Common Share Purchase Rights | New York Stock Exchange |

Securities registered or to be registered pursuant to Section 12(g) of the Act:

**None**

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

**None**

(Title of Class)

For annual reports, indicate by check mark the information filed with this form:

**S** Annual information form **S** Audited annual financial statements

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report:

At December 31, 2006, 202,425,079 common shares were issued and outstanding.

Indicate by check mark whether the Registrant by filing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934 (the Exchange Act ). If Yes is marked, indicate the file number assigned to the Registrant in connection with such Rule.

Yes **o** 82-______ No **x**

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes **x** No **o**

**INCORPORATION BY REFERENCE**

The documents (or portions thereof) forming part of this Form 40-F are incorporated by reference into the following registration statements under the Securities Act of 1933, as amended.

| Form | Registration No. |
| --- | --- |
| S-8 | 333-72454 |
| S-8 | 333-101470 |
| F-10 | 333-87762 |

**CONSOLIDATED AUDITED ANNUAL FINANCIAL STATEMENTS**

**AND MANAGEMENT S DISCUSSION & ANALYSIS**

**A. Consolidated Audited Annual Financial Statements**

For consolidated audited annual financial statements, including the report of independent chartered accountants with respect thereto, see pages 64 through 101 of the TransAlta Corporation 2006 Annual Report to Shareholders included herein. See Exhibit 13.4 for the related supplementary note entitled United States Generally Accepted Accounting Principles for a reconciliation of the important differences between Canadian and United States generally accepted accounting principles.

**B. Management s Discussion & Analysis**

For management s discussion & analysis, see pages 31 through 63 of the TransAlta Corporation 2006 Annual Report to Shareholders included herein under the heading Management s Discussion & Analysis.

For the purposes of this Form 40-F, only pages 64 through 101 and 31 through 63 of the TransAlta Corporation 2006 Annual Report to Shareholders as referred to above shall be deemed incorporated herein by reference and filed, and the balance of such 2006 Annual Report, except as otherwise specifically incorporated by reference in the TransAlta Corporation Annual Information Form filed as Exhibit 13.1 hereto, shall not be deemed to be filed under the Exchange Act with the Securities and Exchange Commission as part of this Form 40-F.

**DISCLOSURE CONTROLS AND PROCEDURES**

TransAlta Corporation (the Company ) has designed disclosure controls and procedures to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to the Chief Executive Officer and Chief Financial Officer by others within the Company, including its consolidated subsidiaries, on a regular basis, and in particular during the period in which its Annual Report on Form 40-F relating to financial results for the fiscal year ended December 31, 2006 is being prepared. The Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded, as of that evaluation date, that the Company s disclosure controls and procedures were effective to ensure that material information relating to the Company, including its consolidated subsidiaries, was made known to them by others within those entities during the period in which this report was being prepared.

**MANAGEMENT S REPORT ON INTERNAL CONTROL**

**OVER FINANCIAL REPORTING**

Management is responsible for establishing and maintaining adequate internal control over financial reporting.

Internal control over financial reporting refers to a process designed by, or under the supervision of, our chief executive officer and chief financial officer and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and members of our board of directors; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our financial statements.

Management evaluated the effectiveness of our internal control over financial reporting as of December 31, 2006 using the framework set forth in the report of the Treadway Commission s Committee of Sponsoring Organizations (COSO), Internal Control Integrated Framework. Management has concluded that our internal control over financial reporting was effective as of December 31, 2006. Certain matters relating to the scope of Management s evaluation and limitations of management s conclusions are described below. See Limitations and Scope of Management s Report on Internal Control over Financial Reporting.

Our independent registered public accounting firm, Ernst & Young LLP, has issued an audit report on management s assessment of our internal control over financial reporting, expressing an unqualified opinion on management s assessment and expressing an opinion on the effectiveness of our internal control over financial reporting as of December 31, 2006. For Ernst & Young LLP s report see page 67 of the TransAlta Corporation 2006 Annual Report to Shareholders under the heading Independent Auditors Report on Internal Controls under Standards of the Public Company Accounting Oversight Board (United States) .

There has been no change in the internal control over financial reporting during the year covered by this report that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

**LIMITATIONS AND SCOPE OF MANAGEMENT S**

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process, and it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Management has not evaluated the internal controls of the Sheerness, CE Generation and Genesee 3 joint ventures (collectively, the Excluded Entities ), in accordance with Frequently Asked Question No. 1, Management s Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, of the Office of the Chief Accountant of the Division of Corporation Finance of the U.S. Securities and Exchange Commission (revised Oct. 6, 2004). Accordingly, management s evaluation ofthe Company s internal control over financial reporting did not include an evaluation of the internal controls of any of the Excluded Entities, and management s conclusion regarding the effectiveness of the Company s internal control over financial reporting does not extend to the internal controls of any of the Excluded Entities.

Proportionate consolidation of the Excluded Entities contributes to the Company s financial statements in the amount of $1,749.5 million of the Company s total assets, $839.8 million of net assets, $498.7 million of revenues and $96.6 million of operating income. The Company s financial statements include the accounts of the Excluded Entities, accounted for via proportionate consolidation, in accordance with EITF 00-1, but management has been unable to assess the effectiveness of internal control at the Excluded Entities because the Company does not have the ability to dictate or modify the controls of the Excluded Entities and does not have the ability, in practice, to assess those controls.

**AUDIT COMMITTEE FINANCIAL EXPERT**

The Registrant s board of directors has determined that it has at least one audit committee financial expert serving on its Audit and Risk Committee (the ARC ). Mr. William D. Anderson has been determined to be an audit committee financial expert, within the meaning of Section 407 of the United States Sarbanes-Oxley Act of 2002 ( Sarbanes-Oxley ), and is independent, as that term is defined by the New York Stock Exchange s ( NYSE ) listing standards applicable to the Registrant. Mr. Gordon S. Lackenbauer has also been determined to be an audit committee financial expert for purposes of Section 407 of Sarbanes-Oxley and independent under the applicable NYSE listing standards. Under Securities and Exchange Commission rules the designation of persons as audit committee financial experts does not make them experts for any other purpose, impose any duties, obligations or liability on them that are greater than those imposed on members of their committee and the board of directors who do not carry this designation or affect the duties, obligations or liability of any other member of their committee.

**CODE OF ETHICS**

The Registrant has adopted a code of ethics as part of its Corporate Code of Conduct that applies to all employees and officers which has been filed with the SEC. In addition, the Registrant has adopted a code of conduct applicable to all directors of the Company and a separate financial code of conduct which applies to all financial management employees. The Registrant s Corporate Codes of Conduct are available on its Internet website at www.transalta.com. There has been no waiver of the codes granted during the 2006 fiscal year.

**PRINCIPAL ACCOUNTANT FEES AND SERVICES**

For the years ended December 31, 2006 and 2005, Ernst & Young LLP and its affiliates were paid approximately $3,596,689 and $2,012,754, respectively, as detailed below:

| | Year-ended December 31 | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| Ernst & Young LLP | | | | |
| Audit Fees | $ | 3,286,212 | $ | 2,006,504 |
| Audit-Related Fees | $ | 300,892 | $ | |
| Tax Fees | $ | 9,585 | $ | 6,250 |
| All Other Fees | $ | | $ | |
| **Total** | **$** | **3,596,689** | **$** | **2,012,754** |

No other audit firms provided audit services in 2006 or 2005.

The nature of each category of fees is described below.

*Audit Fees*

Audit fees were paid for professional services rendered by the auditors for the audit of the Company s annual financial statements or services provided in connection with statutory and regulatory filings or engagements, including the translation from English into French of the Company s financial statements and other documents. Total audit fees paid include payments related to 2005 in the amount of

$2,092,000 and for 2006 in the amount of $1,194,000. The increase in audit fees is mainly attributable to additional work required for SOX certification.

*Audit-Related Fees*

The audit-related fees in 2006 were primarily for work performed by Ernst & Young LLP in relation to the Corporation s financings.

*Tax Fees*

The majority of tax fees for 2006 related to the finalization of tax credit recoveries for which work had commenced in prior years.

*Pre-Approval Policies and Procedures*

The ARC has considered whether the provision of services other than audit services is compatible with maintaining the auditors independence. The ARC has adopted a policy that prohibits the Company from engaging the auditors for prohibited categories of non-audit services and requires pre-approval of the ARC for other permissible categories of non-audit services, such categories as determined under Sarbanes-Oxley.

*Percentage of Services Approved by the ARC*

For the year ended December 31, 2006, none of the services described above were approved by the ARC pursuant to paragraph (c)(7)(i)(C) of Rule 2-01 of Regulation S-X.

**OFF-BALANCE SHEET ARRANGEMENTS**

See page 49 of Exhibit 13.2.

**TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS**

See page 86 of Exhibit 13.3 and pages 47 and 48, under the heading Financing Arrangements of Exhibit 13.2.

**IDENTIFICATION OF THE AUDIT COMMITTEE**

The Registrant has a separately-designated standing ARC. The members of the ARC are:

William D. Anderson (Chair)

Stanley J. Bright

Michael M. Kanovsky

Timothy W. Faithfull

Gordon S. Lackenbauer

Donna S. Kaufman (ex-officio member)

**FORWARD LOOKING INFORMATION**

This document, documents incorporated herein by reference, and other reports and filings made with the securities regulatory authorities, include forward-looking statements. All forward looking statements are based on TransAlta s beliefs as well as assumptions based on information available at the time the assumption was made. In some cases, forward-looking statements can be identified by terms such as may , will , believe, expect , potential , enable , continue or other comparable terminology. These statements are not guarantees of TransAlta s future performance an are subject to risks, uncertainties and other important factors that could cause TransAlta s actual performance to be materially different from those projected. Some of the risks, uncertainties, and factors include, but are not limited to electricity demand and electrical generation capacity, cost and availability of fuel necessary for the production of electricity, legislative and regulatory developments, competition, global capital markets activity, changes in prevailing interest rates, currency exchange rates, inflation levels and general economic conditions in geographic areas where TransAlta operates, results of financing efforts, changes in counterparty risk and the impact of accounting policies issued by Canadian and U.S. standard setters. Readers are cautioned not to place undue reliance on this forward-looking information, which is given as of the date hereof or otherwise, and TransAlta undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise.

**UNDERTAKING**

TransAlta Corporation undertakes to make available, in person or by telephone, representatives to respond to inquires made by the Commission staff, and to furnish promptly, when requested to do so by the Commission staff, information relating to: the securities registered pursuant to Form 40-F; the securities in relation to which the obligation to file an annual report on Form 40-F arises; or transactions in said securities.

**SIGNATURES**

Pursuant to the requirements of the Exchange Act, the Registrant certifies that it meets all of the requirements for filing on Form 40-F and has duly caused this annual report to be signed on its behalf by the undersigned, thereto duly authorized, in the City of Calgary, Province of Alberta, Canada.

**TRANSALTA CORPORATION**

By: /s/ Brian Burden
Brian Burden
Executive Vice-President and Chief
Financial Officer

Dated: March 15, 2007

**EXHIBITS**

| | |
|---|---|
| 13.1 | TransAlta Corporation Annual Information Form for the year ended December 31, 2006. |
| 13.2 | Consolidated Audited Financial Statements for the year ended December 31, 2006 (included on pages 67 through 101 of the 2006 TransAlta Annual Report to Shareholders). |
| 13.3 | Management s Discussion and Analysis (included on pages 31 through 63 of the 2006 TransAlta Annual Report to Shareholders). |
| 13.4 | U.S. GAAP reconciliation of the 2006 Consolidated Audited Financial Statements (included on pages 97 through 101 of the 2006 TransAlta Annual Report to Shareholders). |
| 23.1 | Consent of Ernst and Young LLP Chartered Accountants. |
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 and Section 404 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 and Section 404 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of President and Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

**EXHIBIT INDEX**

| | |
|---|---|
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| 32.1 | Certification of President and Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

**TRANSALTA CORPORATION**

**FOR THE YEAR ENDED DECEMBER 31, 2006**

**MARCH 14, 2007**

TABLE OF CONTENTS

## PRESENTATION OF INFORMATION

Unless otherwise noted, the information contained in this annual information form ( Annual Information Form ) is given at or for the year ended December 31, 2006. Amounts are expressed in Canadian dollars unless otherwise indicated. Financial information is presented in accordance with Canadian generally accepted accounting principles.

## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Information Form, the documents incorporated by reference in this Annual Information Form, and other reports and filings made with the securities regulatory authorities in Canada and the United States include forward-looking statements. All forward-looking statements are based on TransAlta Corporation s ( TransAlta or the Corporation ) beliefs and assumptions based on information available at the time the assumption was made. In some cases, forward-looking statements can be identified by terms such as may , will , believe , expect , potential , enable , continue or other comparable terminology. Forward-looking statements relate to, among other things, statements regarding the anticipated business prospects and financial performance of TransAlta. These statements are not guarantees of TransAlta s future performance and are subject to risks, uncertainties and other important factors that could cause TransAlta s actual performance to be materially different from those projected, including those material risks discussed in this Annual Information Form under the heading Risk Factors , and in TransAlta s Management s Discussion & Analysis of financial condition and results of operations ( MD&A ) for the year ended December 31, 2006 under the heading Risk Factors and Risk Management . The material assumptions in making these forward-looking statements are disclosed in the MD&A under Outlook , Risk Factors and Risk Management and Critical Accounting Policies and Statements , and in this Annual Information Form under Competitive Environment , and Competitive Strengths . Given these uncertainties, the reader should not place undue reliance on this forward-looking information, which is given as of the date it is expressed in this Annual Information Form or otherwise, and TransAlta undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise.

## MANAGEMENT S DISCUSSION AND ANALYSIS

TransAlta s MD&A for the year ended December 31, 2006 and TransAlta s Audited Consolidated Financial Statements for the year ended December 31, 2006 are hereby specifically incorporated by reference in this Annual Information Form. Copies of these documents are available on SEDAR at www.sedar.com.

## CORPORATE STRUCTURE

### Name and Incorporation

TransAlta was formed by Certificate of Amalgamation issued under the *Canada Business Corporations Act* on October 8, 1992. On December 31, 1992 a Certificate of Amendment was issued in connection with a plan of arrangement involving the Corporation and TransAlta Utilities Corporation ( TransAlta Utilities ) under the *Canada Business Corporations Act*. The plan of arrangement, which was approved by shareholders on November 26, 1992, resulted in common shareholders of TransAlta Utilities exchanging their common shares for shares of the Corporation on a one-for-one basis. Upon completion of the arrangement, TransAlta Utilities became a wholly-owned subsidiary of TransAlta.

The registered office and principal place of business of TransAlta are at 110 - 12th Avenue S.W., Calgary, Alberta, Canada, T2R 0G7.

The significant dates and events relating to TransAlta Utilities are set forth in TransAlta Utilities Annual Information Form for the year ended December 31, 2006, a copy of which is available on SEDAR at www.sedar.com.

**Intercorporate Relationships**

The principal subsidiaries of the Corporation and their respective jurisdictions of formation are set out below.

**Notes:**

(1) The limited partnership interests in TransAlta Power, L.P. ( TransAlta Power ) are held by the public, other than a 0.01 per cent interest held by TransAlta Power Ltd., the general partner of TransAlta Power.
(2) Indirectly held.

Unless the context otherwise requires, all references to the Corporation and to TransAlta herein refer to TransAlta Corporation and its subsidiaries, including TransAlta Utilities and TransAlta Energy Corporation ( TransAlta Energy ).

## OVERVIEW

TransAlta and its predecessors have been engaged in the production and sale of electric energy since 1911. The Corporation is among Canada s largest non-regulated electric generation and energy marketing companies with an aggregate net ownership interest of approximately 8,473 megawatts ( MW ) of electrical generating capacity[(1)] in facilities having approximately 10,181 MW of aggregate electrical generating capacity. The Corporation is focused on generating electricity in Canada, the United States, Mexico and Australia through its diversified portfolio of facilities fuelled by coal, gas, hydro, wind and geothermal resources. The following is a brief overview of the Corporation s principal facilities.

(1) TransAlta measures capacity as net maximum capacity (see glossary for definition of this and other key terms) which is consistent with industry standards. Capacity figures represent capacity owned and in operation unless otherwise stated.

In Canada, the Corporation holds a net ownership interest of approximately 5,579 MW of electrical generating capacity in coal-fired, gas-fired, wind-powered and hydroelectric facilities, including 4,882 MW in Alberta and 697 MW in Ontario.

In the United States, the Corporation s principal facilities include a 1,404 MW coal-fired facility and a 248 MW gas-fired facility, both located in Centralia, Washington, which supply electricity to the Pacific Northwest. The Corporation holds a 50 per cent interest in CE Generation, LLC ( CE Generation ), resulting in an aggregate net ownership interest of approximately 378 MW of geothermal and gas fired electrical generating capacity in facilities in California, Texas, Arizona and New York. The Corporation also has 53 MW of electrical generating capacity through gas-fired and hydroelectric facilities located in New York, Washington and Hawaii.

In Mexico, the Corporation owns two facilities with a combined capacity of 511 MW.

The Corporation also has 300 MW of net electrical generating capacity in Australia.

The Corporation is organized into two business segments: Generation and Corporate Development and Marketing. The Generation group is responsible for constructing, operating and maintaining power generation facilities. The Corporate Development and Marketing group is responsible for managing the sale of production, purchases of natural gas, transmission capacity and market risks associated with the Corporation s generation assets and for non-asset backed trading activities. Both segments are supported by a corporate group which includes finance, treasury, legal, human resources and other administrative functions. The corporate group is also responsible for the Corporation s sustainable development initiatives, including investments in renewable energy resources.

## GENERAL DEVELOPMENT OF THE BUSINESS

The significant events and conditions affecting TransAlta s business during the last three financial years are summarized below. Certain of these events and conditions are discussed in greater detail under the heading Business of TransAlta in this Annual Information Form.

### Recent Developments

On February 26, 2007, the Corporation and EPCOR Power Development Corporation ( EPCOR ) announced that they were proceeding with building the 450 MW Keephills 3 power project located approximately 70 kilometres west of Edmonton, Alberta. The capital cost for the project, including mine capital, is expected to be approximately $1.6 billion. Through the Keephills 3 Limited Partnership ( K3LP ), an affiliate of the Corporation, TransAlta and EPCOR will be equal partners in the ownership of Keephills 3, with EPCOR responsible for the construction. Upon completion, which is expected at the end of the first quarter in 2011, the Corporation will operate the facility and EPCOR and TransAlta will independently dispatch and market their share of the unit s electrical output. The project has received approval from the Alberta Energy and Utilities Board and Alberta Environment.

On January 19, 2007, the Corporation announced that it had been awarded a 25-year Power Purchase Agreement (  PPA  ) to provide 75 MW of wind power to New Brunswick Power Distribution and Customer Service Corporation.  Under the agreement, TransAlta will construct, own and operate a wind power facility in New Brunswick.  The capital cost of the project is estimated to be $130 million.  The project is subject to regulatory and environmental approvals and is expected to begin commercial operations by the end of 2008. Natural Forces Technologies Inc., an Atlantic Canada based wind developer is TransAlta  s co-development partner in this project.

On January 2, 2007, the Corporation redeemed, at par, all of its outstanding 7.75 per cent preferred securities, with an outstanding principal amount of $175 million.

**Year ended December 31, 2006**

On December 18, 2006, TransAlta Utilities assigned its rights in the development agreement it held with EPCOR, governing the joint development of the Keephills 3 power project, to K3LP. K3LP subsequently sold a 50% undivided interest in the Keephills 3 power project to the EPCOR Power Development (K3) Limited Partnership and has entered into a joint venture agreement governing the continued development of the Keephills 3 power project. In the event the Keephills 3 power project proceeds to operation, TransAlta Utilities will be the operator of the project pursuant to an operations and maintenance agreement and coal supply agreement respectively.

On November 27, 2006, TransAlta Corporation announced it would immediately stop mining operations at its Centralia, Washington coal mine. TransAlta also announced that it had entered into agreements to purchase and transport coal from the Powder River Basin to fuel TransAlta s Centralia coal-fired facility.

On November 17, 2006, TransAlta Utilities, a subsidiary of the Corporation, entered into a settlement agreement with the Canadian National Railway Company for a portion of outstanding claims for lost margin and incremental expenses relating to the train derailment and resulting oil spill into Lake Wabamun in 2005. The terms of the settlement are subject to a confidentiality agreement and cannot be disclosed.

On February 17, 2006, a subsidiary of TransAlta, together with a subsidiary of Mid-American Energy Company ( Mid-American ), entered into an agreement to purchase a 10 MW hydro facility in Hawaii to be held directly by the Wailuku Holding Company LLC, a company jointly and equally owned by TransAlta and Mid-American.

On February 15, 2006, TransAlta announced it had signed a five-year agreement with the Ontario Power Authority ( OPA ) for the supply of electricity from TransAlta s Sarnia Regional Cogeneration Power Plant. Under the terms of the agreement, Transalta will be available to supply an average of 400 MW of electricity to the Ontario electricity market. The supply contract is effective until December 31, 2010.

On February 1, 2006, TransAlta Utilities entered into a development agreement with EPCOR to jointly pursue the Keephills 3 power project. Keephills 3, formerly referred to as Centennial 1, is a proposed 450 MW facility adjacent to TransAlta s existing Keephills facility, approximately 70 kilometres west of Edmonton, Alberta.

**Year ended December 31, 2005**

On December 9, 2005, the Corporation announced that its wholly-owned subsidiary, TransAlta Energy Marketing (U.S.) Inc. had entered into an agreement for the sale of generation from the Corporation s Centralia generating facility for the period from January 1, 2007 to December 31, 2010. The agreement has a value of approximately US $450 million.

On September 12, 2005, the Corporation announced that its 279 MW Wabamun Unit 4 generating facility had resumed full operations on September 11, 2005 following the successful implementation of its return to service plan. TransAlta was forced to shut down the Wabamun facility on August 3, 2005 due to a train derailment and resulting oil spill into Lake Wabamun, Alberta. The Wabamun unit was on standby until an appropriate return to service plan was developed and reviewed with regulators and the Canadian National Railway Company. The Corporation estimates operating income was impacted by $15 to $18 million as a result of the Wabamun shutdown. The Corporation is seeking recovery for all losses.

On March 1, 2005, the Corporation announced the completion of the 450 MW Genesee 3 generating facility, a joint venture between the Corporation and EPCOR Utilities Inc. See Generation Business Segment Alberta - Coal-fired facilities .

On February 15, 2005, the Corporation redeemed, at par, all of its outstanding 7.5 per cent and 8.15 per cent preferred securities, with an outstanding principal amount of $175 million and $125 million, respectively.

On January 3, 2005, the Corporation announced that it had shut down and retired Units 1 (62 MW) and 2 (57 MW) of its Wabamun facility, effective December 31, 2004. See Generation Business Segment - Alberta - Coal-fired facilities .

**Year ended December 31, 2004**

On December 10, 2004, the Corporation announced that it had applied to the Alberta Energy and Utilities Board ( AEUB ) to amend its 900 MW Keephills (Centennial) permit to allow for the construction of a smaller 450 MW facility using improved technology. See Generation Business Segment Alberta Coal-fired facilities .

On December 3, 2004, the Corporation announced the sale by TransAlta Energy of an aggregate of 7.114 million limited partnership units of TransAlta Power at a net price of $9.00 per unit for net proceeds of $64.0 million. The units sold by TransAlta represented the remaining limited partnership units of TransAlta Power held by TransAlta Energy following the expiration on August 3, 2004 of the unit purchase warrants issued to the public on July 31, 2003 in connection with the acquisition by TransAlta Power of a 25 per cent interest in the Sheerness facility. TransAlta recorded a gain of $13.4 million after-tax ($0.07 per common share) as a result of the sale of the units.

On December 1, 2004, TransAlta announced the completion of the sale of its 50 per cent interest in the 220 MW gas-fired Meridian power plant to TransAlta Cogeneration, LP ( TA Cogen ), for $110 million. The purchase price for the Meridian facility was funded by TA Cogen through the issuance to each of TransAlta Power and TransAlta Energy of $30.0 million of limited partnership units of TA Cogen, the payment of $50.0 million in cash and the issue of a promissory note to TransAlta Energy for $30.0 million. The subscription by TransAlta Energy for limited partnership units of TA Cogen enabled the Corporation to retain its 50 per cent interest therein. TransAlta recorded an after-tax gain of approximately $11.5 million ($0.06 per common share) as a result of the sale. See TA Cogen and TransAlta Power .

On October 13, 2004, TransAlta announced the commencement of commercial operations of the $100 million 68 MW Summerview wind farm located approximately 200 kilometres southwest of Calgary, Alberta. The Summerview facility consists of 38 1.8 MW Vestas V80 wind turbines which brings TransAlta s total operated wind generation capacity to 187 MW, including approximately 150 MW of wind energy owned, all of which is operated through Vision Quest Windelectric. The Summerview wind farm is a merchant facility and TransAlta receives the Government of Canada s 10-year Wind Power Production Incentive ( WPPI ) on the output. See Generation Business Segment Alberta Wind Generation Facilities .

On October 5, 2004, TransAlta completed the acquisition of a dam, a 1 MW hydroelectric generating facility and related assets on the Skookumchuk River near Centralia, Washington, for approximately US $7.5 million. These facilities are used in connection with TransAlta s generation facilities at Centralia, Washington.

At December 31, 2004, TransAlta had a US $51.4 million receivable relating to energy sales in California. At December 31, 2000, TransAlta had made a provision of US $28.8 million to account for potential refund liabilities relating to those energy sales in California. On March 17, 2004, the California Independent System Operator released its preliminary adjusted prices indicating that TransAlta s refund liability was US $46.0 million. Based on those preliminary refund estimates, in the first quarter of 2004 TransAlta increased its provision for potential refund liabilities by US $17.2 million (Cdn. $22.9 million) to US $46.0 million. The final adjusted prices were released in October 2004 and were substantially the same as those released in March 2004. TransAlta has prepared a petition for relief from the refund obligation that may be filed once the U.S. Federal Energy Regulatory Commission provides stakeholders with a direction on the filing of such positions.

**BUSINESS OF TRANSALTA**

**Generation Business Segment**

The following table summarizes the Corporation s generation facilities which are operating, under construction or under development, as at December 31, 2006:

| Region | Facility | Capacity (MW) | Ownership (%) | Net Capacity Ownership Interest | Fuel | Revenue Source | Contract Expiry Date |
|---|---|---|---|---|---|---|---|
| **Canada** | Keephills | 766 | 100 | 766 | Coal | Alberta PPA | 2020 |
| **Alberta** | Sheerness | 770 | 25 | 193 | Coal | Alberta PPA | 2020 |
| **(25 facilities)** | Sundance (1) | 2,073 | 100 | 2,073 | Coal | Alberta PPA | 2017, 2020 |
| | Wabamun | 279 | 100 | 279 | Coal | Merchant | - |
| | Fort Saskatchewan | 118 | 30 | 35 | Gas | Long-term contract ( LTC ) | 2019 |
| | Meridian | 220 | 25 | 55 | Gas | LTC | 2024 |
| | Poplar Creek | 356 | 100 | 356 | Gas | LTC/Merchant(2) | 2024 |
| | Genesee 3 | 450 | 50 | 225 | Coal | Merchant | - |
| | Keephills 3 (3) | 450 | 50 | 225 | Coal | Merchant | - |
| | Hydro assets (4) | 801 | 100 | 801 | Hydro | Alberta PPA | 2013-2020 |
| | Summerview | 68 | 100 | 68 | Wind | Merchant | - |
| | Castle River (5) | 46 | 100 | 46 | Wind | LTC/Merchant | 2011 |
| | McBride Lake | 75 | 50 | 38 | Wind | LTC | 2022 |
| | **Total Alberta** | **6,472** | | **5,160** | | | |
| **Eastern** | Mississauga | 108 | 50 | 54 | Gas | LTC | 2017 |
| **Canada** | Ottawa | 68 | 50 | 34 | Gas | LTC | 2012 |
| **(5 facilities)** | Sarnia | 575 | 100 | 575 | Gas | LTC/Merchant(6) | 2022 |
| | Windsor | 68 | 50 | 34 | Gas | LTC/Merchant(7) | 2016 |
| | Kent Hills (3) | 75 | 100 | 75 | Wind | PPA | 2033 |
| | **Total Eastern Canada** | **894** | | **772** | | | |
| **United States** | Centralia, WA | 1,404 | 100 | 1,404 | Coal | Merchant | - |
| **(18 facilities)** | Centralia Gas (8) | 248 | 100 | 248 | Gas | Merchant | - |
| | Binghamton, NY | 47 | 100 | 47 | Gas | Merchant | - |
| | Skookumchuk, WA | 1 | 100 | 1 | Hydro | - | - |
| | Power Resources, TX | 200 | 50 | 100 | Gas | LTC | - |
| | Saranac, NY | 240 | 37.5 | 90 | Gas | LTC | 2009 |
| | Yuma, AZ | 50 | 50 | 25 | Gas | LTC | 2024 |
| | Imperial Valley Geothermal Facilities (9) | 327 | 50 | 163 | Geothermal | LTC /Merchant | 2016-2035 |
| | Wailuku | 10 | 50 | 5 | Hydro | LTC/PPA | 2023 |
| | **Total US** | **2,527** | | **2,083** | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Mexico** | Campeche | 252 | 100 | 252 | Gas/Diesel | LTC | 2028 |
| **(2 facilities)** | Chihuahua | 259 | 100 | 259 | Gas | LTC | 2028 |
| | **Total Mexico** | **511** | | **511** | | | |
| **Australia** | Parkeston | 110 | 50 | 55 | Gas | LTC | 2016 |
| **(5 facilities)** | Southern Cross (10) | 245 | 100 | 245 | Gas/Diesel | LTC | 2016 |
| | **Total Australia** | **355** | | **300** | | | |
| **Total** | | **10,759** | | **8,826** | | | |

**Notes:**

(1) 53 MW currently under development
(2) Approximately 200 MW of the total 356 MW are contracted under a LTC.
(3) These facilities are currently under development, (Keephills 3 formerly referred to as Centennial 1).
(4) Comprised of 13 facilities.
(5) Includes eight individual turbines at other locations, one of which moved from testing to production.
(6) Approximately 150 MW of the total 575 MW capacity are contracted under LTCs.
(7) Approximately 50 MW of the total 68 MW capacity are contracted under a LTC.
(8) Formerly referred to as Big Hanaford.
(9) Comprises 10 facilities.
(10) Comprises 4 facilities.

**Canada: Alberta**

*Coal-fired facilities*

The following table summarizes the Corporation s Alberta coal-fired generation facilities:

| Location | Plant | Capacity (MW) | Ownership (%) | Commissioning Dates |
|---|---|---|---|---|
| Wabamun (1) | Wabamun Unit No. 4 | 279 | 100 | 1968 |
| Sundance | Sundance Unit No. 1 | 280 | 100 | 1970 |
| | Sundance Unit No. 2 | 280 | 100 | 1973 |
| | Sundance Unit No. 3 | 353 | 100 | 1976 |
| | Sundance Unit No. 4 (2) | 406 | 100 | 1977 |
| | Sundance Unit No. 5 | 353 | 100 | 1978 |
| | Sundance Unit No. 6 | 401 | 100 | 1980 |
| Keephills | Keephills Unit No. 1 | 383 | 100 | 1983 |
| | Keephills Unit No. 2 | 383 | 100 | 1984 |
| | Keephills Unit No. 3 (3) | 450 | 50 | - |
| Sheerness | Sheerness Unit No. 1 | 385 | 25 | 1986 |
| | Sheerness Unit No. 2 | 385 | 25 | 1990 |
| Genesee | Genesee 3 | 450 | 50 | 2005 |
| **Total** | | **4,788** | | |

**Notes:**

(1) Wabamun unit 4 is expected to be removed from service upon the expiry of its license in 2010.
(2) 53 MW currently under development
(3) Facility under development.

The Keephills, Sundance and Wabamun facilities (the Alberta thermal plants ) are located approximately 70 kilometres west of Edmonton, Alberta. The Sheerness facility is located northeast of Calgary, Alberta and is jointly owned by TA Cogen and ATCO Power (2000) Ltd. ( ATCO Power ). The Genesee facility is located southwest of Edmonton and is jointly owned by the Corporation and EPCOR. The Corporation completed the sale of its 50 per cent interest in the Sheerness facility to TA Cogen on July 30, 2003. The Corporation s coal-fired plants are generally all base load plants, meaning that they are expected to operate for long periods of time at or near their rated capacity. Availability is an important measure of the economic success of a coal-fired plant. The weighted equivalent availability factor for the coal-fired Alberta thermal plants in 2006 was 88.7 per cent, compared with 87.6 per cent in 2005 and 86.5 per cent in 2004. For the Sheerness facility, the weighted equivalent availability factor was 92.2 percent in 2006 compared to 91.0 per cent in 2005 and 90.2 per cent in 2004. For the Genesee 3 facility, the weighted equivalent availability factor was 96.9 per cent in 2006 compared to 91.8 per cent in 2005.

Fuel requirements for TransAlta s coal-fired power facilities are supplied by surface strip coal mines located in close proximity to the facilities. TransAlta owns two surface mines in Alberta that supply coal to its Wabamun, Sundance and Keephills facilities. The Whitewood mine supplies the Wabamun plant and the Highvale mine supplies the Sundance and Keephills facilities. TransAlta estimates that the recoverable coal reserves contained in these mines are sufficient to supply the anticipated requirements for the life of these facilities including potential life extension and plant expansion.

Coal for the Sheerness facility is provided from the adjacent Sheerness mine. The coal reserves of the mine are owned, leased or controlled jointly by TA Cogen, ATCO Power and Prairie Mines & Royalties Limited ( PMRL ). TA Cogen and ATCO Power have entered into coal supply agreements with PMRL, which operates the mine, to supply coal until 2026.

Coal for the Genesee 3 facility is provided from the adjacent Genesee mine. The coal reserves of the mine are owned, leased or controlled jointly by PMRL and EPCOR. The Corporation has entered into coal supply agreements with PMRL, which operates the mine, to supply coal for the life of the facility.

In February 2001, the Corporation announced a proposal for a 900 MW expansion at its Keephills facility. In February 2002, the Corporation received regulatory approval to proceed with the expansion, which contemplated the facilities being operational in 2003. In January 2003, the Corporation announced that it had granted to EPCOR an option, exercisable until December 31, 2005, to purchase a 50 per cent interest in the Corporation s Keephills 3 project (formerly referred to as Centennial 1) at a price of 50 per cent of expenditures to the date of the option exercise, plus 50 per cent of future project development costs. On December 10, 2004, the Corporation applied to the AEUB to amend its 900 MW permit to allow for the construction of a smaller 450 MW facility using improved technology.

On February 1, 2006, the Corporation entered into a development agreement with EPCOR to jointly pursue the Keephills 3 power project. On December 18, 2006, the Corporation assigned its rights in the development agreement it held with EPCOR governing the joint development of the Keephills 3 power project to K3LP. K3LP subsequently sold a 50% undivided interest in the Keephills 3 power project to the EPCOR Power Development (K3) Limited Partnership and has entered into a joint venture agreement governing the continued development of the Keephills 3 power project.

On February 26, 2007, the Corporation and EPCOR announced they were proceeding with building the net 450 MW Keephills 3 power project. The capital cost for the project, including mine capital, is expected to be approximately $1.6 billion. Through K3LP, TransAlta and EPCOR will be equal partners in the ownership of Keephills 3, with EPCOR responsible for construction. Upon completion, which is expected at the end of the first quarter in 2011, TransAlta will operate the facility and EPCOR and TransAlta will independently dispatch and market their share of the unit s electrical output. Through a subsidiary, the Corporation will also provide coal to the facility through the Highvale mine. The project has received approval from the Alberta Energy and Utilities Board and Alberta Environment.

*Gas-fired Facilities*

The following table summarizes the Corporation s Saskatchewan and Alberta gas-fired generation facilities:

| **Location** | **Plant** | **Capacity (MW)** | **Ownership (%)** | **Commissioning Dates** |
|---|---|---|---|---|
| Lloydminster, SK | Meridian | 220 | 25 | 1999 |
| Fort McMurray, AB | Poplar Creek | 356 | 100 | 2001 |
| Fort Saskatchewan, AB | Fort Saskatchewan | 118 | 30 | 1999 |
| **Total** | | **694** | | |

The Meridian plant sells electricity to Saskatchewan Power Corporation, a crown corporation owned by the Province of Saskatchewan, and steam to a heavy oil upgrader in Lloydminster, Saskatchewan. The Corporation completed the sale of its 50 per cent interest in the Meridian facility to TA Cogen on December 1, 2004. The remaining 50 per cent interest in the Meridian facility is held by Husky Oil Operations Limited.

The Poplar Creek plant provides electricity and steam to Suncor Energy Inc. s oil sands project. This 356 MW cogeneration plant became fully operational in the first quarter of 2001 and delivers approximately 200 MW of electricity and steam to Suncor Energy Inc. ( Suncor ). Any surplus power not used by Suncor is available for sale by the Corporation to other parties, in which case Suncor is entitled to a share of that revenue, under certain conditions.

The Corporation also holds an indirect interest in the 118 MW Fort Saskatchewan gas-fired combined cycle cogeneration plant in Alberta, which provides electricity and steam to Dow Chemical Canada Inc.

The Corporation s interests in the Meridian and Fort Saskatchewan facilities are held through TA Cogen. See TA Cogen and TransAlta Power .

*Hydroelectric facilities*

The following table summarizes the Corporation s 100% ownership in Alberta hydroelectric facilities:

| Location | Plant | Capacity (MW) | Commissioning Dates |
|---|---|---|---|
| Bow River System | Horseshoe | 14 | 1911 |
| | Kananaskis | 19 | 1913, 1951 |
| | Ghost | 51 | 1929, 1954 |
| | Cascade | 36 | 1942, 1957 |
| | Barrier | 13 | 1947 |
| | Bearspaw | 17 | 1953, 1954 |
| | Pocaterra | 15 | 1955 |
| | Interlakes | 5 | 1955 |
| | Spray | 103 | 1951, 1960 |
| | Three Sisters | 3 | 1951 |
| | Rundle | 50 | 1951, 1960 |
| North Saskatchewan River System | Brazeau | 355 | 1965, 1967 |
| | Bighorn | 120 | 1972 |
| **Total** | | **801** | |

The Corporation s hydroelectric facilities are primarily peaking plants, meaning they are generally only operated during times of peak demand.

*Wind Generation Facilities*

The following table summarizes the Corporation s wind generation facilities:

| Location | Plant | Capacity (MW) | Ownership (%) | Commissioning Dates |
|---|---|---|---|---|
| Fort Macleod | McBride Lake | 75 | 50 | 2003 |
| Pincher Creek | Castle River and Other | 46 | 100 | 1997 2001 |
| Pincher Creek | Summerview | 68 | 100 | 2004 |
| New Brunswick (1) | Kent Hills | 75 | 100 | 2008 |
| **Total** | | **264** | | |

**Note:**

(1) Facility under development, reflects expected capacity and commissioning date.

The Corporation owns and operates approximately 152 MW of net capacity (excluding facilities under development) and operates approximately 189 MW of capacity primarily in three wind farms in Southwestern Alberta.

Castle River is a 40 MW facility comprised of 59 Vestas V47 (660 kW) turbines and 1 Vestas V44 (600 kW) turbine located at Pincher Creek, Alberta. The facility is 71 per cent contracted primarily to ENMAX Energy Corp. and is the sole Green Energy® provider to the City of Calgary s Ride the Wind Light Rail Transit program. The Corporation also owns and operates eight additional turbines totalling 6 MW primarily located in the Pincher Creek and Waterton areas of Southwestern Alberta.

McBride Lake, one of Canada s largest wind generation facilities, is a 75 MW facility comprised of 114 Vestas V47 (660 kW) turbines located at Fort Macleod, Alberta. It was constructed by the Corporation and was completed and producing power in the third quarter of 2003. McBride Lake is operated by the Corporation and is jointly owned with ENMAX Green Power Inc., with each partner owning a 50 per cent interest. The output from the facility is 100 per cent contracted in the form of a 20-year PPA with Enmax. The Corporation is also entitled to receive WPPI payments from the Federal Government at $12/MWh in respect of the McBride Lake facility until 2013.

On October 13, 2004, TransAlta announced the commencement of commercial operations at its $100 million Summerview 68 MW wind farm located approximately 15 kilometres northeast of Pincher Creek, Alberta. The Summerview facility, comprised of 38 1.8 MW turbines, brought the total owned wind generation capacity to approximately 152 MW and total operated capacity to approximately 189 MW. The Summerview wind farm is a merchant facility but is entitled to receive WPPI payments from the Federal Government at $10/MWh until 2014.

On January 19, 2007 the Corporation announced that it had been awarded a 25-year PPA to deliver 75 MWs of wind power to New Brunswick Power Distribution and Customer Service Corporation. Under the agreement, TransAlta will construct, own and operate a wind power facility in New Brunswick. The capital cost of the project is estimated to be $130 million. The project is subject to regulatory and environmental approvals and is expected to begin commercial operations by the end of 2008. Natural Forces Technologies Inc., an Atlantic Canada based wind developer is TransAlta s co-development partner in this project. The single-site, 25-turbine wind farm will be located in the Kent Hills area of New Brunswick. TransAlta expects construction to commence by early 2008. TransAlta will work with local firms for the construction and ongoing operation of the Kent Hills wind farm providing long-term economic benefits to the region. Once complete, the Kent Hills wind farm will provide an estimated 220,000 MWh per year, enough electricity to meet the needs of approximately 13,600 homes. The facility will use 3.0 MW wind turbines purchased from Vestas-Canada Wind Technology Inc.

All of the power generated and sold by the Corporation s wind division is from generation facilities that are EcoLogo-certified. The Corporation is an EcoLogo-certified distributor of Alternative Source Electricity through Environment Canada s Environmental Choice program. EcoLogo certification is granted to products with environmental performance that meet or exceed all government, industrial safety and performance standards. The Corporation s wind facilities constructed after April 2001, also qualify for the Green E and Green Leaf certifications.

*Alberta PPAs*

All of the Corporation s Alberta coal-fired and hydroelectric facilities, other than the Wabamun and Genesee 3 facilities, operate under Alberta PPAs. The PPA for the Wabamun plant expired on December 31, 2003. The Alberta PPAs establish committed capacity and electrical energy generation requirements and availability targets to be achieved by each coal-fired plant, energy and ancillary services obligations for the hydroelectric plants, and the price at which power is to be supplied. The Corporation bears the risk or retains the benefit of volume variances (except for those arising from events considered to be *force majeure*, in the case of the coal-fired plants) and any change in costs required to maintain and operate the facilities.

Under the Alberta PPAs, for the formerly regulated coal-fired facilities, the Corporation is exposed to electricity price risk if production declines below contracted levels (other than as a result of outages caused by an event of *force majeure*). In such circumstances, the Corporation must pay a penalty for the lost production based upon a price equal to the 30-day trailing average of Alberta s market electricity prices. This trailing average provision attempts to mitigate price spikes that can occur as a result of sudden outages. The Corporation attempts to further mitigate this exposure by maintaining contracted and uncontracted capacity in the market, through operating and maintenance practices, and through hedging activities.

The Corporation s hydroelectric facilities are not contracted on a facility-by-facility basis; rather, facilities are aggregated in a single Alberta PPA which provides for financial obligations for energy and ancillary services obligations based on hourly targets. These targeted amounts are met by the Corporation through physical delivery or third party purchases.

The Corporation s compensation under the Alberta PPAs is based on a pricing formula which replaced the cost of service regime which applied previously under utility regulation. Key elements of the pricing formula are the amount of common equity deemed to form part of the capital structure, the amount of risk premium attributable to deemed common equity and a recovery of fixed and variable costs. Common equity is deemed to be 45 per cent of total capital and the return on equity is set annually at a 4.5 per cent premium over the rate on a 10-year Government of Canada Bond.

The pricing formula includes a provision for site restoration costs of the coal-fired generating plants. Restoration and reclamation costs incurred in excess of those previously recovered through the pricing formula may also be recovered, upon successful application to the AEUB. The Alberta PPAs do not provide compensation for site restoration costs related to the Corporation s hydroelectric facilities. The Corporation does not anticipate that its hydroelectric structures will be dismantled because of the water supply, irrigation, flood control and recreation related purposes they serve. Provisions have been made for the removal of the hydroelectric generating equipment.

The expiry dates for the Corporation s Alberta PPAs, range from 2013 to 2020. With the expiry of the PPA at the Wabamun facility, the Corporation procured an extension of the license to operate Unit four of the Wabamun facility until March 31, 2010. The Corporation holds various licenses from Alberta Environment and the AEUB to operate its other facilities. The Corporation intends to procure extensions of the licenses for the other facilities upon the expiry of each respective Alberta PPA. Upon the expiry of the Alberta PPAs and subject to procuring extension of the licenses, the Corporation will then be able to sell its power output to the Alberta Power Pool and to third party purchasers through direct sales agreements. The Corporation is currently selling all of the power output from the Wabamun facility under such direct sales agreements.

The Alberta PPAs (together with legislation which applies thereto) permit the Balancing Pool, an entity established by the Government of Alberta, directly or indirectly as successor to the power purchaser under the Alberta PPAs, to terminate the Alberta PPAs in certain circumstances. These termination provisions are similar to those found in some PPAs entered into by government-related power purchasers. The Corporation will be entitled to receive a lump sum payment in connection with any such termination, other than a termination resulting from the Corporation s default and will thereafter be able to sell the output from any affected facilities for its own account.

**Canada: Ontario**

The Corporation s Ontario generating facilities are summarized in the following table:

| Location | Plant | Capacity (MW) | Ownership (%) | Commissioning Dates |
|---|---|---|---|---|
| Sarnia | Sarnia | 575 | 100 | 2003 |
| Ottawa | Ottawa | 68 | 50 | 1992 |
| Mississauga | Mississauga | 108 | 50 | 1992 |
| Windsor | Windsor | 68 | 50 | 1996 |
| **Total** | | **819** | | |

The Sarnia facility is comprised of a 440 MW facility which commenced commercial operations in March, 2003 and an additional 135 MW of electric generation capacity acquired by the Corporation in 2002. The combined 575 MW facility provides steam and electricity to nearby facilities owned by Dow Chemical Canada Inc., Lanxess (formerly Bayer Inc.), Nova Chemicals (Canada) Ltd. and Suncor Energy Products Inc. Approximately 150 MW of Sarnia s capacity is currently contracted under long term contracts. On February 15, 2006, TransAlta announced that it had signed a five-year agreement with the OPA for production at its Sarnia facility. Under the terms of the contract, TransAlta will be available to supply an average of 400 MW of electricity to the Ontario electricity market. The supply contract is effective until December 31, 2010.

The Ottawa plant is a combined cycle cogeneration facility designed to produce 68 MW of electrical energy. This capacity is sold under a long-term contract with the Ontario Electricity Financial Corporation ( OEFC ), an agency of the Province of Ontario. This agreement expires in 2012. The Ottawa plant also provides thermal energy to the member hospitals and treatment centers of the Ottawa Health Sciences Centre, National Defence Medical Centre and the Perley and Rideau Veterans Health Centre.

The Mississauga plant is a combined cycle cogeneration facility designed to produce 108 MW of electrical energy.  This capacity is contracted under a long-term contract with the OEFC which expires in 2017.  The Mississauga Plant provided cogeneration services to Boeing Canada Inc. (  Boeing  ) until July 2005 at which time Boeing exercised its right under the cogeneration services agreement to no longer take and pay for cogeneration services due to the recent closure of its manufacturing facility.  Boeing remains entitled to any steam credit based on the total plant electricity generation revenue.  On or prior to each of January 1, 2013, 2018 and 2023, Boeing may give notice to purchase the Mississauga Plant at fair market value.  On January 1, 2028, all provisions under the cogeneration services agreement will terminate and Boeing will have the option at that time to either require the removal of the Mississauga Plant from the leased lands or purchase the Mississauga Plant at its net salvage value.

The Windsor plant is a combined cycle cogeneration facility designed to produce 68 MW of electrical energy. Currently, 50 MW of the capacity is sold under a long-term contract to the OEFC. This agreement expires in 2016. The Windsor plant also provides thermal energy to DaimlerChrysler Canada Ltd. s minivan assembly facility in Windsor. In 2003, an agreement was reached with the OEFC to sell the remaining 18 MW to the Ontario power market when it is economic to do so.

The Corporation s interests in the Mississauga, Ottawa and Windsor facilities in Ontario are held through TA Cogen. See TA Cogen and TransAlta Power .

**United States**

The Corporation s generation facilities in the United States are summarized in the following table:

| **Location** | **Plant** | **Capacity (MW)** | **Ownership (%)** | **Commissioning Dates** |
|---|---|---|---|---|
| Washington | Centralia Coal No. 1 | 702 | 100 | 1971 |
| | Centralia Coal No. 2 | 702 | 100 | 1971 |
| | Centralia Gas | 248 | 100 | 2002 |
| | Skookumchuk | 1 | 100 | 1970 |
| New York | Binghamton | 47 | 100 | 1992 |
| | Saranac | 240 | 37.5 | 1994 |
| California | Vulcan | 34 | 50 | 1986 |
| | Del Ranch | 38 | 50 | 1989 |
| | Elmore | 38 | 50 | 1989 |
| | Leathers | 38 | 50 | 1990 |
| | CE Turbo | 10 | 50 | 2000 |
| | Salton Sea I | 10 | 50 | 1987 |
| | Salton Sea II | 20 | 50 | 1990 |
| | Salton Sea III | 50 | 50 | 1989 |
| | Salton Sea IV | 40 | | 1996 |
| | Salton Sea V | 49 | 50 | 2000 |
| Texas | Power Resources | 200 | 50 | 1988 |
| Arizona | Yuma | 50 | 50 | 1994 |
| Hawaii | Wailuku | 10 | 50 | 1993 |
| **Total** | | **2,527** | | |

*Centralia*

The Corporation owns a two-unit 1,404 MW coal-fired facility, an adjacent coal mine and a 248 MW gas-fired facility in Centralia, Washington, located south of Seattle. On November 27, 2006, the Corporation stopped all mining operations at the Centralia coal mine. The Corporation also owns a 1 MW hydro-electric generating facility and related assets on the Skookumchuk River near Centralia, which facilities are used to provide reliable water supply to TransAlta s other generation facilities at Centralia.

The Corporation has entered into a number of medium to long-term energy sales agreements from the Centralia facility. The Corporation also sells power from the Centralia facility into the Western Electricity Coordinating Council and, in particular, the U.S. Pacific Northwest energy market, on the spot market. The Corporation s strategy is to balance contracted and non-contracted sales of electricity to manage production and price risk.

*The Corporation stopped mining operations at its Centralia coal mine on November 27, 2006. Prior to that date, the Centralia mine produced approximately five to six million tons of coal annually, or approximately 70 to 85 per cent of the Centralia plant s annual coal requirements. Although the Corporation estimates that certain coal reserves remain to be extracted, the Corporation has not yet received permits for or developed the new area from which this coal could be produced. The Corporation has entered into contracts to purchase and transport coal from the Powder River Basin in Montana and Wyoming to fuel its facility until it is economic to pursue the extraction of coal at its Centralia mine.*

*Binghamton*

The Corporation owns a 47 MW gas-fired peaking facility in Binghamton, New York. This facility was commissioned in 1992 and is located near the Pennsylvania and New York State border. The Binghamton facility provides electricity to the New York Power Pool during periods of high demand.

*CE Generation*

On January 29, 2003, TransAlta announced the completion of the acquisition from El Paso of a 50 per cent interest in CE Generation, for total consideration of approximately US $240 million, which included approximately US $35 million for working capital.  The CE Generation acquisition included the right to a 50 per cent interest in a geothermal project in the Imperial Valley, California. If TransAlta elects to retain an economic interest and participate in a future phase of this project, Salton Sea VI, TransAlta is required to pay to El Paso certain milestone payments of up to US $10 million.

CE Generation, through its subsidiaries, is primarily engaged in the development, ownership and operation of independent power production facilities in the United States using geothermal and natural gas resources.  CE Generation holds a net ownership interest of approximately 378 MW in 13 facilities, having an aggregate operating capacity of 817 MW, including 327 MW of geothermal generation in California and 490 MW of gas-fired cogeneration in New York, Texas and Arizona.

CE Generation affiliates currently operate 10 geothermal facilities in Imperial Valley, California.  Each of the geothermal facilities, excluding CE Turbo and Salton Sea V, sells electricity pursuant to independent, long-term contracts which provide for energy payments, capacity payments and capacity bonus payments.  Salton Sea V is currently a merchant facility; however, it has a PPA to sell approximately 20 MW of its net output.  The balance of available capacity from Salton Sea V and CE Turbo is sold through market transactions.

CE Generation affiliates currently operate three natural gas-fired facilities in Texas, Arizona and New York State, having an aggregate generation capacity of 490 MW.  The New York and Arizona facilities sell their output pursuant to long term contracts while the Texas facility has contracted a tolling agreement for capacity.

*Wailuku*

On February 17, 2006, a subsidiary of TransAlta, together with a subsidiary of Mid-American entered into an arrangement to purchase a 10 MW hydro facility in Hawaii to be held directly by the Wailuku Holding Company LLC, each of TransAlta and Mid American hold a 50 per cent interest in the facility.  The facility sells electricity pursuant to the terms of a 30 year PPA with the Hawaii Electricity Light Company.

**Mexico**

*Campeche*

In May 2003, the Corporation announced the commencement of commercial operations at its 252 MW combined cycle gas/diesel fuelled facility located in the Mexican state of Campeche in the Yucatan Peninsula. The Corporation and Mexico s state owned Comisión Federal de Electricidad ( CFE ) have entered into a 25 year long term contract for all of the output of this plant, commencing on the date commercial operations began. The Corporation has also entered into a related gas transportation agreement with CFE. In addition to the long term contract and gas transportation agreement, the Corporation has entered into a corresponding 25 year fuel supply agreement with Pemex Gas y Petro Quimica Basica. CFE bears the price risk on fuel up to the guaranteed heat rate under the long term contract.

*Chihuahua*

In September 2003, the Corporation announced the commencement of commercial operations at its 259 MW Chihuahua combined-cycle gas-fired facility located near Ciudad de Juarez, Mexico, located approximately 40 kilometres south of the United States/Mexico border. The Corporation has entered into a 25 year long-term contract with CFE for all of the output of this plant, commencing on the date commercial operations began. The Corporation has also entered into a related 25 year gas transportation agreement with CFE and a 5 year gas supply contract with Cynergy Marketing and Trading, LP. CFE bears the price risk on fuel up to the guaranteed heat rate under the long term contract.

**Australia**

The Corporation holds interests in Western Australia consisting of the 110 MW Parkeston generation facility through a 50/50 joint venture with NP Kalgoorlie Pty Ltd, a subsidiary of Newmount Australia Limited, and the 245 MW Southern Cross gas and diesel generation facilities. In 2005, Southern Cross installed a 20 MW gas turbine, which was commissioned effective January 6, 2006, resulting in additional capacity at this facility of 20 MW from the previous year.

**TA Cogen and TransAlta Power**

The Corporation s interest in the 220 MW Meridian gas-fired generation facility in Saskatchewan, the 770 MW Sheerness coal-fired generation facility, the 118 MW Fort Saskatchewan gas-fired cogeneration facility in Alberta, and the Mississauga, Ottawa and Windsor-Essex facilities in Ontario, are held through TA Cogen, an Ontario limited partnership owned 50.01 per cent by subsidiaries of TransAlta and 49.99 per cent by TransAlta Power, a publicly held Ontario limited partnership. The Corporation formed TA Cogen in 1998 to directly or indirectly hold interests in generation facilities capable of producing stable cash flows that would be distributed to TransAlta Power s unitholders. The partnership units of TransAlta Power are publicly traded on the Toronto Stock Exchange.

**Corporate Development and Marketing Segment**

The Corporate Development and Marketing group provides a number of strategic functions to the Corporation, including the following:

Gathering and assessing market intelligence, enabling management to more effectively engage in strategic planning and decision-making for the Corporation. This includes identifying and ranking markets which are the most attractive to enter, developing strategies and plans to effectively compete in each market where the Corporation operates, and identifying specific opportunities to develop or acquire assets that will capture value or mitigate risks in the electric generation business;

Negotiating and entering into contractual agreements with customers for the sale of output from the Corporation s generating assets, including electricity, steam or other energy related commodities;

Scheduling physical deliveries of natural gas supplies used to generate electricity and the electrical generation outputs from each asset to meet contractual obligations while managing the physical and financial risks associated with the generation and transmission of electrical energy, including during those periods of unplanned outages;

Increasing the value of electricity output and fuel inputs from each generating asset through a variety of regional portfolio optimization strategies in both the current year and over the long term; and

Recommending optimum maintenance schedules and operating levels according to current and anticipated market conditions that will maximize earnings from each of the generation assets.

Beyond these functions, the Corporate Development and Marketing group derives additional revenue and earnings from the wholesale trading of electricity and other energy related commodities and derivatives.

The group seeks to manage and limit risk exposures from both financial and physical positions, as well as counterparty risks. The key risk control activities of the Corporate Development and Marketing group, in conjunction with other functions of the Corporation, include credit review approval and reporting, risk measurement monitoring and reporting, validation of transactions, and trading portfolio valuation monitoring and reporting.

The Corporation uses mark-to-market valuation and the application of a value at risk ( VAR ) determination for risk control practices for its trading portfolios. This approach is a measure of assessing the potential trading losses that the Corporation could experience over a given time, due to fluctuations in energy prices in each market. The Corporation s policy is to actively manage and limit the group s aggregate VAR exposure within board approved limits.

**Competitive Environment**

As the largest generator of electricity in Alberta, measured by capacity, and with generation assets in Ontario, the U.S. Pacific Northwest, California, Arizona, Texas and New York, Mexico and Australia, the Corporation believes it is well-positioned to capitalize on opportunities in these regions. Alberta is Canada s fourth largest province by population with approximately 3.2 million residents representing approximately 10 per cent of Canada s total population. Alberta consumed approximately 69,400 GWh of electricity in 2006. As at December 31, 2006, the aggregate installed capacity of generating facilities in Alberta was approximately 11,500 MW.

Ontario is Canada s largest province with approximately 12.5 million residents representing approximately 39 per cent of Canada s total population. Ontario consumed approximately 151,000 GWh of electricity in 2006. Ontario Power Generation Inc., the successor to the generation business of Ontario s former integrated electric utility, controls over two-thirds of Ontario s approximately 30,600 MW of installed capacity, the balance of which is owned by municipal electric utilities and private independent power producers or industrial consumers.

Electrical utilities in the U.S. Pacific Northwest are organized into the Western Electricity Coordinating Council ( WECC ). The WECC is the largest geographically of the 10 regions in the North American Electric Reliability Council and is divided into four sub-regions, of which Region 1 includes British Columbia, Alberta, Washington, Oregon, Idaho, Montana, Utah, western Wyoming and northern Nevada. This sub-region is referred to as the Northwest Power Pool ( NWPP ). The WECC estimates that approximately 423,900 GWh of electricity was consumed in the NWPP in 2006. The WECC also reported an estimated aggregate electrical generating capacity of approximately 83,800 MW in the NWPP for the year ending 2006.

The Corporation expects that the demand for electricity will continue to grow in its target markets. In addition to increased demand, the market for electricity in some of these regions has undergone deregulation. Legislation in Alberta and Ontario and many states in the United States mandated the unbundling of generation, transmission and distribution services traditionally provided by vertically integrated utilities to promote competition in the market for generation, which caused some integrated utilities to sell all or parts of their generation assets. While the pace of this process has changed, the Corporation believes that the combination of increased demand for electricity, deregulation and the increased availability of generation assets may provide it with an opportunity to increase its generation capacity and leverage its Corporate Development and Marketing capabilities, provided that in doing so, the financial position of the Corporation is not compromised.

The Corporation believes that the demand for electricity in Mexico will continue to grow in the next several years due to increased commercial and residential consumption. For the period 2006 to 2016, the CFE is projecting a growth in demand for electricity of 4.8 per cent per year. It is expected that independent power plants will contribute up to 30 per cent of the installed capacity and contribute approximately 40 per cent of the total energy produced. At the end of December 2006, the national electrical system had approximately 49,200 MWs. The system is expected to have approximately 69,000 MWs by the end of December 2016. As a result, the CFE has indicated that it is planning to offer for tender the construction of more independent power plants that may be similar to the Corporation s plants in Campeche and Chihuahua. Over the next 10 years increased fuel diversity will be sought with natural gas fuelled generating stations making up no more than 55% of the installed capacity by 2016.

Although significant hydro capacity exists in Mexico, the bulk of generation is currently oil fired and gas fired. Demand requirements are affected to a large degree by the differential in gas prices relative to oil prices. Demand tends to be lower in Northern Mexico in the colder months of December and January and further reduced during the period from December 15 to

January 2, as several assembly plants shutdown or limit shifts for the holiday period. The demand for electricity produced at the Campeche facility is relatively stable due to transmission constraints in the area.

Several factors influence power demand in Mexico ranging from fuel prices, plant major maintenance in the CFE fleet and IPP s fleet, to the recently commissioned plants during the previous year, as well as the geographical location of power plants and various efficiencies and availabilities.

Australia is heavily dependent on coal for electricity, more so than any other developed country except Denmark and Greece. About 80% of power produced is derived from coal. Australia s electricity is low-cost by world standards. Natural gas is increasingly used for electricity, especially in South Australia and Western Australia. In 2006, Australia s power stations produced 255,000 (GWh) of electricity growing at 3.2% pa. The reform of the Australian electricity industry commenced in the early 1990s. Separate commercial structures have been developed for the monopoly transmission and distribution ( wires ) functions and the competitive generation and retailing functions of the industry. The major reform in the Australian electricity industry involved the establishment in southern and eastern Australia of the National Electricity Market (NEM). The NEM operates in the States of New South Wales, Victoria, Queensland, South Australia and Tasmania and in the Australian Capital Territory.

In Western Australia, where TransAlta s power assets are located, a new Wholesale Electricity Market (WEM) was introduced in late 2006. Although most of TransAlta s generation is used to supply two large mining companies through long term capacity contracts, a small amount of surplus energy and capacity is sold into the WEM. Total installed capacity in the WEM is about 3800MW s, while TransAlta s capacity in the region is approximately 350MW s. TransAlta enjoys a solid competitive advantage in power supply to mining operations, especially remote mining operations, and has built up significant knowledge and expertise in this field.

**Competitive Strengths**

The Corporation believes it is well positioned to achieve its business strategy due to its competitive strengths, which include the following:

*Stable cash flow base* In 2006, approximately 95 per cent of the Corporation s expected production was sold under contracts with original durations of at least 12 months, with the remaining production subject to market pricing. Revenues received under contractual arrangements are not subject to short-term fluctuations in the spot price for electricity.

*Geographic diversity* The Corporation has a geographically diverse asset base with assets in Alberta and Ontario, Canada, in certain parts of the United States, Mexico and Australia.

*Fuel diversity* The Corporation has a diverse mix of fuels used for the generation of electricity, including coal, natural gas, hydro, geothermal and wind. The Corporation believes that this mix reduces the impact on corporate performance in the event of external events affecting one fuel source.

*Management team* The Corporation s management team has substantial industry, international and local market experience.

*Corporate Development and Marketing expertise* The Corporation believes that it s Corporate Development and Marketing group has enhanced returns from the Corporation s existing generation base and has allowed the Corporation to obtain more favourable pricing for uncommitted electricity, secure fuel supply on a cost-effective basis and fulfill electricity delivery obligations in the event of an outage.

*Financial strength* The Corporation has investment grade ratings from Moody s Investor Services, Inc. ( Moody s ), Standard & Poor s, a division of the McGraw-Hill Companies, Inc. ( S&P ) and Dominion Bond Rating Service Limited ( DBRS ).

*Ownership or control of coal supply* The Corporation owns, controls or leases extensive coal reserves in Alberta that provide a long-term and stable source of fuel for all of its coal-fired generation capacity in Alberta. The Corporation s mines in Alberta contain some of the lowest sulphur coal in North America, averaging 0.25 per cent sulphur at the Whitewood mine and 0.25 per cent at the Highvale mine. Coal with lower sulphur content emits less sulphur dioxide when it is burned.

*Wind Generation* The Corporation is one of the largest owners and operators of wind generation in Canada. The Wind management team has developed key relationships with customers, suppliers and policy makers that provide a competitive advantage in the development, operations and marketing of wind generation.

**Capital Expenditures**

Capital expenditures for property and investments (including acquisitions) by TransAlta for the past five years were:

| | | | |
|---|---|---|---|
| 2006 | $224.9 million | 2003 | $757.8 million |
| 2005 | $325.5 million | 2002 | $985.9 million |
| 2004 | $345.7 million | | |

## ENVIRONMENTAL RISK MANAGEMENT

TransAlta is subject to federal, provincial, state and local environmental laws, regulations and guidelines concerning the generation and transmission of electrical and thermal energy and surface mining. TransAlta is committed to complying with legislative and regulatory requirements and to minimizing the environmental impact of its operations. TransAlta works with governments and the public to develop appropriate frameworks to protect the environment and, at the same time, to promote sustainable development.

TransAlta s approach to managing its environmental, health and safety ( EHS ) risk has three elements:

Compliance-based activities, such as permitting and reporting;

ISO-based EHS Management systems and programs, such as safety programs and auditing; and

Longer-term strategic initiatives, including climate change and government policy development.

These elements are integrated into TransAlta s corporate-wide operations and management systems. They are designed to mitigate risks of TransAlta s activities to employees, the public and the environment, and to address potential competitive risks from future changes in environmental policy. They are also supportive of TransAlta s corporate commitment to sustainability.

To meet regulatory requirements and improve environmental performance, TransAlta made environmental operating and capital expenditures in fiscal year 2006 of approximately $49.8 million. Environmental expenditures are generally defined as expenditures incurred to comply with Canadian or international environmental regulations, conventions or voluntary agreements.

Environmental risk at the plants operated by TransAlta, has been reduced by actions in several areas:

Continued investment in mercury control technology evaluation leading to installation of mercury capture equipment at our Alberta coal plants in 2010;

Uprate improvements delivering higher efficiency generation at the Sundance plant;

The planned decommissioning of the older Wabamun coal-fired plant in 2010; and

Continued expansion of the wind energy business, with minimal emissions footprint.

On a longer time horizon, TransAlta anticipates future environmental regulatory developments in areas such as climate change, air quality and water. Regulatory changes and policy developments are tracked in all relevant jurisdictions.

On October 19, 2006, the Canadian Government introduced its Clean Air Act, designed to regulate greenhouse gases and air pollutants from industries and other sources. While uncertainty still exists as to the ultimate form and specific detail of

Canada s climate change regulations, TransAlta s climate change strategy addresses the potential competitive risks to its fossil generation plants. The strategy includes, increased use of less carbon-intensive fuels such as natural gas and renewable resources, continued investment in international emission offsets and internal efficiency improvements and development of clean coal technology. TransAlta continues to be an active participant with federal and provincial governments in the development of climate change policy in the international, national and provincial arenas.

Mercury standards are expected to be implemented in both the United States and Alberta by 2010. Requirements for capital control equipment are clear in Alberta, and work is on schedule to select and install the necessary control technology. Mercury control requirements in the United States at TransAlta s Centralia plant are not yet defined.

TransAlta is a member of the Canadian Clean Power Coalition, which is committed to developing and implementing a clean coal technology project in Canada before 2010.

Environmental issues concerning water use are managed within the ISO 14001 framework. TransAlta continues to work with regulators in each jurisdiction in which it operates, to ensure water is used wisely on site and that all regulations pertaining to water and wetlands management, both on and off site, are met at all times.

TransAlta s environmental efforts have been recognized by the Dow Jones Sustainability Index for eight years in a row. The Index represents the best environmental performance leaders worldwide.

To date, TransAlta does not believe that its competitive position in the wholesale generation business has been adversely affected by environmental concerns. Increasing use of natural gas and renewable generation means typically lower environmental compliance costs. Emissions of oxide of nitrogen ( NOx ) and SO2 from coal-fired operations at Centralia are significantly below national average levels due to installed pollution controls, including scrubbers and low-NOx burners for both units.

**RISK FACTORS**

Regulatory and political risks exist in all jurisdictions in which TransAlta operates. TransAlta seeks to manage these risks by working with regulators and other stakeholders to resolve issues as fairly and expeditiously as possible. For a discussion of risk factors affecting TransAlta, reference is made to Risk Factors and Risk Management , in TransAlta s MD&A for the year ended December 31, 2006, which is incorporated by reference herein.

**EMPLOYEES**

As of December 31, 2006, the Corporation had 2,687 (1) full and part-time employees, of which 2,114 were employed in TransAlta s generation business and 148 were employed in TransAlta s energy marketing business. Approximately 1,503 of the Corporation s employees are represented by labour unions. The Corporation is currently a party to 12 different collective bargaining agreements. The Corporation has recently renewed

4 of the agreements and negotiations for the remaining agreements are underway and are expected to be completed before their respective expiry dates.

**Note:**

(1) Of the 2687 full-time and part-time employees at December 31, 2006, 567 were on notice of termination relating to the closure of the Centralia mine, effective January 31, 2007.

## CAPITAL STRUCTURE

### General

The Corporation s authorized share capital consists of an unlimited number of common shares and an unlimited number of first preferred shares, issuable in series. As at March 14, 2007, 202,627,578 common shares were outstanding and no first preferred shares were outstanding.

**Common Shares**

Each common share of the Corporation entitles the holder thereof to one vote for each common share held at all meetings of shareholders of the Corporation, except meetings at which only holders of another specified class or series of shares are entitled to vote, to receive dividends if, as and when declared by the Board of Directors, subject to prior satisfaction of preferential dividends applicable to any first preferred shares, and to participate rateably in any distribution of the assets of the Corporation upon a liquidation, dissolution or winding up and subject to prior rights and privileges attaching to first preferred shares. The common shares are not convertible and are not entitled to any pre-emptive rights. The common shares are not entitled to cumulative voting.

**First Preferred Shares**

The Corporation is authorized to issue an unlimited number of first preferred shares, issuable in series and, with respect to each series, the Board of Directors is authorized to fix the number of shares comprising the series and determine the designation, rights, privileges, restrictions and conditions attaching to such shares, subject to certain limitations.

The first preferred shares of all series rank senior to all other shares of the Corporation with respect to priority in payment of dividends and with respect to distribution of assets in the event of liquidation, dissolution or winding up of the Corporation, or a reduction of stated capital. Holders of first preferred shares are entitled to receive cumulative quarterly dividends on the subscription price thereof as and when declared by the Board of Directors at the rate established by the Board of Directors at the time of issue of shares of a series. No dividends may be declared or paid on any other shares of the Corporation unless all cumulative dividends accrued upon all outstanding first preferred shares have been paid or declared and set apart. In the event of the liquidation, dissolution or winding up of the Corporation, or a reduction of stated capital, no sum shall be paid or assets distributed to holders of other shares of the Corporation until the holders of first preferred shares shall have been paid the subscription price of the shares, plus a sum equal to the premium payable on a redemption, plus a sum equal to the arrears of dividends accumulated on the first preferred shares to the date of such liquidation, dissolution, winding up, or reduction of stated capital, as applicable. After payment of such amount, the holders of first preferred shares shall not be entitled to share further in the distribution of the assets of the Corporation.

The Corporation s Board of Directors may include, in the share conditions attaching to a particular series of first preferred shares, certain voting rights effective upon the Corporation failing to make payment of six quarterly dividend payments, whether or not consecutive. These voting rights continue for so long as any dividends remain in arrears. These voting rights are the right to one vote for each $25 of subscription price on all matters in respect of which shareholders vote, and additionally, the right of all series of first preferred shares, voting as a combined class, to elect two directors of the Corporation if the Board of Directors then consists of less than 16 directors, or three directors if the Board of Directors consists of 16 or more directors. Otherwise, except as required by law, the holders of first preferred shares shall not be entitled to vote or to receive notice of or attend any meeting of the shareholders of the Corporation.

Subject to the share conditions attaching to any particular series providing to the contrary, the Corporation may redeem first preferred shares of a series, in whole or from time to time in part, at the redemption price applicable to each series and the Corporation has the right to acquire any of the first preferred shares of one or more series by purchase for cancellation in the open market or by invitation for tenders at a price not to exceed the redemption price applicable to the series.

## CREDIT RATINGS

**Issuer Rating**

As of December 31, 2006, the Corporation s issuer rating from S&P was BBB (stable) and from Moody s was Baa2 (stable).

**Commercial Paper**

As of December 31, 2006, the Corporation s guaranteed commercial paper was rated R-1(low) (stable) by DBRS. The Corporation s non-guaranteed commercial paper was rated R-2(high) (stable) by DBRS.

**Senior Unsecured Long-Term Debt**

As of December 31, 2006, the Corporation s senior unsecured long-term debt is rated BBB (stable) by DBRS, BBB (stable) by S&P and Baa2 (stable) by Moody s. The ratings for debt instruments range from a high of AAA to a low of D in the case of both DBRS and S&P and from a high of Aaa to a low of C in the case of Moody s.

According to the DBRS rating system, debt securities rated BBB are of adequate credit quality. Protection of interest and principal is considered acceptable, but the entity is more susceptible to adverse changes in financial and economic conditions, or there may be other adverse conditions present which reduce the strength of the entity and its rated securities. High or Low grades indicate the relative standing within a rating category. DBRS also assigns rating trends to each of its ratings to give investors an understanding of DBRS opinion regarding the outlook for the rating in question.

According to the S&P rating system, debt securities rated BBB exhibit adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on such obligations than on obligations in the higher rating categories. The ratings from AA to B may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.

According to the Moody s rating system, debt securities rated Baa are subject to moderate credit risk. They are considered medium-grade and as such may possess certain speculative characteristics. Numerical modifiers 1, 2 and 3 are applied to each rating category, with 1 indicating that the obligation ranks in the higher end of the category, 2 indicating a mid-range ranking and 3 indicating a ranking in the lower end of the category.

**Note Regarding Credit Ratings**

Credit ratings are intended to provide investors with an independent measure of credit quality of an issue of securities. The credit ratings accorded to the Corporation s outstanding securities by S&P, Moody s and DBRS, as applicable, are not recommendations to purchase, hold or sell such securities inasmuch as such ratings do not comment as to market price or suitability for a particular investor. There is no assurance that the ratings will remain in effect for any given period or that a rating will not be revised or withdrawn entirely by S&P, Moody s or DBRS in the future if, in its judgment, circumstances so warrant.

**DIVIDENDS**

In setting its dividend, TransAlta s Board of Directors considers several factors: the Corporation s earnings record, cash flow, capital requirements, the expectations of shareholders and future earnings prospects. The payment and level of future dividends on the common shares are determined by the Board of Directors of TransAlta upon consideration of such factors. TransAlta has declared and paid the following dividends per share on its outstanding common shares during the past three years:

| Period | | Dividend per Common Share |
|---|---|---|
| 2004 | First Quarter | $ 0.25 |
| | Second Quarter | $ 0.25 |
| | Third Quarter | $ 0.25 |
| | Fourth Quarter | $ 0.25 |
| 2005 | First Quarter | $ 0.25 |
| | Second Quarter | $ 0.25 |
| | Third Quarter | $ 0.25 |
| | Fourth Quarter | $ 0.25 |
| 2006 | First Quarter | $ 0.25 |
| | Second Quarter | $ 0.25 |
| | Third Quarter | $ 0.25 |
| | Fourth Quarter | $ 0.25 |

On January 1, 2007, TransAlta paid cash dividends of $0.25 per common share. The Corporation s Board of Directors on January 25, 2007 declared a cash dividend of $0.25 per common share, payable on April 1, 2007.

## MARKET FOR SECURITIES

TransAlta s common shares are listed on the Toronto Stock Exchange ( TSX ) under the symbol TA and the New York Stock Exchange under the symbol TAC . TransAlta s preferred securities were listed on the Toronto Stock Exchange under the symbol TA.PR.C until January 2, 2007 at which time they were redeemed (see General Development of the Business ). The following table sets forth the reported high and low trading prices and trading volumes of the Corporation s common shares as reported by the TSX for the period indicated:

| | Price ($) | | |
|---|---|---|---|
| **Month** | **High** | **Low** | **Volume** |
| **2006** | | | |
| January | 26.91 | 23.15 | 16,922,946 |
| February | 24.64 | 22.91 | 15,327,317 |
| March | 24.20 | 21.88 | 17,224,425 |
| April | 23.61 | 22.00 | 13,842,416 |
| May | 25.00 | 23.11 | 11,606,703 |
| June | 24.54 | 22.63 | 11,746,765 |
| July | 24.03 | 22.25 | 10,436,526 |
| August | 24.96 | 23.26 | 10,220,926 |
| September | 25.05 | 23.25 | 12,609,538 |
| October | 24.23 | 22.76 | 14,960,436 |
| November | 25.79 | 22.78 | 15,783,400 |
| December | 26.72 | 25.28 | 10,316,581 |
| **2007** | | | |
| January | 27.25 | 24.38 | 14,675,110 |
| February | 25.71 | 24.01 | 20,305,992 |
| March (to March 14) | 24.85 | 13.59 | 6,990,727 |

The following table sets forth the reported high and low trading prices and trading volumes of the Corporation s preferred securities as reported by the TSX in January 2006:

| | Price ($) | | |
|---|---|---|---|
| **Month** | **High** | **Low** | **Volume** |
| **2006** | | | |
| January | 25.70 | 25.41 | 152,613 |
| February | 25.90 | 25.61 | 100,224 |
| March | 25.97 | 25.21 | 104,403 |
| April | 25.45 | 25.15 | 73,523 |
| May | 25.50 | 25.25 | 82,282 |
| June | 25.77 | 24.96 | 89,479 |
| July | 25.78 | 25.08 | 99,033 |
| August | 25.65 | 25.36 | 57,716 |

| | | | |
|---|---|---|---|
| September | 25.69 | 25.12 | 73,063 |
| October | 25.49 | 25.21 | 71,790 |
| November | 25.43 | 25.20 | 116,632 |
| December | 25.43 | 24.93 | 144,731 |

**DIRECTORS AND OFFICERS**

The names, province or state and country of residence of the directors and officers of TransAlta as at March 14, 2007, their respective position and office and their respective principal occupation during the five preceding years, are set out below. The year in which each director was appointed to serve to the Board is also set out below. Each director is appointed to serve until the next annual meeting of TransAlta or until his or her successor is elected or appointed.

| Name, Province (State) and Country of Residence | Year first became Director | Principal Occupation |
|---|---|---|
| **William D. Anderson** Ontario, Canada | 2003 | Corporate Director. Mr. Anderson was President of BCE Ventures (telecommunications), a subsidiary of BCE Inc. from 2001 to 2005 and Chief Financial Officer of BCE Inc. (telecommunications) from 1998 to 2000. He has been a director of Bell Canada International Inc. (telecommunications) since 2000, Four Seasons Hotels Inc. (hospitality) since 2005, Gildan Activewear Inc. (apparel manufacturing) since 2006 and MDS Inc. (health sciences) since 2007. He is a member of the Institute of Chartered Accountants of Ontario and is Chair of the Audit and Risk Committee of the Board, previously the Audit and Environment Committee. |
| **Stanley J. Bright** (1) Maryland, U.S.A. | 1999 | Corporate Director. Mr. Bright was a director of MidAmerican Energy Holdings Company (electric generation and delivery, natural gas supply, transportation and delivery), a subsidiary of Berkshire Hathaway, Inc., from 1999 to February 2006 and a director of MidAmerican Energy predecessor companies from 1987. Mr. Bright was Chairman and CEO of MidAmerican Energy Company (electric and gas utility) from 1997 to 1999 and President, CEO & Chairman and CEO of predecessor companies from 1991 to 1997. He is Chair of the Human Resources Committee and a member of the Audit and Risk Committee of the Board. |
| **Timothy W. Faithfull** England, U.K. | 2003 | Corporate Director. Mr. Faithfull was President and Chief Executive Officer of Shell Canada Limited (energy) from 1999 to 2003 when he completed a 36 year international oil and gas career with Royal Dutch/Shell group. He has been a director of Canadian Pacific Railway Limited (transportation) since 2003, AMEC plc in the United Kingdom (international engineering, construction services) since 2005 and Shell Pension Trust Limited in the United Kingdom (pension fund trustee) since 2004. He is also a council member of the Canada-United Kingdom Colloquia and a trustee of the Starehe Endowment Fund (UK). He is a member of the Audit and Risk Committee and the Human Resources Committee of the Board. |
| **Ambassador Gordon D. Giffin** Georgia, U.S.A | 2002 | Senior Partner, McKenna Long & Aldridge LLP (attorneys). Mr. Giffin has been a director of Bowater, Inc., (newsprint and paper) since 2003, Canadian National Railway Company (transportation) since 2001, Canadian Imperial Bank of Commerce (banking) since 2001, Canadian Natural Resources Ltd. (oil and gas) since 2002 and Ontario Energy Savings Corp. (natural gas and electricity supplier) since 2006. He is a member of the Council of Foreign Relations, an advisory board member of the Canadian-American Business Council and serves on the Board of Trustees for the Carter Center in Georgia. Mr. Giffin served as United States Ambassador to Canada from 1997 to 2001. He is Chair of the Governance and Environment Committee of the Board, previously the Nominating and Corporate Governance Committee. |
| **C. Kent Jespersen** Alberta, Canada | 2004 | Corporate Director. Mr. Jespersen has been Chair and CEO of La Jolla Resources International Ltd. (advisory and investments) since 1998. He has also been Chair and a director of CCR Technologies Ltd. (technology) since 1999, a director of Matrikon Inc. (technology) since 2001, Axia NetMedia Corporation (telecommunications) since 2000 and Chairman of North American Oil Sands Ltd. (oil and gas) since 2006. Mr. Jespersen worked with NOVA Corporation (gas transportation and chemicals) for over 20 years in various management positions, including as president of NOVA International. He is a member of the Governance and Environment Committee and the Human Resources Committee of the Board. |

| Name, Province (State) and Country of Residence | Year first became Director | Principal Occupation |
|---|---|---|
| **Michael M. Kanovsky**<br>British Columbia, Canada | 2004 | Corporate Director and Independent Businessman. Mr. Kanovsky, P. Eng, has been President of Sky Energy Corporation (oil, gas and investments) since 1993. He is a director of Accrete Energy Corporation (oil and gas) since 2004, Devon Energy Corporation (oil and gas) since 1998, ARC Energy Trust (oil and gas) since 1996, Bonavista Energy Trust (oil and gas) since 1997 and Pure Technologies Inc. (technology) since 2003. He has been involved in investment banking and the oil, gas and power industries for over 30 years. He is a member of the Audit and Risk Committee and the Governance and Environment Committee of the Board. |
| **Donna Soble Kaufman**<br>Ontario, Canada | 1989 | Lawyer and Corporate Director. Mrs. Kaufman has been a director of BCE Inc. (telecommunications) since 1998, Bell Canada (telecommunications) since 2003 and Telesat Canada (telecommunications) since 2001. She is also a director of Historica, the Baycrest Centre, a Fellow of the Institute of Corporate Directors and a member of the Canadian Board of Advisors of Catalyst.Mrs. Kaufman is Chair of the Board of the Company and an ex-officio member of all committees of the Board. |
| **Gordon S. Lackenbauer**<br>Alberta, Canada | 2005 | Corporate Director. Mr. Lackenbauer was Deputy Chairman of BMO Nesbitt Burns Inc. (investment banking) from 1990 to 2004. He has been a director of Tembec Inc. (paper and forest products) since 1973, NAL Oil & Gas Trust (oil and gas) since July 2006 and CTV Globemedia Inc. (telecommunications) since 2006.<br>Mr. Lackenbauer is also a Governor of Mount Royal College. He is a member of the Governance and Environment Committee and the Audit and Risk Committee of the Board. |
| **Martha C. Piper**<br>British Columbia, Canada | 2006 | Corporate Director. Dr. Piper was President and Vice-Chancellor of the University of British Columbia (education) from 1997 to 2006. She has been a director of the Bank of Montreal (banking) since 2006. She is also a director of the B.C. Progress Board, the Pierre Elliott Trudeau Foundation and the Council of Canadian Academies. She is an officer of the Order of Canada, a recipient of the Order of British Columbia, was named Educator of the Year by the Learning Partnership in 2004 and was appointed in 2006 as a member of the Trilateral Commission. She is a member of the Human Resources Committee of the Board. |
| **Luis Vázquez Senties**<br>Mexico | 2001 | President and CEO and Chair of Group Diavaz (oilfield services and natural gas distribution) since 1982. Mr. Vázquez has also been Chair of Compania Mexicana de Gas, S.A. de CV., and of the Mexican Natural Gas Association since 2004. He is a member of the Human Resources Committee of the Board. |
| **Stephen G. Snyder**<br>Alberta, Canada | 1996 | President and Chief Executive Officer of TransAlta Corporation (power generation), since 1996. He has been a director of Canadian Imperial Bank of Commerce (banking) since 2000. He has also been Chair of the Calgary Stampede Foundation since February 2005, a director of the Calgary Exhibition and Stampede since April 2004, a director of the Alberta College of Art & Design since June 2006 and a trustee of the Conference Board of Canada since 1996. |

**Officers**

| Name | Principal Occupation | Residence |
|---|---|---|
| Stephen G. Snyder | President and Chief Executive Officer | Calgary, Alberta |
| Brian Burden | Executive Vice-President and Chief Financial Officer | Calgary, Alberta |
| Linda K. Chambers | Executive Vice-President, Generation Technology | Calgary, Alberta |
| Richard P. Langhammer | Executive Vice-President, Generation Operations | Calgary, Alberta |
| Thomas M. Rainwater | Executive Vice-President, Corporate Development and Marketing | Calgary, Alberta |
| Kenneth S. Stickland | Executive Vice-President, Legal | Calgary, Alberta |
| Michael Williams | Executive Vice-President, Human Resources, and Communications | Calgary, Alberta |
| Michael Bartel | Vice-President, Engineering Services | Calgary, Alberta |
| William D.A. Bridge | Vice-President, Western Canada Operations | Calgary, Alberta |
| Jeff A. Curran | Vice-President and Comptroller | Calgary, Alberta |
| Kelly L. Gunsch | Vice-President, Commercial Portfolio Management | Calgary, Alberta |
| David J. Koch | Vice-President, Financial Operations | Calgary, Alberta |
| Mark MacKay | Vice-President, Energy Technology | Calgary, Alberta |
| Alex McFadden | Vice-President, Major Maintenance | Calgary, Alberta |
| Parviz Mohamed | Vice-President, Information Technology | Calgary, Alberta |
| Daniel Pigeon | Vice-President, Portfolio Strategy and Execution Development | Calgary, Alberta |
| Gregory P. Reinhart | Vice-President, Generation Human Resources | Calgary, Alberta |
| Donald Thomas | Vice-President, Vision Quest | Calgary, Alberta |
| Marvin J. Waiand | Vice-President and Treasurer | Calgary, Alberta |
| Jubran R. Whalan | Vice-President, Trading and Delivery Optimization | Calgary, Alberta |
| W. Frank Hawkins | Assistant Treasurer | Calgary, Alberta |
| Maryse C. St.-Laurent | Corporate Secretary | Calgary, Alberta |

**Note:**

(1) Mr. Bright served as a director of Access Air Inc. for the period of December 4, 1997 to January 31, 2000, a privately held start-up airline company. The company Mr. Bright was employed by, and whom he represented, supported this airline in the hope that it would improve air service to the state of Iowa. Access Air Inc. filed for bankruptcy protection on November 29, 1999.

All of the directors and officers of TransAlta have held their present principal occupations or executive positions with the same or associated firms for the past five years, except for the following:

Prior to January 2006, William Anderson was President of BCE Ventures.

Prior to July 2003, Timothy Faithfull was President and Chief Executive Officer of Shell Canada Limited.

Prior to December 2005, Brian Burden was Executive Vice-President and Chief Financial Officer of Molson Inc.; and prior to 2002, he was Senior Vice-President, Seagram Corporate/Venture Transition of Diageo PLC.

Prior to July 2003, Linda Chambers was President of TransAlta Centralia Generation LLC and TransAlta Centralia Mining LLC, subsidiaries of TransAlta; and prior to June 1999, she was Senior Vice-President of Human Resources of TransAlta.

Prior to October 2005, Richard Langhammer was President, TransAlta Centralia Generation LLC and TransAlta Centralia Mining LLC, subsidiaries of the Corporation; and prior to December 2003, he was Vice-President, Plant Operations of TransAlta.

Prior to November 2002, Thomas Rainwater was President, Praxis Solutions, Inc.; and prior to February 2000, he was Vice-President, Central Region, Illinova Energy Partners Inc., a division of Illinova Corporation.

Prior to January 2006, Michael Williams was Senior Vice-President, Human Resources and Communications for the Corporation; prior to June 2002, he was Vice-President of EMEA HR, Lucent Technologies; and prior to April 2001, he was senior director of EMEA HR, Cisco Systems.

Prior to February 2006, Michael Bartel was Director Major Maintenance; prior to November 2003, he was Leader Life Cycle Planning-Coal; prior to February 2003 he was Manager Development Engineering; and prior to October 2000 he was Manager.

Prior to October 2005, William Bridge was Vice-President, Customer and Asset Management; prior to September 2003, he was Vice-President, Development & Acquisition; and prior to September 2001 he was Director, Commercial Operations, Eastern Canada.

Prior to October 2006, Jeff Curran was Interim Vice-President and Comptroller; prior to May 2006, he was Director, Financial Operations - Generation Technology; prior to June 2004, he was Manager, Investment Analysis; prior to March 2003, he was Manager - Financial Reporting & Planning; and prior to March 2001, he was a Senior Audit Manager with Arthur Andersen LLP.

Prior to December 2005, Kelly Gunsch was Director, Commercial Portfolio Management; and, prior to that date, Ms. Gunsch held various commercial facing positions within the business development group of the Corporation since joining TransAlta in 1995.

Prior to January 2007, David Koch was Director, Financial Operations, Generation of TransAlta; prior to January 2004, he was Manager, Generation Finance; prior to March 2003, he was Director of Finance for Telus Mobility; and prior to February 2000, he was Controller of Agricore.

Prior to February 2006, Mark MacKay was Director, Engineering Services; prior to February 2003, he was Director, Project Management CAN/USA; prior to April 2002, he was Director, Keephills Expansion; prior to February 2001, he was Director, Projects; and prior to April 2000 he was Senior Project Manager.

Prior to February 2007, Alex McFadden was Director, Major Maintenance; prior to November 2003, he was Business Integration Manager, Mexico; prior to February 2003, he was Commissioning Manager for TransAlta s Sarnia Regional Cogeneration Plant; and prior to December 2001, he was Commissioning Supervisor at TransAlta s Poplar Creek Cogeneration facility near Fort McMurray, Alberta.

Prior to July 2006, Parviz Mohamed was Director, Major Maintenance Planning; prior to April 2004, she was Director, IT Development Services; prior to June 2002, she was the acting CIO of IT; and Prior to October 2001, she was Director, Application Development & Support.

Prior to March 2006, Daniel Pigeon was Director, Investor Relations; and prior to April 2001 he was Director, Financial Operations, Corporate Development and Marketing.

Prior to February 2002, Gregory Reinhart was Human Resources Director, IPP of TransAlta; and prior to June 1999; he was Vice-President of Human Resources of Engage Energy Ltd.

Prior to January 2006, Donald Thomas was Vice-President, Business Development Vision Quest; prior to October 2003, he was Director, Corporate Development; and prior to April 2002 he was Director, Business Development.

Prior to October 2005, Jubran Whalan was Director, Trading and Delivery Optimization of TransAlta; and prior to that date, he held various corporate development and marketing positions within the Corporation since joining TransAlta in 2002.

Prior to June 2005, Maryse St.-Laurent was Secretary of TC PipeLines, LP since September 2003 and Recording Secretary since January 2001; and Senior Legal Counsel TransCanada Corporation since June 1997.

As of March 14, 2007, the directors and executive officers of TransAlta and its subsidiaries, as a group, beneficially own, directly or indirectly, less than one per cent of each class or series of the outstanding securities of TransAlta. The number of common shares held, directly or indirectly or over which control or direction is exercised, by all directors and the executive officers of the Company are disclosed in the Company s Management Proxy Circular, dated March 9, 2006 and which is hereby incorporated by reference.

**INTERESTS OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS**

No director or executive officer of the Corporation, no person or company that is the direct or indirect beneficial owner of, or who exercises control or direction over more than 10 per cent of the common shares of the Corporation, and no associate or affiliate of any of them, has or has had any material interest, direct or indirect, in any transaction involving the Corporation since the commencement of the Corporation s last financial year or in any proposed transactions that has materially affected or will materially affect the Corporation.

**INDEBTEDNESS OF DIRECTORS, EXECUTIVE OFFICERS AND SENIOR OFFICERS**

Since January 1, 2006, there has been no indebtedness, other than routine indebtedness, outstanding to TransAlta from any of TransAlta s directors, nominees for election as directors, executive officers, senior officers or associates of any such directors, nominees or officers.

**LEGAL PROCEEDINGS AND REGULATORY ACTIONS**

TransAlta is occasionally named as a party in various claims and legal proceedings which arise during the normal course of its business. TransAlta reviews each of these claims, including the nature of the claim, the amount in dispute or claimed and the availability of insurance coverage. Although there can be no assurance that any particular claim will be resolved in the Corporation s favour, the Corporation does not believe that the outcome of any claims or potential claims of which it is currently aware will have a material adverse effect on the Corporation, taken as a whole, after taking into account amounts reserved by the Corporation. For further information, please refer to Note 22 of the Corporation s audited consolidated financial statements for the year ended December 31, 2006, which note is hereby incorporated by reference herein.

**TRANSFER AGENT AND REGISTRAR**

The transfer agent and registrar for TransAlta s common shares is CIBC Mellon Trust Company in Vancouver, Calgary, Winnipeg, Toronto and Montreal. The transfer agent and registrar for the common shares in the United States is Mellon Investor Services LLC at its principal office in New York, New York.

**INTERESTS OF EXPERTS**

Ernst & Young LLP, Chartered Accountants, 1000, 440 - 2nd Avenue, SW., Calgary, Alberta, T2P 5E9 are the auditors of the Corporation.

Our auditors, Ernst & Young LLP, are independent in accordance with the Rules of Professional Conduct of the Institute of Chartered Accountants of Alberta and have complied with the SEC s rules on auditor independence.

**ADDITIONAL INFORMATION**

Additional information including compensation of directors and officers of TransAlta, indebtedness of directors and officers of TransAlta, principal holders of TransAlta s securities, options to purchase securities and interests of insiders in material transactions, where applicable, is contained in TransAlta s Management Proxy Circular dated March 9, 2007. Additional financial information is provided in TransAlta s 2006 Annual Report which contains audited comparative consolidated financial statements for the most recently completed financial year and the MD & A. The MD & A contained in the 2006 Annual Report is specifically incorporated by reference and forms a part of this Annual Information Form. These documents and additional information with respect to the Corporation are available at www.sedar.com.

TransAlta has adopted a procedure for employees, shareholders or others to report concerns or complaints regarding accounting or auditing matters on an anonymous, confidential basis to the Audit and Risk Committee. Such submissions may be directed to the Chair of the Audit and Risk Committee, Subject matter 003 , c/o TransAlta Corporation, Box 1900, Station M , 110 12th Avenue S.W. Calgary AB, T2P 2M1.

When the securities of TransAlta are in the course of distribution pursuant to a preliminary short form prospectus or a short form prospectus, TransAlta will, upon request to the Corporate Secretary, provide to any person or company the following information:

1. one copy of this Annual Information Form, together with one copy of any document, or the pertinent pages of any document, incorporated by reference in this Annual Information Form;

2. one copy of the comparative consolidated financial statements of TransAlta for its most recently completed financial year for which financial statements have been filed, together with the accompanying report of the auditor, and one copy of the most recent interim financial statements of TransAlta that have been filed, if any, for any period after the end of its most recently completed financial year;

3. one copy of TransAlta s Management Proxy Circular in respect of its most recent annual meeting of its shareholders that involved the election of directors; and

4. one copy of any other documents that are incorporated by reference into the preliminary short form prospectus or the short form prospectus and are not required to be provided under clauses (1), (2) or (3) above.

At any other time, TransAlta will, upon request, provide to any person or company one copy of any documents referred to in clauses (1), (2) and (3) above, provided that TransAlta may require the payment of a reasonable charge if the request is made by a person or company who is not a security holder of TransAlta. For additional copies of this Annual Information Form or any of the materials listed in this paragraph, please contact Investor Relations, TransAlta Corporation at Box 1900, Station M , Calgary, Alberta, T2P 2M1; telephone: 1-800-387-3598 in North America outside of Calgary, (403) 267-2520 in Calgary and outside North America; fax: (403) 267-2590; or e-mail: investor_relations@transalta.com.

**AUDIT AND RISK COMMITTEE**

**General**

On October 25, 2006, the Board of Directors delegated to the Audit and Environment Committee oversight responsibility for the Company s risk management reporting to the Board. At the same time, the responsibilities for oversight over environment, health and safety were delegated to the Nominating and Corporate Governance Committee of the Board. These new responsibilities took effect January 1, 2007 and were renamed Audit and Risk Committee ( ARC ) and Governance and Environment Committee, respectively. The members of TransAlta s ARC satisfy the requirements for independence under the provisions of Canadian Securities Regulators, Multilateral Instrument 52-110 Audit Committees, Section 303A of the New York Stock Exchange Rules and Rule 10A-3 under the U.S. Securities and Exchange Act of 1934. The ARC s Charter requires that it be comprised of a minimum of three independent directors. It currently has five independent members, William D. Anderson (Chair), Stanley J. Bright, Timothy W. Faithfull, Michael M. Kanovsky and Gordon S. Lackenbauer, and the Chair of the Board, Donna Soble Kaufman (who is independent), attends all meetings as an ex-officio member of the committee. All members of the committee (including the Chair of the Board) are financially literate pursuant to both Canadian and U.S. securities requirements and each of Mr. William D. Anderson and Mr. Gordon S. Lackenbauer have been determined by the Board to be an audit committee financial expert , within the meaning of Section 407 of the Sarbanes-Oxley Act.

**Mandate of the Audit and Risk Committee**

The mandate of the committee is to provide assistance to the Board of Directors of the Corporation in fulfilling its oversight responsibility to the shareholders of the Corporation, the investment community and others, relating to the integrity of the Corporation s financial statements and the financial reporting process, the systems of internal accounting and financial controls, the internal audit function, the external auditors qualifications, independence, performance and reports, and oversight in respect to legal compliance programs established by management which may have a material effect on the financial statements of the Corporation. As of January 1, 2007, the responsibilities for environmental compliance have been delegated to the Governance and Environment Committee of the Board. The ARC has instead undertaken the responsibility for oversight of management s risk identification, assessment and response, reporting to the Board. In performing its functions, the ARC is responsible for maintaining an open avenue of communication with the external auditors, the internal auditors and management of the Corporation.

The ARC s function is oversight. Management is responsible for the preparation, presentation and integrity of the financial statements of the Corporation. Management and the internal audit group of the Corporation are responsible for maintaining appropriate accounting and financial reporting principles and policy and internal controls and procedures for compliance with accounting standards and applicable laws and regulations.

While the ARC has the responsibilities and powers set forth herein, it is not the duty of the ARC to plan or conduct audits or to determine that the Corporation s financial statements are complete and accurate and in accordance with generally accepted accounting principles. This is the responsibility of management and the external auditors.

Management is responsible for preparing the interim and annual financial statements and financial disclosure of the Corporation and for maintaining a system of internal controls to provide reasonable assurance that assets are safeguarded and that transactions are authorized, executed, recorded and reported properly. The audit committee s role is to provide direct, meaningful and effective oversight of the Corporation s financial reporting and counsel to management without assuming responsibility for management s day-to-day duties.

**Audit and Risk Committee Charter**

The Charter of the Audit and Risk Committee is attached hereto as Appendix A .

**Relevant Education and Experience of Audit and Risk Committee Members**

The following is a brief summary of the education or experience of each member of the ARC that is relevant to the performance of their responsibilities as a member of the ARC, including any education or experience that has provided the member with an understanding of the accounting principles used by TransAlta to prepare its annual and interim financial statements.

| Name of ARC Member | Relevant Education and Experience |
|---|---|
| **W. D. Anderson** | Mr. Anderson is a Chartered Accountant. Mr. Anderson has served as Chief Executive Officer of a public company and as Chief Financial Officer of several public companies. In such capacities, Mr. Anderson actively supervised persons engaged in preparing, auditing, analyzing or evaluating financial statements. Mr. Anderson has also served as a principal financial officer, accounting officer and controller and as a director and audit committee member of several public companies. |
| **S. J. Bright** | Mr. Bright is a Certified Public Accountant and has served as a Chief Executive Officer, Chief Financial Officer and a corporate controller of several public companies. Mr. Bright has actively supervised persons engaged in preparing, auditing, analyzing or evaluating financial statements. Mr. Bright also has experience actively overseeing or assessing the performance of companies in the preparation of financial statements. |
| **T. W. Faithfull** | Mr. Faithfull holds a Bachelor of Arts degree in Economics and has acquired significant financial experience and exposure to accounting and financial issues as Chief Executive Officer of Shell Canada Limited and in his other capacities during his 36 years with the Royal Dutch/Shell group of companies. |

| Name of ARC Member | Relevant Education and Experience |
|---|---|
| **M. M. Kanovsky** | Mr. Kanovsky has over 30 years of financial and industry experience gained through working in the investment banking business as well as a director, officer and audit committee member of several public companies and trusts. Mr. Kanovsky is a graduate of the MBA program from the Richard Ivey School of Business of the University of Western Ontario. |
| **G. S. Lackenbauer** | Mr. Lackenbauer has over 35 years of experience in the investment banking industry. Mr. Lackenbauer has also appeared as an expert financial witness with respect to financial markets, capital structure, cost of capital and fair return on common equity, in over 40 regulatory proceedings. Mr. Lackenbauer also has extensive experience as a director or governor of public companies and not-for-profit organizations. Mr. Lackenbauer holds a Bachelor of Arts in Economics, an MBA degree from the University of Western Ontario and is a Chartered Financial Analyst. |

**Fees Paid to Ernst & Young LLP**

For the years ended December 31, 2006 and December 31, 2005, Ernst & Young LLP and its affiliates were paid $3,596,689 and $2,012,754 respectively, as detailed below:

| Year ended Dec. 31 | | | | |
|---|---|---|---|---|
| **Ernst & Young LLP** | | **2006** | | **2005** |
| Audit fees | $ | 3,286,212 | $ | 2,006,504 |
| Audit related fees | | 300,892 | | |
| Tax fees | | 9,585 | | 6,250 |
| Total | **$** | **3,596,689** | **$** | **2,012,754** |

No other audit firms provided audit services in 2006 or 2005.

The nature of each category of fees is described below:

*Audit Fees*

Audit fees were paid for professional services rendered by the auditors for the audit of the Company s annual financial statements or services provided in connection with statutory and regulatory filings or engagements, including the translation from English to French of the Company s financial statements and other documents. Total audit fees paid in 2006 include payments related to 2005 in the amount of $2,092,000 and 2006 in the amount of $1,194,000.

*Audit-Related Fees*

The audit-related fees in 2006 were primarily for work performed by Ernst & Young LLP in relation to the Corporation s financings.

*Tax Fees*

Majority of tax fees for 2006 relate to the finalization of tax credit recoveries for which work had commenced in prior years.

**Pre-Approval Policies and Procedures**

The ARC has considered whether the provision of services other than audit services is compatible with maintaining the auditors independence. The ARC has adopted a policy that prohibits TransAlta from engaging the auditors for prohibited categories of non-audit services and requires pre-approval of the ARC for other permissible categories of non-audit services, such categories being determined under the United States Sarbanes-Oxley Act of 2002.

**APPENDIX A**

AUDIT AND RISK COMMITTEE

CHARTER

**A. Establishment of Committee and Procedures**

1. Composition of Committee

The Audit and Risk Committee (the Committee ) of the Board of Directors of TransAlta Corporation (the Corporation ) shall consist of not less than three Directors. All members of the Committee shall be determined by the Board to be independent as required under securities regulations for Audit Committees or other applicable laws or regulations. Determinations as to whether a particular director satisfies the requirements for membership on the Committee shall be made by the full Board of Directors (the Board ).

2. Appointment of Committee Members

Members of the Committee shall be appointed from time to time by the Board, on the recommendation of the Nominating and Corporate Governance Committee, and shall hold office until the next annual meeting of shareholders, or until their successors are earlier appointed, or until they cease to be Directors of the Corporation.

3. Vacancies

Where a vacancy occurs at any time in the membership of the Committee, it may be filled by the Board. The Board shall fill any vacancy if the membership of the Committee is less than three directors.

4. Committee Chair

The Board shall appoint a Chair for the Committee on the recommendation of the Nominating & Corporate Governance Committee.

5. Absence of Committee Chair

If the Chair of the Committee is not present at any meeting of the Committee, one of the members of the Committee who is present at the meeting shall be chosen by the Committee to preside at the meeting.

6. Secretary of Committee

The Committee shall appoint a Secretary who need not be a director of the Corporation.

7. Meetings

The Chair of the Committee or any of its members may call a meeting of the committee. The Committee should meet at least quarterly and at such other time during each year as it deems appropriate. In addition, the Chair of the Committee or any of its members may call a special meeting of the Committee at any time. Although the Company s Chief Executive Officer may attend meetings of the Committee, the Committee shall also meet in separate executive sessions.

8. Quorum

A majority of the members of the Committee present in person or by telephone or other telecommunication device that permit all persons participating in the meeting to speak to each other, shall constitute a quorum.

9. Notice of Meetings

Notice of the time and place of every meeting shall be given in writing (including by way of written facsimile communication or email) to each member of the Committee at least 48 hours prior to the time fixed for such meeting, provided, however, that a member may in any manner waive a notice of a meeting; and attendance of a member at a meeting constitutes a waiver of notice of the meeting, except where a member attends a meeting for the express purpose of objecting to the transaction of any business on the ground that the meeting is not lawfully called. Notice of every meeting shall also be provided to the external and internal auditors.

10. Attendance at Meetings

At the invitation of the Chair of the Committee, other Board members, officers or employees of the Corporation, the external auditors, outside counsel and other experts or consultants may attend any meeting of the Committee.

11. Procedure, Records and Reporting

Subject to any statute or the articles and by-laws of the Corporation, the Committee shall fix its own procedures at meetings, keep records of its proceedings and report to the Board generally not later than the next scheduled meeting of the Board.

12. Review of Charter

The Committee shall evaluate its performance and review and reassess the adequacy of its Charter at least annually or otherwise, as it deems appropriate, and if necessary propose changes to the Board.

13. Outside Experts and Advisors

The Committee Chair, on behalf of the Committee, or any of its members is authorized, at the expense of the Corporation, when deemed necessary or desirable, to retain independent counsel, outside experts and other advisors to advise the Committee independently on any matter.

**B. General Mandate of Committee**

The Committee provides assistance to the Board in fulfilling its oversight responsibility to the shareholders, the investment community and others, relating to the integrity of the Corporation s financial statements and the financial reporting process, the systems of internal accounting and financial controls, the internal audit function, the external auditors qualifications, independence, performance and reports, the risk identification assessment conducted by management and the programs established by management and the Board in response to such assessment. In so doing, it is the Committee s responsibility to maintain an open avenue of communication between the Committee, the external auditors, the internal auditors and management of the Corporation.

The function of the Committee is oversight. Management is responsible for the preparation, presentation and integrity of the financial statements of the Corporation. Management of the Corporation is responsible for maintaining appropriate accounting and financial reporting principles and policy and internal controls and procedures that provide for compliance with accounting standards and applicable laws and regulations.

While the Committee has the responsibilities and powers set forth herein, it is not the duty of the Committee to plan or conduct audits or to determine that the Corporation s financial statements are complete and accurate and are in accordance with generally accepted accounting principles. This is the responsibility of management and the external auditors. The designation of a member or members as an audit committee financial expert is based on that individual s education and experience, which the individual will bring to bear in carrying out his or her duties on the Committee. Designation as an audit committee financial expert does not impose on such person any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of the Committee and Board in the absence of such designation.

Management is responsible for preparing the interim and annual financial statements and financial disclosure of the Corporation and for maintaining a system of internal controls to provide reasonable assurance that assets are safeguarded and that transactions are authorized, executed, recorded and reported properly. The Committee s role is to provide meaningful and effective oversight and counsel to management without assuming responsibility for management s day-to-day duties.

The Committee also performs the function of the Qualified Legal Compliance Committee (the QLCC ) of the Board of the Corporation and in this role: (i) receives, reviews and takes appropriate action with respect to any report made or referred to the Committee by a counsel or the chief legal officer, of evidence of a material violation of applicable securities laws, a material breach of a fiduciary duty under applicable laws or a similar material violation by the Corporation or by any officer, director, employee, or agent of the Corporation (in this charter a material violation ) and (ii) otherwise fulfill the responsibilities of a qualified legal compliance committee pursuant to Section 307 of the Sarbanes Oxley Act of 2002 and the rules promulgated thereunder.

**C. Duties and Responsibilities of the Committee**

The Committee shall have the following specific duties and responsibilities:

1. <u>Audit and Financial Matters:</u>

The Committee shall:

(a) have direct responsibility for the compensation and oversight of the external auditors including nominating the external auditors to the Board to be proposed for Shareholder approval in any management proxy circular, and in doing so, shall:

(i) review the experience and qualifications of the external auditors senior personnel who are providing audit services to the Corporation and the quality control procedures of the external auditors, including obtaining confirmation that the external auditors are in compliance with Canadian and U.S. regulatory registration requirements;

(ii) review and approve the basis and amount of the external auditors fees and ensure the Corporation has provided appropriate funding for payment of compensation to the external auditors;

(iii) review and discuss with the external auditors all relationships that the external auditors and their affiliates have with the Corporation and its affiliates in order to determine the external auditors independence, including, without limitation, (i) requesting, receiving and reviewing, on a periodic basis, a formal written statement from the external auditors delineating all relationships that may reasonably be thought to bear on the independence of the external auditors with respect to the Corporation, (ii) discussing with the external auditors any disclosed relationships or services that the external auditors believe may affect the objectivity and independence of the external auditors, and (iii) recommending that the Board take appropriate action in response to the external auditors report to satisfy itself of the external auditors independence;

(iv) resolve disagreements between management and the external auditors regarding financial reporting;

(v) pre-approve audit services including all non-prohibited non-audit services provided by the external auditors; the Chair of the Committee, on behalf of the Committee, may at his discretion approve all non-prohibited non-audit services provided by the external auditors, and report all such approvals to the Committee at its next scheduled meeting following such approval;

(vi) inform the external auditors and management that the external auditors shall have access directly to the Committee at all times, as well as the Committee to the external auditors; and

(vii) instruct the external auditors that they are ultimately accountable to the Committee as representatives of the shareholders of the Corporation;

(b) review with management and the Corporation s external auditors the Corporation s financial reporting in connection with the annual audit and the preparation of the financial statements, including, without limitation, the annual audit plan of the external auditors, the judgment of the external auditors as to the quality, not just the acceptability, of and the appropriateness of the Corporation s accounting principles as applied in its financial reporting and the degree of aggressiveness or conservatism of the Corporation s accounting principles and underlying estimates;

(c) review with management and the external auditors all financial statements and financial disclosure and

(i) recommend to the Board for approval the Corporation s audited annual financial statements including the notes thereto and, Management s Discussion and Analysis ,

(ii) review any report or opinion to be rendered in connection therewith;

(iii) review with the external auditors the cooperation they received during the course of their review and their access to all records, data and information requested;

(iv) discuss with management and the external auditors all significant transactions which were not a normal part of the Corporation s business;

(v) review the management processes for formulating sensitive accounting estimates and the reasonableness of the estimates;

(vi) review with management and the external auditors any changes in accounting principles and their applicability to the business;

(vii) review with management and the external auditors alternative treatments of financial information within generally accepted accounting principles that have been discussed with management, ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the external auditors;

(viii) satisfy itself that there are no unresolved issues between management and the external auditors that could reasonably be expected to materially affect the financial statements;

(d) review with management and the external auditors the Corporation s interim financial statements, including the notes thereto, , Management s Discussion and Analysis and earnings release, and approve the release thereof by management to the public;

(e) review and discuss with management and external auditors the use of pro forma or adjusted non-GAAP information and the applicable reconciliation;

(f) review quarterly or as required the public disclosure of financial information extracted or derived from the financial statements, and review with management at least annually the approach and nature of the disclosure of financial information and earnings guidance provided to analysts and rating agencies;

(g) at least annually, obtain and review a report by the external auditors describing the auditing firm s internal quality-control procedures, any material issues raised by the most recent internal quality-control review or peer review of the auditing firm or by any inquiry or investigation by governmental or professional authorities within the preceding five years respecting one or more independent audits carried out by the external auditors, and any steps taken to deal with any such issues and all relationships between the external auditors and the Corporation;

(h) review with senior management, the chief legal officer and, as necessary, outside legal advisors, and the Corporation s internal and external auditors, the effectiveness of the Corporation s internal controls to ensure the Corporation is in compliance with legal and regulatory requirements and with the Corporation s policies;

(i) review at least annually with the chief legal officer, and, if necessary, outside legal advisors, significant legal, compliance or regulatory matters that may have a material effect on the financial statements of the business;

(j) review the audit plans of the internal and external auditors of the Corporation including the degree of detail of those plans and the coordination between those plans;

(k) review and consider, as appropriate, any significant reports and recommendations made by internal audit relating to internal audit issues, together with management s response thereto;

(l) review management s plans regarding any changes in accounting practices or policies and the financial impact thereof;

(m) discuss with the external auditors their perception of the Corporation s financial and accounting personnel, any recommendations which the external auditors may have, including those contained in the management letter, with respect to improving internal financial controls, choice of accounting principles or management reporting systems, and review all management letters from the external auditors together with management s written responses thereto;

(n) review with management, the external auditors and, as necessary, internal and external legal counsel, any litigation, claim or contingency, including tax assessments, that could have a material effect upon the financial position of the Corporation, and the manner in which these matters may be, or have been, disclosed in the financial statements;

(o) review annually the Annual Pension Report and financial statements of the Corporation s pension plans including the actuarial valuation, asset/liability forecast, asset allocation, manager performance and plan operating costs;

(p) together with the Human Resources Committee of the Board, review annually and as required the overall governance of the Corporation s Pension Plans, and approve the broad objectives of the plan and any material changes to the plan(s) and report to the Board at least annually;

(q) review annually the internal audit department charter, review with the internal auditors the Corporation s internal control procedures, the scope and plans for the work of the internal audit group, the annual checklist of responsibilities of the Committee; review the adequacy of resources and ensure that the internal auditors have unrestricted access to all functions, records, property and personnel of the Corporation and inform the internal auditors and management that the internal auditors shall have unfettered access directly to the Committee at all times, as well as the Committee to the internal auditors;

(r) meet separately with management, the external auditors and internal auditors to review issues and matters of concern respecting audits and financial reporting;

(s) review the annual audit of expense accounts and perquisites of the Directors, the CEO and his direct reports, including the use of the Corporation s assets, as well as the Corporation s annual sponsorship, donations and political contributions;

(t) review disclosures made to the Committee by the CEO and CFO during their certification process for the periodic reports filed with securities regulators about any significant deficiencies in the design or operation of internal controls or material weaknesses therein and any fraud involving management or other employees who have a significant role in the Company s internal controls;

(u) review incidents or alleged incidents of fraud, illegal acts and conflicts of interest;

(v) review periodically and at least annually the Corporate Code of Conduct and inquire of management as to policies and practices in place to ensure compliance, and inquire of the internal and external auditors as to any instances of deviation from the Corporate Code of Conduct which have come to their attention and the action taken as a result of same;

(w) establish procedures for the receipt, retention and treatment of complaints received by the Corporation regarding accounting, internal accounting controls or auditing matters and the confidential, anonymous submission by employees of concerns regarding accounting or auditing matters;

(x) discuss with management and the external auditors any correspondence from or with regulators or governmental agencies, any employee complaints or any published reports that raise material issues regarding the Corporation s financial statements or accounting policies;

(y) annually prepare a report from the Committee to shareholders or others, concerning the work of the Committee during that year in the discharge of its responsibilities; and

(z) review and approve the Corporation s hiring policies for employees or former employees of the external auditors and monitor the Corporation s adherence to the policy.

2. Risk Management

In particular, the Committee shall:

(a) approve and oversee the process developed by Management to consider the overall risk culture of the Corporation and to identify principal risks, to evaluate potential impact and to implement appropriate systems to manage such risks;

(b) review annually Management s assessment of the significant risks to which the Corporation is exposed; discuss with management the Corporation s policies and procedures for identifying and managing the principal risks of its business, to determine that management has:

A. identified appropriate business strategies taking into account the principal risk identified, and

B. implemented and is maintaining systems and procedures to manage or mitigate those risks, including programs of loss prevention, insurance and risk reduction and disaster response and recovery programs;

(c) review quarterly managements update of its risk assessment and management programs;

(d) review annually the Corporation s Financial and Commodity Exposure Management Policies and approve changes to such policies; review and authorize strategic hedging program guidelines and risk tolerance; review and monitor quarterly results of financial and commodity exposure management activities, including foreign currency and interest rate risk strategies, counterparty credit exposure and the use of derivative instruments;

(e) review the Corporation s annual insurance program, including the risk retention philosophy and resulting uninsured exposure and corporate liability protection programs for directors and officers including directors and officers insurance coverage;

(f) periodically consider the respective roles and responsibilities of the external auditor, the internal audit department, internal and external counsel concerning risk management of the Corporation and annually evaluate their performance in relation to such roles and responsibilities; and

(g) annually, together with management report to the Board of Directors on:

A. the Corporation s strategies in light of the overall risk profile of the Corporation;

B. the nature and magnitude of all significant risks;

C. the processes, policies, procedures and controls in place to manage these significant risks; and

D. the overall effectiveness of risk management processes including highlighting risk management problems and the actions that have been or will be taken to address them.

3. <u>QLCC Matters:</u>

The Committee shall:

(aa) inform the chief legal officer and chief executive officer of any report of evidence of a material violation of applicable securities laws, a material breach of a fiduciary duty under applicable laws or a similar material violation by the Corporation or by any officer, director, employee or agent of the Corporation, which has been reported to the Committee;

(bb) determine whether an investigation is necessary regarding any such report;

(cc) if the Committee has determined that an investigation is necessary, (i) notify the Board, (ii) initiate an investigation to be conducted either by the Corporation s chief legal officer or by an outside counsel retained by the Committee and (iii) retain such additional expert personnel as the Committee deems necessary;

(dd) at the conclusion of an investigation, (i) recommend, by majority vote, that the Corporation implement an appropriate response and (ii) inform the chief legal officer, the chief executive officer and the Board of the results of the investigation and the appropriate remedial measures that it recommends to be adopted;

(ee) have the authority and responsibility to act, by majority vote, to take all other appropriate action, including the authority to notify, where required, those securities commissions or the U.S. Securities and Exchange Commission having jurisdiction, in the event that the Corporation fails in any material respect to implement an appropriate response that the Committee has recommended to the Corporation;

(ff) adopt written procedures for the confidential receipt, retention and consideration of any oral or written reports received by the Committee;

(gg) report to the Board on all QLCC matters that it deals with;

(hh) take appropriate measures so that, to the maximum extent possible, consistent with its obligations, the Corporation s legal privileges are protected in connection with the Committee s activities; and

(ii) maintain confidentiality in its activities to the maximum extent possible consistent with performing a full and fair investigation.

The Committee may, at the request of the Board or on its own initiative, investigate such other matters as are considered necessary or appropriate in carrying out its mandate

## APPENDIX B

### GLOSSARY OF TERMS

This Annual Information Form includes the following defined terms:

**AEUB** means the Alberta Energy and Utilities Board;

**Alberta PPA** means an Alberta government mandated power purchase arrangement;

**availability** means the weighted average equivalent availability factor , which is a term used to calculate availability for a pool or fleet of units of varying sizes. It is a measure of time and energy expressed in percentage of continuous operation, 24 hours a day, 365 days a year, that a generating unit is capable of generating electricity, whether or not it is actually generating electricity;

**capacity** means net maximum capacity that a unit can sustain over a period of time;

**gigawatt hour** or **GWh** means one million kilowatt hours of electrical power;

**kilowatt** or **kW** means 1,000 watts of electrical power;

**kilowatt hour** or **kWh** means one hour during which one kilowatt of electrical power has been continuously produced;

**megawatt** or **MW** means 1,000 kilowatts or one million watts of electrical power;

**megawatt hour** or **MWh** means 1,000 kilowatt hours;

**PPA** means a power purchase agreement having an initial term of five years or greater;

**watt** means the scientific unit of electrical power, being the rate of energy use that gives rise to the production of energy at a rate of one joule per second;

**watt hour** is a measure of energy production or consumption equal to one watt produced or consumed for one hour; and

**WPPI** means the Government of Canada s Wind Power Production Incentive available to approved wind generation facilities commissioned between April 1, 2002 and March 31, 2007.

**Balanced,**

**disciplined,**

**sustainable**

**growth in the**

**markets we know**

**Pull tab to**

**learn more.**

**IN MILLIONS OF CANADIAN DOLLARS**
except per common share data

# financial highlights

| Year ended Dec. 31 | | **2006** | | 2005 | | 2004 |
|---|---|---|---|---|---|---|
| Revenues | **$** | **2,796.5** | $ | 2,838.5 | $ | 2,586.2 |
| Net earnings | **$** | **44.9** | $ | 186.3 | $ | 169.2 |
| Comparable earnings [1] | **$** | **233.8** | $ | 161.3 | $ | 127.1 |
| Cash flow from operations | **$** | **489.6** | $ | 619.8 | $ | 591.2 |
| Per common share data | | | | | | |
| Net earnings | **$** | **0.22** | $ | 0.94 | $ | 0.88 |
| Comparable earnings [1] | **$** | **1.16** | $ | 0.82 | $ | 0.66 |
| Dividends | **$** | **1.00** | $ | 1.00 | $ | 1.00 |
| Ratios | | | | | | |
| Cash flow to interest coverage (times) | | **5.5** | | 4.7 | | 4.3 |
| Cash flow to total debt (%) | | **26.2** | | 23.0 | | 19.1 |
| Debt to invested capital (%) [2] | | **40.9** | | 43.9 | | 46.4 |
| Return on capital employed (%) | | **2.5**[3] | | 7.1 | | 7.6 |

1. *Comparable earnings is not a defined term under Canadian generally accepted accounting principles (GAAP). Refer to the Non-GAAP Measures section on page 61 of the MD&A for a further discussion of comparable earnings.*

2. *Includes non-recourse debt.*

3. *Includes $153.6 million after-tax charge related to Centralia mine decision and $84.4 million impairment of the Centralia Gas facility. On a comparable basis, return on capital employed would be 8.3%.*

**MESSAGE**

**STEPHEN G. SNYDER**

President & Chief Executive Officer

# a world of opportunity

Our team is highly focused on delivering disciplined and steady capacity growth over the next five years.

**MESSAGE**

**Ready**
**to pursue growth**

Three years ago I laid out some tough goals for our company. Our industry had just come through a difficult period bankruptcies, price collapses, massive capacity over-builds. We needed to get our company into fighting shape so we could be ready when the industry s next growth wave began.

OUR ACHIEVEMENTS

For the past three years, we have outlined our operating and financial goals (see page 13). Since 2004:

comparable earnings[1] have grown 76 per cent,

cash flow from operations has increased 14 per cent,

credit ratings have improved to stable investment grade,

plant availability has remained high at 89 to 90 per cent,

contracting objectives have been achieved and

total shareowner return over the three-year period has been 67 per cent versus the Toronto Stock Exchange Capped Utility Index total shareowner return of 61 per cent.

Today your company is in great shape. Market conditions are improving. And we can punch above our weight as we showed in 2006, where we faced a number of challenges that tested our team. They met each one with resilience and dedication. There s an employee story behind each event. Each story illustrates the values that drive our success: a focus on the fundamentals and the ability to achieve results through disciplined action, teamwork and a commitment to safety.

One such event occurred in August at Unit 2 of our coal-fired Centralia plant. We had to shut down the unit after a blade failure in a five-year-old low-pressure turbine. Typically these blades last about 30 years so the shutdown was totally unexpected. Our repair teams acted quickly and worked with our procurement specialists to source new blades despite industry shortages. They knew they had to get the plant up and running as fast as possible. The team effort worked. We could have been off-line for months, but 40 days after the event, Unit 2 was producing power. We also completed a precautionary check on the Centralia Unit 1 blades. They checked out fine.

This quick response by our teams contributed to a record gross margin[1] of $1.4 billion in our generation business, a $41 million increase over 2005. Also contributing to these results was our high availability from our Alberta coal-fired plants, averaging 89.6 per cent for the year versus 88.1 per cent in 2005. Strong pricing in Alberta and increased production from our Alberta-based merchant operations also supported the strong operating results.

*1 Comparable earnings and gross margin are not defined under Canadian GAAP. Refer to the Non-GAAP Measures section on page 61 of the MD&A for a further discussion of comparable earnings and gross margin, including a reconciliation to net earnings.*

**MESSAGE**

## >AVAILABILITY AND PRODUCTION

Availability is a key factor in determining revenue in many of our contracts. Availability is the percentage of time a generating unit is capable of running, regardless of whether or not it is generating electricity. As plants need maintenance and occasionally break down, 100 per cent availability over an extended period of time is not achievable.

Production is also a significant driver of revenue in certain contracts. Production is the amount of electricity generated and is measured in gigawatt hours.

| | **04** | **05** | **06** | **Target** |
|---|---|---|---|---|
| Availability (%) | 89.2 | 89.4 | 89.0 | 90+ |
| Production (GWh) | 51,396 | 51,810 | 48,213 | Increase |

## >CONTRACTS

Electricity prices vary hour-by-hour and year-over-year. To reduce our exposure to large swings in electricity prices, we contract a large percentage of our expected capability for terms of one year or more. The weighted average remaining life of our contracts is 12 years.

| | **04** | **05** | **06** | **Target** |
|---|---|---|---|---|
| Contracted capability (%) | 83 | 82 | 81 | ≥75 |

## >MARGIN AND PRODUCTIVITY

Growing gross margin is essential to our success. We increase revenues by capturing market opportunities through higher contract pricing and in the spot market. Managing our fuel costs is also critical, although many of our contracts allow for the recovery of fuel through contract terms.

Managing our maintenance and administration costs is also essential to improving the bottom line. Productivity is measured as operations, maintenance and administration (OM&A) expense per installed megawatt hour (MWh). Our goal is to offset the impact of inflation on OM&A.

| | **04** | **05** | **06** | **Target** |
|---|---|---|---|---|
| Gross margin ($/installed MWh) | 18.62 | 19.74 | 20.35 | Increase |
| OM&A ($/installed MWh) | 7.53 | 8.16 | 7.93 | Hold with inflation |

**>CAPITAL EXPENDITURES**

Capital expenditures are investments in our business. We classify our capital expenditures as either sustaining or growth. Sustaining capital expenditures include investments in such things as equipment for our mines, new information systems and routine and major maintenance on our plants. Our goal is to make sustaining capital expenditures more predictable and in line with our long-range plans. Capital expenditures on growth are discretionary and will vary over time.

| | **04** | **05** | **06** | **Target** |
|---|---|---|---|---|
| Sustaining ($ millions) | 204 | 287 | 207 | 07 budget 320 340 |
| Growth ($ millions) | 142 | 42 | 17 | Variable |

**>EARNINGS PER SHARE AND CASH FLOW**

Earnings per share (EPS) is frequently used to measure a company s profitability. Our target is to increase EPS on a comparable basis annually.

Cash generated from operations is used to maintain our equipment, meet our debt repayment obligations and pay dividends to our shareholders. Our goal is to generate cash in excess of these obligations so we may invest in growth projects, further reduce debt, or return it to shareholders. Our previous target was to generate cash from operations of $550 $650 million. We achieved that goal and accordingly have increased our target for 2007.

| | **04** | **05** | **06** | **Target** |
|---|---|---|---|---|
| Earnings/share (comparable basis) ($) | 0.66 | 0.82 | 1.16 | Increase 6 10% annually |
| Cash from operations ($ millions) | 591 | 620 | 675*1* | 650 750 |

*1 This includes the $185 million receivable of Jan. 2, 2007 due to timing of November 2006 sales.*

**>INVESTMENT RATIOS**

Financial ratios measure our overall financial strength and flexibility. We focus on cash flow to interest, cash flow to total debt, and debt to invested capital. Credit rating agencies use these ratios when evaluating the company. Our goal is to maintain the equivalent of BBB+ credit ratios, which is considered to be a strong investment grade.

We also measure returns to our shareholders and investors two ways: return on capital employed (ROCE) and total shareholder return (TSR). ROCE is a measure of the efficiency and profitability of capital investments. TSR is the total amount returned to investors over a specific holding period and includes capital gains and dividends.

| | **04** | **05** | **06** | **Target** |
|---|---|---|---|---|
| Cash flow to interest (times) | 4.3 | 4.7 | 5.5 | 4.2 |
| Cash flow to total debt (%) | 19.1 | 23.0 | 26.2 | 28.0 |
| Debt to invested capital (%) | 46.4 | 43.9 | 40.9 | 48.0 |
| ROCE (%) | 7.6 | 7.1 | 2.5 | ≥ 10% |
| TSR (%) | 3.3 | 47.6 | 9.2 | ≥ 10% |

## MESSAGE

**The 245 megawatt (MW) Southern Cross power plant in Western Australia is strategically located near our customers to help meet their growing demand for electricity.**

A different operations challenge, however, negatively impacted our 2006 results: our decision to stop mining at our Centralia coal pits and to transition the plant to 100 per cent imported Powder River Basin (PRB) coal. This was our toughest decision in recent history. In addition to the financial implications, we had to tell nearly 600 employees they no longer had jobs. I can t describe how difficult and emotional that was. However, since the existing pits had reached the end of their economic lives, the facts were inescapable: we had to stop mining.

Our decision to use 100 per cent PRB coal at our Centralia coal-fired plant brings new challenges and opportunities. Historically, our units were designed to burn only 30 per cent imported coal. However, because imported PRB coal has a higher BTU content than our local coal, we will have to reconfigure our units. Until we make these necessary changes, we ll have to derate the plant (produce less power) to protect the equipment and maintain safe, reliable operations.

Once we get back to higher operating rates, we ll be able to generate more power with less coal in the future.

So, how did we do in 2006?

**FINANCIAL RESULTS**

Excluding one-time events, comparable 2006 earnings were $233.8 million or ($1.16 per share) compared to $161.1 million ($0.82 per share) in 2005, a 42 per cent increase in earnings per share. Our comparable earnings reflect the underlying strength of our asset portfolio as well as ongoing earnings from our energy trading business.

Including one-time events, TransAlta reported GAAP earnings of $44.9 million ($0.22 per share) versus $186.5 million ($0.94 per share) in 2005. Included in 2006, GAAP earnings were major onetime after-tax charges of $153.6 million ($0.76 per share) for the writedown of the Centralia mine assets and related costs, and $84.4 million ($0.42 per share) due to changes in our future market assumptions requiring the financial impairment of our Centralia gas-fired plant. These were partially offset by a $55.3 million ($0.28 per share) gain related to prior year tax rate changes. Net earnings for 2005 included a onetime after-tax gain of $12 million ($0.12 per share) and $13 million ($0.07 per share) resulting from a tax settlement on a deferred receivable.

For our shareowners, these 2006 results delivered total shareowner return of nine per cent. This is on top of 48 per cent in 2005. On a comparable earnings basis, ROCE was 8.3 per cent. While below our 10 per cent long-term ROCE goal, I believe our decision to stop Centralia mining, our productivity progress, as well as our future growth initiatives position us to meet and sustain our total shareowner return and ROCE goals in the years to come.

Long-term investors in TransAlta know how much we value cash flow. In 2006, our operating cash flow increased to $675[1] million, up from $620 million in 2005. We used this cash to maintain our plants ($207 million) and make required debt repayments ($51 million). The remaining free cash was used to pay dividends to shareowners ($121 million) and distributions ($74 million) to subsidiaries non-controlling interest holders. At the end of the year, we still had $217 million in cash remaining which we will reinvest in our business.

*1 2006 cash flow includes a $185 million receivable received Jan. 2, 2007 due to timing of collection of November 2006 sales.*

**MESSAGE**

**OPERATING RESULTS**

I m especially proud that our teams stayed focused on essential, day-to-day operating activities. Our ability to block and tackle each day ensures that our earnings will remain strong even in the face of large-scale, one-time events. Below are just a few examples of how our teams generated strong earnings by focusing daily on the small stuff :

Our **ENERGY TRADING** business turned in an outstanding performance. Their views on market and pricing trends were superbly analyzed. The result gross margins were $65.7 million compared to $56.9 million in 2005. We see increased potential for the electricity trading business as the market matures and becomes even more liquid. In 2007, we are raising our annual run rate expectation to $50 $70 million of gross margin from this business, up from the $30 $50 million we had been expecting.

**MAJOR MAINTENANCE** planning is paying off. We outperformed our annual targets for spend and outage duration during the year, while achieving our availability goals. We spent a total of $140 million in 2006, 40 per cent of which was expensed. We have now reached our objective to stabilize this ongoing expenditure in the $150 $175 million per year range one year ahead of plan. Outage duration was only 2,325 GWh compared to the 2,818 GWh originally budgeted.

**OM&A** decreased year-over-year by $14.7 million. On an OM&A per gross installed MWh basis, OM&A was $7.93 in 2006 versus $8.16 in 2005. This is strong performance in the face of inflationary pressures. Our focus now is to sustain these gains in the years ahead.

Our **FINANCE** team met our year-end goal to certify that we are Sarbanes-Oxley Act compliant. News stories of how much work is required to achieve this milestone are not exaggerated and our team tackled this job efficiently and effectively. They also reduced interest expense by $20 million due to lower debt levels and favourable settlements of net investment hedges.

**READY, STEADY, GROW**

In my report last year, I introduced you to our Four Pillars of Performance: Operational Excellence, Plant Maintenance, Lifecycle Planning and Portfolio Management & Growth. Collectively, these pillars create our sustainable competitive edge and position us to steadily grow our capacity, earnings and cash flow.

**OPERATIONAL EXCELLENCE**

Our goal is to sustain reliable operations at optimal costs in our generation plants and coal operations. We have maintained high fleet-wide availability at 89 to 90 per cent levels. To do this, our operations and engineering teams systematically assess plant maintenance requirements. They have the skills and resources to be flexible and act promptly if any problems emerge. We conduct preventative maintenance between planned outages to further sustain reliability. As a result, our unplanned outage and derates now average only six per cent per year. That s strong performance in our industry and with our plant mix.

Production rates and costs at our Alberta coal mines remain relatively predictable and stable, despite the volatility and price inflation in the mining industry. Investments we ll make in 2007 on new 400-ton trucks will reduce our coal-handling costs by the end of 2008. And of course, our decision to source PRB coal at Centralia will dramatically reduce those coal costs starting around the middle of 2008.

When it comes to productivity we ll take big breakthroughs when they come. But our focus is on

**MESSAGE**

**The 259 MW Chihuahua plant in Mexico during a maintenance outage.**

doing every task slightly better and safer. Our goal is to offset inflation on a per megawatt hour installed basis. To support this initiative, we have linked compensation to cost management. We re investing in technology and developing more efficient workforce strategies to reduce staff costs. The productivity focus extends right across the company. In 2007, I will operate with three fewer senior direct reports than I did in 2006. Corporate overhead costs will be challenged just as aggressively as every other cost in the company.

You know from past letters that I believe operational excellence is as much about safety as it is about making availability targets, reducing our costs and minimizing our environmental footprint. Our goal throughout the company is to achieve a Target Zero incident record. In 2006, we did not perform as well as in 2005. Our combined employee and contractor injury frequency rate for the year was 1.95 versus 1.41 the previous year. We must do better. Our objective is to make everyone in the company aware of incident prevention and to look out for each other. I expect to report better progress to you in 2007.

**PLANT MAINTENANCE**

We must maintain our asset base of $5.5 billion. Our goal is to drive up the profitability of our current fleet of assets while installing the systems and maintaining the discipline required to extract top performance from our future fleet.

Depending on the technology, our plants must have periodic major maintenance every two to four years. These outages cost as much as $40 million for labour and components and require shutdowns as long as six weeks. That s a big revenue loss. Our success is measured by extending the intervals between major maintenance outages and completing maintenance work as quickly as possible, without compromising plant availability, reliability, and safety.

Over the last couple of years, we have gained very deep asset knowledge and developed detailed maintenance plans for each facility. We have made a lot of progress in moving our coal fleet from a two- to three-year major maintenance interval. This transition will be completed by the end of 2007. It will result in fewer major outages, lower spend over the life of the asset and turn more megawatts into incremental gross margin. We are deploying this same discipline to optimize spending on our gas plants. We want to run these longer between major maintenance outages.

As a result of all these efforts, the predictability of our major maintenance program has increased and the level of maintenance spending has declined.

**LIFECYCLE PLANNING**

Like a car, every generation plant over time develops different operating characteristics and maintenance needs. We strive to find the sweet spot for each plant to spend just enough money and not a cent more to extract the full value over its lifetime. Last year, I told you how we collect fleet-wide data on equipment and operating assets so we can gauge

**MESSAGE**

how each asset in our portfolio will perform over its life. Our teams completed this work in 2006.

Now we can make timely, economical decisions about which plants need to be retired, which require capital to extend their useful lives, and which plants we should expand. Our success will be measured by the hundreds of millions of dollars we expect to save in reduced capital spends over the life of our fleet. While our power purchase arrangements don t begin to expire until 2017, we are already hard at work assessing the best long-term options for our Alberta fleet.

Our analysis supports the merits of adding approximately 50MW to our coal-fired Sundance 4 facility. With peak electricity demand in Alberta growing at approximately five per cent per year, the modest $50 million we will invest in this Sundance uprate will allow us to add incremental production that will generate attractive future returns. We expect this uprate to be completed by the end of 2007.

We also continue to focus on key strategic supplier partnerships. These give us more reliable access to materials and components, savings due to economies of scale in purchasing and a continuing source of technical expertise that we can build on over the years.

**PORTFOLIO MANAGEMENT & GROWTH**

Through Portfolio Management, we are guided to make investment decisions that maintain the strength of our diverse portfolio of generation assets and contracts. In the immediate and medium term we must optimize our risk reward ratios whenever we make power purchase versus production decisions and in procuring fuel. We optimize our long-term risks and returns when we decide which assets we will buy, build, continue to hold or choose to divest.

Our portfolio of approximately 8,800 MW of generating assets is diversified by geography, fuel type, technology and contractual status. We operate in four countries: Canada, the United States, Mexico and Australia. We are 59 per cent coal-based, 28 per cent natural gas and 13 per cent hydro and renewable energy. Our technologies include conventional and supercritical coal-fired plants; combined cycle and peaker gas plants; cogeneration plants; and hydro, wind and geothermal plants. We have bilateral contracts with cogeneration partners and short-, medium- and long-term contracts with other creditworthy wholesale customers.

We manage this portfolio to reduce our earnings volatility and protect our cash flows. Our lifecycle planning models allow us to plan investments in existing and new assets over their expected asset lives. Our long-term strategic supplier contracts support our portfolio management. Our energy trading operations track record proves that we have a strong understanding of market fundamentals.

our markets 2006

We see opportunity for growth in our existing markets where we have the expertise in buying, building and managing plants. Our market diversity and varied fuel mix allow us to approach these opportunities in a prudent, disciplined manner.

**ALBERTA 58%**

Small, deregulated market peak load of 9,600 MW

Peak demand growing at 4.7% per year compressing reserve margins

Long term, oil sands and clean coal technology provide growth opportunities.

**ONTARIO 8%**

Large, hybrid market peak load of 27,000 MW

RFP driven market

Demand growing at 3.8%

Short-term opportunities in renewables

**UNITED STATES 25%**

Large, hybrid market peak load of 28,300 MW

Participate mostly in the Pacific Northwest

Demand growing at approximately 1% per year

Opportunities for expansion of geothermal assets

**MEXICO 6%**

Large, fully regulated market peak load of 32,400 MW

Strong demand growth at 4.8% per year

Opportunities for acquisitions and new gas development

**AUSTRALIA 3%**

We limit ourselves to a niche market, doing cogeneration projects with resource companies in Western Australia.

Our customers power needs are growing as demand from Asia for natural resources increases dramatically.

*Percentages above represent installed capacity in regions.*

**Our growth plans include the 53 MW uprate at the 2,020 MW Sundance plant in Alberta, the 450 MW Keephills 3 supercritical coal-fired plant in Alberta and a 75 MW wind farm in New Brunswick.**

## MESSAGE

**We have a long-term rail transportation agreement with BNSF Railway Company to deliver sufficient coal to meet annual fuel requirements at our Centralia coal-fired plant. BNSF is constructing additional track, as shown here, to increase its coal-carrying capacity.**

We use this market intelligence to make both short-term production decisions and long-term investment decisions.

I also remind you that our goal is to contract at least 75 per cent of our plant availability in order to reduce our exposure to price swings in the market. In 2006, we signed contracts with the Ontario Power Authority to supply an average of 400 MW from our Sarnia cogeneration plant for approximately five years. We also met our re-contracting targets for our Centralia coal-fired plant. We signed contracts extending from 2007 to 2009 for approximately 900 MW per year of our capability at an average price of US$45 to $55 per MWh. This is a significant uplift from the US$30 per MWh of the original contracts.

This overall ability to optimize our portfolio is key to understanding our growth strategy.

### WHAT YOU CAN EXPECT IN 2007

### GROWTH INITIATIVES

Our team is highly focused on delivering disciplined and steady capacity growth. But, we will maintain our targeted credit ratios and stay with the technologies and geographies we know best. We will balance our greenfield development (building of new plants) with brownfield expansions (existing asset expansion) and acquisitions. Our goal is simple and achievable: deliver five per cent average annual capacity growth over the next five years.

| online | | To learn more about our energy trading and marketing business, visit www.transalta.com |
|---|---|---|

Whether it is a single asset or a portfolio of assets, each new project and transaction will be put through our comprehensive capital allocation process. It screens and ranks each investment alternative against criteria such as market, size of investment, ownership, technology and operations, commercial contracts, portfolio effects and environmental risks. And of course financial metrics are analyzed in detail. It s a tough screen.

We are already off to a solid start to meet our growth objectives. In addition to our previously announced plans to expand our Sundance plant, we announced in January 2007 that we would build a new 75 MW wind facility. It will supply electricity to New Brunswick Power under a 25-year long-term contract. The wind farm is expected to cost $130 million and to be in operation by the end of 2008.

In February 2007, we announced our decision to expand our Keephills plant by 450 MW using supercritical technology. This will be a joint venture with EPCOR, our partner in Genesee 3. Commissioned in 2005, it was the first supercritical pulverized coal plant to be built in Canada. Because this type of facility burns coal more efficiently than conventional coal plants, it has fewer emissions and delivers more megawatts per BTU. The total cost, estimated at $1.6 billion, will be shared equally by EPCOR and TransAlta. Once commercial in 2011, Keephills 3 along with Genesee 3 will be among the most advanced coal-fired plants in the world. These additions will allow us to decommission our oldest coal plant, Wabamun 4, as planned in 2010.

Additional investment opportunities exist in Alberta from the economic expansion related to the oil sands. In Australia the explosive world demand for commodities provides opportunities. New generation investments will be needed in Eastern Canada, the Western United States and Mexico to meet steadily growing demand. Building on the lessons from our past, I am confident that we can execute successfully on our growth goals.

## MESSAGE

**CENTRALIA CHALLENGES
IN THE TRANSITION TO PRB COAL**

We are implementing a plan that will result in more predictable and lower coal costs for the Centralia coal-fired power plant. In November 2006, we secured a long-term rail transportation agreement with BNSF Railway Company to deliver sufficient coal to meet our annual fuel requirements and to give TransAlta access to multiple mines for supply flexibility.

We also executed medium-term coal supply contracts. The contracts allow us to keep our costs predictable and in line with market prices. Given that there are many suppliers in the PRB and we have a long-term rail agreement in place, we are confident we can continually contract ideal coal mixes for the life of the plant.

In 2007 and 2008, we expect to invest CDN $50 $60 million of capital in our on-site rail capacity to streamline the handling, unloading and stockpiling of PRB coal deliveries. This investment will be split evenly between the two years. When complete, we will be able to meet our full fuel requirements for the Centralia coal-fired facility.

Also in 2007, we will work diligently to reconfigure the Centralia coal-fired plant to be able to fully use PRB coal. Over the next two years, we estimate capital spending of approximately CDN $50 $60 million on Centralia coal-fired plant specific modifications, split evenly between 2007 and 2008.

As discussed earlier, until we complete our reconfiguration, the higher heat content PRB coal forces us to temporarily derate our Centralia plant. Our current estimate is that the 2007 revenue loss from derating the plants is, unfortunately, about equal to our fuel cost savings derived from our new sourced coal. That will hold us back in 2007, although we will benefit from higher contracted prices on our Centralia coal-fired electricity sales.

The good news is that we ll get the benefit of the full cost savings by mid-2008, and more importantly, every year after that. Meanwhile, in 2007, our engineering and operation teams are focused on minimizing any derates and getting our new equipment installed as quickly as possible.

**ENVIRONMENTAL LEADERSHIP**

Your company has aggressively invested in sustainable development for over 10 years. We did that not only because it was our obligation and the right thing to do for the environment, but also because it made business sense to us.

A founding member of the Canadian Clean Power Coalition, our goal is to cost-effectively reduce our environmental footprint. Public opinion, public policy and our industry are catching up to our leadership. That s a good thing. It s also why these efforts will continue to be a cornerstone of our strategy.

Our environmental management strategy includes:

participating in policy development with non-governmental organizations (NGOs) and all levels of government to ensure clear and sensible rules are established and compliance costs are acceptable to our customers,

investing in renewable energy such as wind and geothermal, now four per cent of our portfolio, with a long-term goal of achieving 10 per cent of our capacity from renewables,

acquiring and trading offsets of carbon and other emissions, an area where we are recognized innovators and leaders,

management of environmental risk using ISO-14001-based management systems and market mechanisms,

investing in advanced technologies such as $SO_2$ scrubbers at our Centralia coal-fired plant and in supercritical boiler technology at our Genesee 3 plant and Keephills 3 project and

testing new enhanced activated carbon injection technology at our Sundance plant that we believe will reduce mercury emissions 70 per cent by 2010.

We have made meaningful progress on managing our impact on the environment. Since 2000 we have reduced:

sulphur dioxide intensity by 64 per cent,

nitrogen oxide intensity by 16 per cent and,

greenhouse gas emission intensity by 4 per cent.

In 2006, we were recognized by the Dow Jones Sustainability Index for the eighth consecutive year. Within the annual report, pages 22-23 are dedicated to our sustainable development report to investors. We are proud of these achievements and we will continue to strive for even better progress in the future.

**OUR TEAM AND OUR MISSION**

TransAlta is unique. We are a wholesale generation and marketing company that pays investors a dividend. We operate a diversified and highly contracted portfolio of generation assets. And, we have stable investment-grade credit ratings.

Our teams drive our success. In 2006, unusual and large-scale events challenged us. The men and women of TransAlta responded quickly and effectively. In 2007, you can expect the same dedication to results.

**MESSAGE**

*standing left to right* **Mike Williams, Executive Vice-President Human Resources & Communications, Ken Stickland, Executive Vice-President Legal, Linda Chambers, Executive Vice-President Generation Technology, Richard Langhammer, Executive Vice-President Generation Operations** *sitting left to right* **Brian Burden, Executive Vice-President & Chief Financial Officer, Tom Rainwater, Executive Vice-President Corporate Development & Marketing**

Each month, our executive team checks our progress against our short-term goals and our five-year plan. We revisit our strategy with our Board of Directors at each meeting. If regulations change or opportunities arise, we can change our strategy to meet the shifts. Our Board continues to provide superb governance and management guidance. They actively participate in our strategy development. They set and monitor our overall risk profile. Their stewardship includes setting the highest standards for ethical behaviour.

Today, TransAlta is fit and ready to pursue value growth opportunities. We are located in good geographies with tightening reserve margins. We have the assets, technology and expertise to optimize a diversified portfolio. We have the lifecycle management systems and strategic supplier relationships to manage a more predictable capital spend. We are environmental leaders and we proactively mitigate our impact on the environment. We have the balance sheet strength and liquidity to support commercial activities and sustainable growth objectives.

As a shareowner and as TransAlta s leader, I am very proud of this company. We were severely tested by industry events over the last few years and emerged in strong shape. I want to sincerely thank each and every one of our employees for their unfailing efforts day-in- and-day-out to meet our goals. If you come to our shareholder meeting this April in Calgary, you can meet many of them in person.

We will continue to be tested. The environment looms big for us. We must stretch our resources and our ideas to do more. New technologies must be chosen. Growth decisions must be made. Fortunately, TransAlta s employees have the spirit, the resilience and the dedication to succeed in these upcoming challenges. We will continue to strive to improve and do better than anyone else in our industry.

STEPHEN G. SNYDER

President & Chief Executive Officer

February 27, 2007

*above* Festival performers from the TransAlta Festival City in a Box program

# COMMUNITY

## Connecting with communities

TransAlta s connection with communities grew this year through efforts to deepen existing partnerships and develop new ones. Over $5 million was contributed to organizations in communities where our employees live and work.

With a significant portion of our operations in the Edmonton area, we partnered with The City of Edmonton to showcase the artistic wealth of the city.

Through the **TRANSALTA FESTIVAL CITY** grant program we will build artistic capacity in the greater Edmonton area. Managed by the Edmonton Arts Council, the program helps position arts organizations for growth. Organizations can use grants to develop better festivals by adding new artistic resources or seeking mentoring and consulting services.

At the same time, the **TRANSALTA FESTIVAL CITY IN A BOX** program acknowledges the strength of the city s arts community in achieving tourism and economic development objectives. Through this program, samplings of Edmonton s arts community are packaged in a box to entice visits by tourists and conventions. In 2006, the **TRANSALTA FESTIVAL CITY IN A BOX,** operated through the Edmonton Economic Development Authority, was featured prominently at an Alberta Days event staged by the Government of Alberta with the Smithsonian Institute in Washington, D.C.

We believe community investment partnerships are more than financial commitments. Engaging our employees, including TransAlta s senior executives and retirees, is an integral element of our successful partnerships. Including the contributions of our TransAlta Community Transformers **(TACT)**, our employees volunteered over 12,300 hours in support of company and community-led programs. In 2006, we created the Executive Connection program, which encourages our Executive Vice-Presidents to become involved on community boards, lending their experience and expertise in support of a variety of causes. TransAlta s retiree group, Projects Organized With Energetic Retireees (**POWER**), took on a range of projects last year including growing vegetables for the Calgary Inter-faith Food Bank, knitting and donating items to local hospitals for children and participating in the Tim Horton s Children s Ranch fall clean-up.

Our relationship with aboriginal communities grew through our participation in Traditional Land Use studies conducted by the Paul and Blood First Nations. Productive dialogue about our operations continues to be a focus, with regular communication meetings with the Paul Band and the creation of a Transmission Advisory Committee, including representatives from the 13 First Nations where we have operations.

TransAlta s community investment focuses on a small number of initiatives where we can have the most meaningful impact over the long term.

*left* TransAlta retiree, Brian Peters, harvests the POWER garden for the Calgary Inter-faith Food Bank.

| | | |
|---|---|---|
| online | | To learn more about our community investment programs, visit www.transalta.com |

## SUSTAINABLE DEVELOPMENT

Sustainability remains one of the key components in how we conduct our business

TransAlta has a long history of taking on the challenges of sustainable development. Since the 1990s, we have been focused on building a sustainable company, balancing the economic, environmental and social implications of our business decisions. Today, sustainability remains one of the key components in how we conduct our business.

We strive to:

- operate with the highest standards of safety,
- reduce the environmental impacts of our operations and develop long-term plans to achieve more aggressive environmental standards,
- recruit and retain the best employees,
- consult with people impacted by our operations and
- support communities where our employees live and work.

Every year, we aim to improve the accuracy and completeness of the reporting of our sustainability performance to stakeholders. In 2006, we reviewed our processes and controls relating to the measurement, calculation, consolidation and reporting of some of our key sustainability data. We will have these reviewed by an external party in 2007.

Voluntary reporting is only one of the ways TransAlta reinforces our sustainable development commitment. We openly report on economic, environmental and social performance because it encourages us to accurately and comprehensively assess the year s performance. Voluntary reporting illustrates how sustainable thinking is part of our business influencing the decisions we make and the actions we take.

ECONOMIC SUSTAINABILITY

We believe we have a sustainable business model. Our diversified portfolio of generating assets combined with our technical and commercial expertise means we have the right components to deliver balanced, sustainable and profitable growth for our shareholders.

In 2006, our total shareholder return was nine per cent. This was in spite of incredible business challenges such as the decision to stop mining at our Centralia coal mine and transition to PRB coal and the impairment of the Centralia gas-fired asset. Excluding these events, comparable earnings were up 41 per cent at $1.16 per share compared to $0.82 per share in 2005. Cash flow increased to $675 million[1], up from $620 million in 2005. We use this cash to maintain our plants, pay dividends to our shareholders, pay down debt and reinvest in the business.

Looking forward, we are pursuing growth opportunities in the markets and geographies we know. We have announced plans to build a 75 MW wind farm in New Brunswick, add 53 MW of additional capacity at our Sundance facility and proceed with building the next supercritical coal-fired plant in Alberta Keephills 3.

ENVIRONMENTAL SUSTAINABILITY

We remain committed to reducing the environmental impacts of our operations. In addition to our active participation in policy discussions that will affect our industry, we have a comprehensive environmental strategy:

find internal efficiencies at plants,

increase our investment in renewables,

continue to build our offsets portfolio and emissions trading strategy and

support development of cleaner emerging generation technologies.

This strategy has been in place for several years to reduce environmental risk and deliver competitive opportunities. We use the internationally recognized ISO-14001 standard to manage our environmental risk.

While we have made some meaningful progress in reducing our impact on the environment, we know that we must develop long-term plans to ensure we achieve the aggressive environmental

*1 2006 cash flow includes a $185 million receivable received Jan 2, 2007 due to timing of collection of November 2006 sales.*

# SUSTAINABILITY

Danielle Stuart, Environmental Specialist and

Don Wharton, Director Sustainable Development,

help balance the economic, environmental

and social implications of business decisions.

standards of the future. We are prepared for new environmental regulations and believe our ongoing stakeholder engagement and our early, proactive and voluntary action will pay off over the long term.

## SOCIAL SUSTAINABILITY WORKPLACE SAFETY AND COMMUNITY RELATIONS

Our goal is to provide a safe and healthy workplace for all employees and contractors. Our Target Zero initiative is designed to drive improvements in safety, health and environmental performance. Under Target Zero, a leadership committee meets monthly to identify leadership actions and develop proactive work plans to improve our performance through standard processes and company-wide environment, health and safety initiatives.

Regrettably, in 2006, there was a contractor fatality at one of our facilities. We have completed our internal investigation and are fully cooperating with Workplace Health and Safety as they conduct their investigation. We remain focused on finding out what happened and will do whatever we can to prevent tragedies like this from happening in the future.

We have a strong base of internal policies governing how we conduct our business. TransAlta employees fulfill these policies while upholding the highest level of ethical conduct and meeting responsibilities as good corporate citizens.

Since our operations affect many different individuals and groups of people, public consultation is a significant part of our business. Through open houses, one-on-one meetings and other engagement strategies, we listen and respond to stakeholder concerns about development, ongoing operations and decommissioning activities. Meaningful relationships with affected parties enable us to continue operating our facilities. As we decommission our Wabamun facility and begin construction on the 450 MW Keephills 3 power plant, we will continue to engage local government officials, local businesses, regulatory agencies and other stakeholders from the surrounding communities.

Community investment is part of our social commitment. TransAlta is dedicated to helping sustain vibrant and healthy communities and the environment for today and for tomorrow. For more information on our community investment activities, turn to page 21.

The investment community is increasingly concerned with how companies are managing environmental and social pressures and how this risk management translates into economic performance. We believe such factors will become another competitive differentiator for TransAlta. That is why we continue to speak with the investment community regarding our progress in this area. We believe sustainability is an integral part of our business.

| | | |
|---|---|---|
| online | | To learn more about TransAlta s sustainability efforts, visit our website at www.transalta.com |

In our business, air emissions associated with generating electricity are a key environmental issue. The following charts* illustrate how we are managing the primary emissions associated with our business:

* *Data above represents only those facilities for which TransAlta holds the operating permits.*

# LETTER
FROM THE
CHAIR OF THE BOARD

Approaching business oversight from economic, environmental and social perspectives makes good business sense.

DONNA SOBLE KAUFMAN

Chair of the Board

AS you see in this annual report, TransAlta achieved strong operational and financial results in 2006 while working through significant business challenges. This performance reflects the resilience of your Company. On behalf of the Board of Directors, I congratulate the TransAlta management team and the dedicated employees across the company on a job well done.

During my time on TransAlta s Board, I have seen many changes in the industry, the company and shareholders expectations. Throughout these changes, the Board has remained focused on building a sustainable company a company that will continue to deliver profitable growth for you over time. To do this, your Board is fully engaged in the development of the strategic plan, has established the appropriate risk parameters, has monitored progress and has demanded results. We have ensured TransAlta has operated in an ethical, economically rewarding and environmentally and socially responsible manner.

The Directors of TransAlta recognize that corporations are expected to deliver more than positive economic performance. Corporations that factor the social and environmental risks and benefits are recognized by society as doing the right thing and by investors for delivering a sustainable business model. I am pleased to report your Company continues to be recognized for its efforts in approaching business from this perspective. For the eighth consecutive year, TransAlta has been listed on the Dow Jones Sustainability Index. This index represents the top 10 per cent of sustainable companies worldwide. We are very pleased to be included in this list not only for the honour, but also because these listed companies have been shown to consistently outperform others financially.

TransAlta s sustainable development performance is due in large part to the leadership of Dr. Bob Page, who retired from TransAlta in January 2007 to become the first TransAlta Professor at the University of Calgary s Institute for Sustainable Energy, Environment and Economy. On behalf of the Board, I would like to thank Bob for his tireless dedication to TransAlta s sustainability efforts.

Sustainable development and good governance contribute to corporate performance. Your Board is fully engaged in creating and maintaining shareholder value and dedicated to good stewardship of

# LETTER

the Corporation. During 2006, the Board and its committees devoted considerable time, effort and thought to assure that we maintain best practices in Corporate Governance.

Further, we have an annual two-day strategy session where we discuss the Corporation s strategic plan with our management team. This year a significant part of the discussion was focused on the Corporation s plans for sustainable growth.

With TransAlta s growth plans articulated, the Directors wanted a clear understanding of how management is assessing and addressing the risk associated with those plans. To facilitate this, the Board modified its previous committee structure to ensure more direct oversight on risk and the environment. Both the Audit and Risk and the Governance and Environment committees have clear mandates to carefully study their respective areas, review management s decisions and report to the Board regularly. Our Board believes these modifications will better align priorities and ensure environment and risk management issues are being diligently handled.

Our Board s commitment to maintaining a culture of the highest ethical and professional standards with sound corporate governance was recognized by *The Globe and Mail s Report on Business* report on corporate governance. For the fifth consecutive year, TransAlta has been ranked among the best governed corporations in Canada. Board composition is a major component in this determination. We have a highly qualified, independent Board, with members from various parts of the world. In addition to providing regional insight and expertise, each Board member brings both depth and diversity of experience to the table.

In July, we welcomed Dr. Martha Piper to our Board. An exceptional academic and scholar, Martha is an Officer of the Order of Canada, a recipient of the Order of British Columbia and has made extraordinary contributions around the world.

She was recently appointed a member of the Trilateral Commission an international think tank focused on fostering closer cooperation among democratic industrialized areas of the world. Her experience as a senior university administrator and in international relations will serve the Board well.

As Chair, I very much appreciate the support of my colleagues on the Board for their wise counsel during what has been an extremely demanding year at TransAlta.

TransAlta s Board of Directors is convinced that approaching business oversight from economic, environmental and social perspectives makes good business sense. We recognize that our shareholders entrust this duty to us and we are determined to continue to earn this trust. The foundation we have built in the years leading up to 2007, both at the Board and operating levels, has positioned us to create profitable growth. As a Board, we have every confidence in TransAlta s management team and employees to deliver this for our shareholders.

Thank you for placing your confidence in us.

DONNA SOBLE KAUFMAN

**Chair of the Board**

**BOARD OF DIRECTORS**

**WILLIAM D. ANDERSON** Director since 2003 and resident of Toronto, Ont. Mr. Anderson was President of BCE Ventures, a subsidiary of BCE Inc., from 2001 to 2005 and CFO of BCE Inc. from 1998 to 2000. He is a director of Bell Canada International Inc., the Four Seasons Hotels Inc., Gildan Activewear Inc. and MDS Inc. He is a member of the Institute of Chartered Accountants of Ontario.

**STANLEY J. BRIGHT** Director since 1999 and resident of Oxford, Maryland. Mr. Bright was Chair and CEO of MidAmerican Energy Company from 1997 to 1999 and President, CEO and Chair and CEO of predecessor companies from 1991 to 1997. He served as a director of MidAmerican Energy Holdings Company, a subsidiary of Berkshire Hathaway Inc., from 1999 to February 2006 and has been a director of MidAmerican Energy predecessor companies since 1987.

**TIMOTHY W. FAITHFULL** Director since 2003 and resident of Oxford, United Kingdom. Mr. Faithfull was President and CEO of Shell Canada Limited from 1999 to 2003, when he completed a 36-year international oil and gas career with the Royal Dutch/Shell Group. He is a director of Canadian Pacific Railway Limited, Shell Pension Trust Limited and AMEC plc in the United Kingdom. He is a council member of the Canada United Kingdom Colloquia and a trustee of the Starehe Endowment Fund (U.K.).

**GORDON D. GIFFIN** Director since 2002 and resident of Atlanta, Ga. Ambassador Giffin is a Senior Partner of McKenna Long & Aldridge LLP. He is a director of Bowater, Inc., Canadian National Railway Company, Canadian Imperial Bank of Commerce and Canadian Natural Resources Ltd. and Ontario Energy Savings Corp. He is a member of the Council of Foreign Relations, an advisory board member of the Canadian- American Business Council and serves on the Board of Trustees for the Carter Center in Georgia. Ambassador Giffin served as United States Ambassador to Canada from 1997 to 2001.

**C. KENT JESPERSEN** Director since January 2004 and resident of Calgary, Alta. Mr. Jespersen has been Chair and CEO of La Jolla Resources International Ltd. since 1998. He worked with NOVA Corporation for over 20 years in various management positions, including President of NOVA International. He is Chair of North American Oilsands Ltd., Chair and a director of CCR Technologies Ltd., a director of Matrikon Inc. and Axia NetMedia Corporation.

**MICHAEL M. KANOVSKY** Director since January 2004 and resident of Victoria, B.C. Mr. Kanovsky has been President of Sky Energy Corporation since 1993. He has been involved in investment banking and the oil, gas and power industries for over 30 years. He is a director of Accrete Energy Corporation, Devon Energy Corporation, ARC Energy Trust, Bonavista Energy Trust and Pure Technologies Inc.

**DONNA SOBLE KAUFMAN** Director since 1989 and resident of Toronto, Ont. Mrs. Kaufman is Chair of the Board of TransAlta Corporation. Mrs. Kaufman is a director of BCE Inc., Bell Canada and Telesat Canada. She is also a director of Historica, The Baycrest Centre, a Fellow of the Institute of Corporate Directors and a member of the Canadian Board of Advisors of Catalyst.

## corporate governance

TransAlta s directors are experienced business leaders representing varied geographic and professional backgrounds, including business, finance, law and public service. On behalf of TransAlta s shareholders, the Board of Directors is responsible for the stewardship of the corporation, establishing overall policies and standards and reviewing strategic plans. In 2006, the directors met on 11 occasions, including one special meeting devoted exclusively to TransAlta s corporate strategy and direction.

After a detailed examination of the relationships between each of the directors and TransAlta, the Board determined that 10 of the existing 11 board members are independent, excluding only Stephen Snyder, President and CEO of the company. All of the members of each of the committees of the Board are independent. In 2006, the Board had three committees, which are briefly described as follows. Further detailed information with respect to TransAlta s approach to corporate governance is contained in the 2006 Management Proxy Circular.

**AUDIT AND ENVIRONMENT COMMITTEE**

The committee is responsible for reviewing financial reporting, financial controls, internal audit matters, financial risks inherent in the business and environmental risks and regulations affecting the Corporations s activities. This committee met 11 times in 2006. Committee chair: William D. Anderson. Members: Stanley J. Bright, Timothy W. Faithfull, Michael M. Kanovsky, Gordon S. Lackenbauer and Donna Soble Kaufman (as an ex-officio member).

**HUMAN RESOURCES COMMITTEE**

The committee is responsible for reviewing and recommending executive compensation programs, succession plans, the CEO s compensation and performance as well as acting as steward for the corporate pension plan. This committee met six times in 2006. Committee chair: Stanley J. Bright. Members: Timothy W. Faithfull, C. Kent Jespersen, Dr. Martha C. Piper, Luis Vázquez Senties and Donna Soble Kaufman (as an ex-officio member).

# BOARD

**GORDON S. LACKENBAUER** Director since September 2005 and resident of Calgary, Alta. Mr. Lackenbauer was Deputy Chairman of BMO Nesbitt Burns Inc. from 1990 to 2004. He is a director of Tembec Inc., NAL Oil & Gas Trust and CTV Globemedia Inc. Mr. Lackenbauer is also a Governor of Mount Royal College.

**MARTHA C. PIPER** Director since 2006 and resident of Vancouver, B.C. Dr. Piper was President and Vice- Chancellor of the University of British Columbia from 1997 to 2006. She is a Director of the Bank of Montreal, the B.C. Progress Board, the Pierre Elliot Trudeau Foundation and the Council of Canadian Academies.

**STEPHEN G. SNYDER** Director since 1996 and resident of Calgary, Alta. Mr. Snyder has been President and CEO of TransAlta Corporation since 1996. He is Chair of the Calgary Stampede Foundation and a director of the Calgary Exhibition and Stampede, the Canadian Imperial Bank of Commerce and the Alberta College of Art + Design. Mr. Snyder is a Trustee of the Conference Board of Canada.

**LUIS VÁZQUEZ SENTIES** Director since 2001 and resident of Mexico City, Mexico. He is President and CEO and Chair of Group Diavaz, an oilfield services and natural gas distribution company he founded with partners in 1973. Mr. Vázquez is Chair of Compania Mexicana de Gas, S.A. de C.V. and of the Mexican Natural Gas Association.

**NOMINATING AND CORPORATE GOVERNANCE COMMITTEE**

The committee is responsible for reviewing the composition and compensation of the Board of Directors and developing the company s approach to governance issues. This committee met four times in 2006. Committee chair: Ambassador Gordon D. Giffin. Members: C. Kent Jespersen, Michael M. Kanovsky, Gordon S. Lackenbauer and Donna Soble Kaufman (as an ex-officio member).

**2006 CHANGES**

Louis D. Hyndman retired from the Board in April 2006. Dr. Martha C. Piper joined the Board in July 2006.

*left to right* Michael Kanovsky, Stephen Snyder, Bill Anderson

*left to right* Gordon Giffin, Luis Vázquez Senties,

Donna Soble Kaufman, Martha Piper, Gordon Lackenbauer

*left to right* Kent Jespersen, Stanley Bright, Tim Faithfull a wealth of experience

We have a highly qualified, independent Board whose members have diverse professional experience.

# PLANT SUMMARY

| Facility | Capacity (MW) | Ownership (%) | TransAlta operated | Capacity owned or operated (MW) | Fuel | Revenue source* | Contract expiry date |
|---|---|---|---|---|---|---|---|
| Genesee 3 | 450 | 50 | No | 225 | Coal | Merchant | |
| Keephills | 766 | 100 | Yes | 766 | Coal | Alberta PPA | 2020 |
| Keephills 3 [1] | 450 | 50 | Yes | 225 | Coal | Merchant | |
| Sheerness | 770 | 25 | No | 193 | Coal | Alberta PPA | 2020 |
| Sundance [2] | 2,073 | 100 | Yes | 2,073 | Coal | Alberta PPA | 2017, 2020 |
| Wabamun [3] | 279 | 100 | Yes | 279 | Coal | Merchant | |
| Fort Saskatchewan | 118 | 30 | Yes | 35 | Gas | Long-term contract | 2019 |
| Meridian | 220 | 25 | Yes | 55 | Gas | Long-term contract | 2024 |
| Poplar Creek | 356 | 100 | Yes | 356 | Gas | Long-term contract | 2024 |
| | | | | | | & Merchant | |
| Hydro assets [4] | 801 | 100 | Yes | 801 | Hydro | Alberta PPA | 2013 2020 |
| Castle River | 46 | 100 | Yes | 46 | Wind | Long-term contract | 2011 |
| McBride Lake | 75 | 50 | Yes | 38 | Wind | Long-term contract | 2022 |
| Summerview | 68 | 100 | Yes | 68 | Wind | Merchant | |
| **Western Canada Total** | **6,472** | | | **5,160** | | | |
| Kent Hills [5] | 75 | 100 | Yes | 75 | Wind | Long-term contract | 2033 |
| Mississauga | 108 | 50 | Yes | 54 | Gas | Long-term contract | 2017 |
| Ottawa | 68 | 50 | Yes | 34 | Gas | Long-term contract | 2012 |
| Sarnia | 575 | 100 | Yes | 575 | Gas | Long-term contract | 2022 |
| | | | | | | & Merchant | |
| Windsor-Essex | 68 | 50 | Yes | 34 | Gas | Long-term contract | 2016 |
| | | | | | | & Merchant | |
| **Eastern Canada Total** | **894** | | | **772** | | | |
| Centralia | 1,404 | 100 | Yes | 1,404 | Coal | Merchant | |
| Binghamton | 47 | 100 | Yes | 47 | Gas | Merchant | |
| Centralia Gas | 248 | 100 | Yes | 248 | Gas | Merchant | |
| Power Resources | 200 | 50 | No | 100 | Gas | Merchant | |
| Saranac | 240 | 37.5 | No | 90 | Gas | Long-term contract | 2009 |
| Yuma | 50 | 50 | No | 25 | Gas | Long-term contract | 2024 |
| Imperial Valley [6] | 327 | 50 | No | 163 | Geothermal | Long-term contract | 2016 2035 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| geothermal assets | | | | | | & Merchant | |
| Skookumchuck | 1 | 100 | Yes | 1 | Hydro | Merchant | |
| Wailuku | 10 | 50 | Yes | 5 | Hydro | Long-term contract | 2023 |
| **United States Total** | **2,527** | | | **2,083** | | | |
| Campeche | 252 | 100 | Yes | 252 | Gas | Long-term contract | 2028 |
| Chihuahua | 259 | 100 | Yes | 259 | Gas | Long term contract | 2028 |
| **Mexico Total** | **511** | | | **511** | | | |
| Parkeston | 110 | 50 | Yes | 55 | Gas | Long-term contract | 2016 |
| Southern Cross [7] | 245 | 100 | Yes | 245 | Gas & Diesel | Long-term contract | 2016 |
| **Australia Total** | **355** | | | **300** | | | |
| **Total** | **10,759** | | | **8,826** | | | |

| | | | |
|---|---|---|---|
| *1* | *Facility under construction. Expected online 2011* | | |
| *2* | *Includes 53 MW uprate planned for 2007* | | |
| *3* | *To be retired by 2010* | | |
| *4* | *Comprised of 13 facilities* | | |
| *5* | *Construction to begin by the end of 2007. Expected online 2008* | | |
| *6* | *Comprised of 10 facilities* | | |
| *7* | *Comprised of nine facilities* | | |
| * | *Merchant includes both short-term contracted and spot sales* | | *Details as of March 1, 2007* |

This management s discussion and analysis (MD&A) should be read in conjunction with the consolidated financial statements included in this Annual Report and the fourth quarter news release dated Jan. 26, 2007. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). The effect of significant differences between Canadian and U.S. GAAP has been disclosed in *Note 30* to the consolidated financial statements. All tabular amounts in the following discussion are in millions of Canadian dollars unless otherwise noted. This MD&A is dated Feb.27, 2007. Additional information respecting TransAlta Corporation ( TransAlta , we , our , us or the corporation ), including its annual information form, is available on SEDAR at www.sedar.com and on our website at www.transalta.com.

**MANAGEMENT S DISCUSSION AND ANALYSIS**

This management s discussion and analysis (MD&A) should be read in conjunction with the consolidated financial statements included in this Annual Report and the fourth quarter news release dated Jan. 26, 2007. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). The effect of significant differences between Canadian and U.S. GAAP has been disclosed in *Note 30* to the consolidated financial statements. All tabular amounts in the following discussion are in millions of Canadian dollars unless otherwise noted. This MD&A is dated Feb. 27, 2007. Additional information respecting TransAlta Corporation ( TransAlta , we , our , us , or the corporation ), including its annual information form, is available on SEDAR at www.sedar.com and on our website at www.transalta.com.

**RESULTS OF OPERATIONS**

The results of operations are presented on a consolidated basis and by business segment. TransAlta has two business segments: Generation and Corporate Development & Marketing (CD&M). TransAlta s segments are supported by a corporate group that provides finance, treasury, legal, environmental health and safety, sustainable development, corporate communications, government relations, information technology, human resources and other administrative support.

Some of TransAlta s accounting policies require management to make estimates or assumptions that in some cases may relate to matters that are inherently uncertain. Critical accounting policies and estimates include: revenue recognition, valuation and useful life of property, plant and equipment (PP&E), asset retirement obligations (ARO), valuation of goodwill, income taxes and employee future benefits. See additional discussion under Critical Accounting Policies and Estimates in this MD&A.

In this MD&A, the impact of foreign exchange fluctuations on foreign currency transactions and balances is discussed with the relevant income statement and balance sheet items. While individual balance sheet line items will be impacted by foreign exchange fluctuations, the net impact of the translation of individual items is reflected in the cumulative translation account on the consolidated balance sheet.

**HIGHLIGHTS AND SUMMARY OF RESULTS**

During 2006, the corporation:

Generated net earnings of $44.9 million compared to $186.3 million for 2005 and $169.2 million for 2004.

Generated earnings on a comparable basis* of $233.8 million compared to $161.3 million for 2005 and $127.1 million for 2004.

Generated cash flow from operations of $489.6 million compared to $619.8 million in 2005 and $591.2 million in 2004. In addition, contractually scheduled payments related to services provided in 2006 of approximately $185 million were received on Jan. 2, 2007.

Invested $223.7 million in new and existing plants versus $325.9 million in 2005 and $345.7 million in 2004.

Repaid $48.6 million of net debt compared to $262.9 million in 2005 and $367.4 million in 2004.

* *Earnings on a comparable basis is not defined under GAAP. Refer to the Non-GAAP Measures section on page 61 of this MD&A for a further discussion of earnings on a comparable basis, including a reconciliation to net earnings.*

The following table depicts key financial results and statistical operating data:

| Year ended Dec. 31 | | 2006 | | 2005 | | 2004 |
|---|---|---|---|---|---|---|
| | | | | *(Restated, Note 1)* | | *(Restated, Note 1)* |
| Availability (%) | | **89.0** | | 89.4 | | 89.2 |
| Production (GWh) | | **48,213** | | 51,810 | | 51,396 |
| Revenue | **$** | **2,796.5** | $ | 2,838.5 | $ | 2,586.2 |
| Gross margin [1] | **$** | **1,491.4** | $ | 1,442.0 | $ | 1,353.3 |
| Operating income before mine closure and asset impairment charges [1] | **$** | **478.5** | $ | 456.8 | $ | 467.4 |
| Mine closure charges | | **(191.9)** | | | | |
| Asset impairment charges | | **(130.0)** | | (36.2) | | |
| Operating income [1] | **$** | **156.6** | $ | 420.6 | $ | 467.4 |
| Earnings from continuing operations | **$** | **44.9** | $ | 174.3 | $ | 159.6 |
| Earnings from discontinued operations, net of tax | | | | 12.0 | | 9.6 |
| Net earnings | **$** | **44.9** | $ | 186.3 | $ | 169.2 |
| Basic and diluted earnings per common share: | | | | | | |
| Earnings from continuing operations | **$** | **0.22** | $ | 0.88 | $ | 0.83 |
| Earnings from discontinued operations, net of tax | | | | 0.06 | | 0.05 |
| Basic and diluted earnings per common share | **$** | **0.22** | $ | 0.94 | $ | 0.88 |
| | | | | | | |
| Total assets | **$** | **7,460.1** | $ | 7,693.1 | $ | 8,000.3 |
| Total long-term financial liabilities | **$** | **3,094.1** | $ | 3,463.1 | $ | 3,601.5 |
| Cash dividends declared per share | **$** | **1.00** | $ | 1.00 | $ | 1.00 |
| Cash flow from operating activities | **$** | **489.6** | $ | 619.8 | $ | 591.2 |

*1 Gross margin, operating income before mine closure and asset impairment charges and operating income are not defined under Canadian GAAP. Refer to the Non-GAAP Measures section on page 61 of this MD&A for a further discussion of operating income and gross margin, including a reconciliation to net earnings.*

31

**STRATEGY AND KEY MEASURES**

TransAlta is a wholesale power generator and marketer. We own, operate and manage a highly contracted and geographically diversified portfolio of assets and have expertise in generation fuels including coal, natural gas, hydro and renewable energy. Over the long-term two of our key financial goals are to deliver greater than 10 per cent total shareholder return and a 10 per cent return on capital employed.

In addition to traditional metrics such as earnings per share, total shareholder return and return on capital employed, we have six sets of key measures which, in our opinion, are critical to meeting our goal. These key measures include a mix of operational, risk management and financial metrics against which we can measure and gauge our performance. Each are described below.

**1. Availability and Production**

Our plants must be available to meet the requirements of customers who have contracted our capacity or to be able to capture merchant market opportunities. Our long-term target is to have our plants available 90 per cent or more of the time.

Availability can be limited by the requirement to perform planned maintenance at regular intervals or by outages and derates caused by minor mechanical problems. While we expect that there will be a certain number of these unplanned outages or derates, our goal is to minimize these events through constant equipment monitoring and assessments, comprehensive maintenance plans and the formation of strategic relationships with suppliers. Over the past three years, we have achieved an average availability of 89.2 per cent, which is in line with our long-term target of 90 per cent availability.

Production is affected by our total generating capacity, the availability of our equipment and market conditions. During 2006, production decreased at our Centralia coal-fired plant (Centralia Coal) as well as at our hydro facilities. This decrease in production was partially offset by lower planned and unplanned outages at the Alberta Thermal plants (Alberta Thermal), incremental production from Genesee 3 and increased production at Centralia Gas and Poplar Creek.

Production increased in 2005, compared to 2004 due to the commissioning of Genesee 3 and from a full year of production at the Summerview wind farm. This increase in production was partially offset by the decommissioning of units one and two of the Wabamun plant in December 2004. Production was also negatively impacted by shutdowns caused by the Canadian National Railway (CN Rail) train derailment at Lake Wabamun and reduced production at our Poplar Creek plant.

**2. Contracts**

Our strategy is to contract a minimum of 75 per cent of our available output in any year to minimize our exposure to any potential volatility in electricity and gas prices in the markets in which we operate. This contracting strategy allows us to achieve a balance between cash flow stability and the ability to capture short-term opportunities in merchant markets.

Contracts can be structured as:

capacity commitments, such as Alberta Power Purchase Arrangements (PPA), which allow TransAlta to minimize fuel cost risks by passing the majority of these costs onto the customer,

a combination of production, availability and other services, such as at the Ontario and Alberta gas plants under which TransAlta is compensated for availability, electricity and steam production, or

medium- to longer-term contracts directly with our customers, such as at Centralia Coal.

The remainder of our production is sold into markets as spot sales or under contracts with terms less than one year.

During 2006, approximately 95 per cent of the Generation segment s revenues were derived from contracts with terms greater than one year. This percentage is consistent with prior years.

A further discussion of these contracting strategies is provided beginning on page 38 of this MD&A.

**3. Margin & Productivity**

Together with increasing our production base, growing our gross margin is essential for our success. We manage margins through our contracting strategy and managing fuel costs.

Coal-fired assets are mostly contracted through PPAs or long-term contracts. Fuel costs are managed by owning our own coal reserves or by signing contracts for stable and low cost supplies.

Gross margins at our contracted gas plants are generally managed by passing fuel costs on to customers or by signing long-term gas contracts that match the terms of the electricity and thermal sales. At our merchant gas plants, the margins are driven by the ratio of gas prices to electricity prices (market heat rates) and by our ability to produce electricity at heat rates that are better than the market heat rates.

In 2006, our gross margins increased due to incremental production from Genesee 3, favourable spark spreads and production at Poplar Creek, higher pricing and lower unplanned outages at Alberta Thermal, higher contract pricing and gains resulting from contracts recorded at fair market value (mark-to-market) at Centralia, increased gross margins at Sarnia, and higher trading margins, partially offset by lower production at Centralia Coal, higher coal costs, Centralia Coal inventory writedown and lower hydro production.

During 2005, our margins increased due to higher gas prices which in turn influenced electricity prices. These higher electricity prices had a significant impact on the margins from our coal plants. Margins also increased from the addition of Genesee 3 and increased hydro production. These increases were partially offset by higher coal costs.

Gross margin per installed megawatt hour (MWh)[1] in 2006 increased from 2005 mainly due to favourable pricing at Alberta Thermal and Centralia Coal and from incremental revenue at Sarnia. In 2005, gross margin per installed MWh increased over 2004 due to increased hydro production and higher merchant coal capacity from the coal plants that benefited from higher electricity prices. These gains were partly offset by higher coal costs. Our operations, maintenance and administration (OM&A) costs reflect the operating cost of our facilities. These costs

*1 We have traditionally presented gross margins and other key elements of the income statement on a per MWh produced. While for specific types of contracts this is an effective measure of profitability between periods, levels of production and associated revenues and costs are not comparable across all segments. To better gauge overall fleet performance and return on the investment in assets, we have presented overall results on an installed MWh, which is a measure of overall fleet capacity. We have used this measure for the first time in this annual report and will continue this practice going forward.*

can fluctuate due to the timing and nature of planned maintenance activities. The remainder of OM&A costs reflect the cost of day-to-day operations. Our target is to absorb the impact of inflation in our recurring operating costs as much as possible through various productivity initiatives and measure our ability to do so based on the cost per installed MWh of capacity.

In 2006, our OM&A costs decreased $14.7 million due to lower planned outages and general cost reductions. On a per installed MWh basis, this cost was lower by $0.23 compared to the same period in 2005.

During 2005, our OM&A costs increased from $547.5 million to $596.0 million due to the addition of Genesee 3 and higher salary, contracting and material costs due to market demands for labour and commodities.

**4. Capital Expenditures**

We are in a long-cycle capital-intensive business. In 2006, we spent $123 million on routine and mine capital, $84 million on planned maintenance, and $17 million on growth. In 2007, we expect to spend between $320 million and $340 million on sustaining expenditures which includes $100-$110 million for routine capital, $80 million for mining equipment, $55 million for equipment modifications at Centralia Coal, and $85-95 million on planned maintenance.

**5. Cash Flow**

Our goal in 2007 is to generate $650-$750 million of cash flow from operating activities to meet the requirements of maintaining our equipment, reducing our debt, maintaining our dividend, and having cash available to invest in growth initiatives.

In 2006, cash flow from operating activities decreased $130.2 million due to the timing of collection of receivables amounting to $185 million partially offset by higher cash earnings. These accounts receivable balances in respect of November 2006 revenues were contractually scheduled to be paid, and were received, on Jan. 2, 2007. These inflows will appear in our 2007 statements. In 2005, the November contractually scheduled payments were received on Dec. 30, 2005.

In 2005, cash flow from operating activities improved to $619.8 million from $591.2 million in 2004 due to improved cash earnings.

**6. Financial Ratios**

TransAlta is focused on maintaining a strong balance sheet and an investment grade credit rating. Financial strength provides us with continued access to capital and greater flexibility in contracting the output of our plants.

Over the long term our financial condition will dictate our ability to grow. Our objective is to maintain an investment grade rating to give us the capacity to take on new debt or issue equity.

At Dec. 31, 2006, our total debt (including non-recourse debt) to invested capital was 40.9 per cent (37.0 per cent excluding non-recourse debt) compared to the Dec. 31, 2005 ratio of 43.9 per cent and Dec. 31, 2004 ratio of 46.4 per cent. Cash flow to interest increased to 5.5x compared to 4.7x in 2005 and 4.3x in 2004. Cash flow to total debt increased to 26.2 per cent from 23.0 per cent in 2005 and 19.1 percent in 2004.

**REPORTED EARNINGS**

In 2006, reported earnings decreased to $44.9 million compared to $186.3 million in 2005 and $169.2 million in 2004 as shown below:

| | | |
|---|---|---|
| Net earnings for the year ended Dec. 31, 2004 | $ | 169.2 |
| Increased Generation gross margins | | 78.6 |
| Higher CD&M gross margins | | 10.1 |
| Increase in operations, maintenance and administration costs | | (48.5) |
| Increase in depreciation expense | | (10.4) |
| Increase in asset impairment charges | | (36.2) |
| Decrease in net interest expense | | 18.8 |
| Decrease in equity loss | | 7.6 |
| Decrease in non-controlling interests | | 27.5 |
| Decrease in income tax expense | | 7.0 |
| Increase in earnings from discontinued operations, net of tax | | 2.4 |
| Gain on sale of Meridian cogeneration facility (2004) | | (17.7) |
| Gain on sale of TransAlta Power partnership units (2004) | | (44.8) |
| Prior period regulatory decision (2004) | | 22.9 |
| Other | | (0.2) |
| Net earnings for the year ended Dec. 31, 2005 | $ | 186.3 |
| Increased Generation gross margins before writedown of coal inventory | | 85.0 |
| Higher CD&M gross margins | | 8.8 |
| Decrease in operations, maintenance and administration costs | | 14.7 |
| Increase in depreciation expense | | (42.4) |
| Writedown of coal inventory to lower of cost and market (2006) | | (44.4) |
| Centralia mine closure charges (2006) | | (191.9) |
| Increase in asset impairment charges | | (93.8) |
| Decrease in net interest expense | | 20.1 |
| Increase in equity loss | | (16.1) |
| Increase in non-controlling interests | | (33.0) |
| Decrease in income tax expense | | 165.4 |
| Earnings from discontinued operations, net of tax (2005) | | (12.0) |
| Other | | (1.8) |
| **Net earnings for the year ended Dec. 31, 2006** | **$** | **44.9** |

In 2006, our gross margins before the Centralia Coal inventory write-down were $93.8 million higher than in 2005 due to incremental production from Genesee 3, favourable spark spreads and production at Poplar Creek, higher pricing and lower unplanned outages at Alberta Thermal, higher contract pricing and mark-to-market gains at Centralia, increased gross margins at Sarnia, and higher trading margins. These increases were partially offset by higher unplanned outages and derates at Centralia Coal, higher coal costs and lower hydro production.

For the year ended Dec. 31, 2005, our gross margins were $88.7 million higher than in 2004 due to the addition of Genesee 3, higher hydro production, higher prices at Centralia Coal and Alberta Thermal, higher contract prices at some of our gas plants, and higher trading margins. These increases were offset by increased coal costs, increased net penalties at Alberta Thermal as a result of our planned maintenance activities, and the decommissioning of units one and two of the Wabamun plant.

In 2006, OM&A costs decreased $14.7 million from 2005 due to lower planned maintenance and general cost reductions. OM&A costs increased $48.5 million in 2005 compared to the same period in 2004 due to the addition of Genesee 3, materials cost escalations, increased incentive compensation costs and increased labour costs. These increases were partially offset by lower planned maintenance expenses.

In 2006, depreciation and amortization increased $42.4 million due to the impairment of turbines held in inventory, revised depreciation rates at the Ottawa, Mississauga, Windsor-Essex, Fort Saskatchewan, and Meridian plants, and the impact of revised ARO estimates at Alberta Thermal. Depreciation and amortization increased by $10.4 million in 2005 compared to the same period in 2004 primarily due to the addition of Genesee 3.

Interest expense decreased $20.1 million compared to 2005 due to lower debt levels, unwinding of cross currency swaps, favourable foreign exchange rates and the settlement of net investment hedges, partially offset by higher floating interest rates. Interest expense declined in 2005 by $18.8 million compared to 2004 due to reduced debt levels.

In 2006, non-controlling interests increased $33.0 million compared to 2005 due to the impairment charge attributable to TransAlta Power, L.P. s (TA Power) interest in the Ottawa plant in 2005 as discussed in Significant Events in this MD&A. Excluding this impairment charge, non-controlling interests decreased $3.2 million.

Non-controlling interests decreased by $27.5 million in 2005 as a result of the impairment of the Ottawa facility. Excluding this amount, non-controlling interests increased $8.7 million in 2005 compared to 2004 as we disposed of our remaining interest in TA Power in 2004.

As a result of the decision to stop mining at the Centralia Coal mine, we wrote down the remaining internally produced coal inventory held at Centralia to fair market value and recognized various closure-related charges which are discussed in more detail in the Significant Events section of this MD&A.

During the fourth quarter of 2006, we recorded an impairment charge for the Centralia Gas plant as the full book value of this plant was unlikely to be recovered from future cash flows. In 2005, the value of the Ottawa plant in TransAlta Cogeneration, L.P. (TA Cogen) was written down to its fair value. The charge for the Ottawa impairment in 2005 was offset by a reduction in earnings attributable to non-controlling interests.

**SIGNIFICANT EVENTS**

Our consolidated financial results include the following significant events.

***2006***

**Centralia Coal Mine**

On Nov. 27, 2006, we stopped mining at our Centralia Coal mine as a result of increased costs and unfavourable geological conditions. Inventory extracted up to the date on which we ceased operations will be consumed throughout 2007. Coal requirements for the foreseeable future are expected to be sourced from coal imported from the Powder River Basin (PRB). In 2007, we will reduce production at the plant by 2,500 gigawatt hours (GWh) until the necessary equipment modifications can be made to burn the higher thermal content PRB coal. The modifications to the equipment at Centralia Coal are anticipated to be completed after the 2008 maintenance turnaround currently scheduled for the second quarter of 2008.

We incurred an after-tax charge of $153.6 million ($0.76 per share) due to asset and inventory writedowns, reclamation liabilities, severance costs and other charges.

As required by GAAP, the restructuring charges appear on their appropriate lines on the statements of earnings but have been summarized in the following table and are described below:

| | | |
|---|---|---|
| Writedown of coal inventory | $ | 44.4 |
| Impact on gross margin | | (44.4) |
| **Mine closure charges** | | |
| Mine equipment and infrastructure writedown | | 72.1 |
| ARO writedown | | 81.3 |
| Severance costs and other | | 38.5 |
| Total mine closure charges | | 191.9 |
| **Loss before income taxes** | $ | (236.3) |
| Income tax recovery | | 82.7 |
| **Net loss impact of event** | $ | (153.6) |

34

**Write-down of coal inventory**

Since all coal requirements are now being sourced from an external source, the existing internally produced coal inventory was written down to fair market value, which is the current PRB cost.

**Mine equipment and infrastructure writedown**

Mine equipment used in the mine was valued at the lower of current net book value and fair value. The majority of this equipment is anticipated to be sold in 2007. Mining infrastructure, which includes processing facilities, was also written down to its expected fair values.

**ARO write-down**

The unamortized cost of future reclamation expenses was recognized immediately.

**Severance costs and other**

This includes salaries payable to employees, estimated benefit obligations, other transition payments as a result of the closure, amounts accrued for estimated contract termination penalties, writedown of materials, and supplies and other immaterial amounts.

Further, since Centralia Coal will not be operating at full capacity in 2007 and 2008, certain contracts are no longer backed by physical production of the plant and therefore no longer qualify for hedge accounting. Therefore, under GAAP, we recognized mark-to-market gains on these contracts. As well, we have entered into additional contracts to offset some of this exposure recorded at fair market value. As a result, on a net basis, based on current forward price estimates, we have recorded mark-to-market gains of $35.5 million in 2006. These mark-to-market adjustments, which are not included in the table above have no cash impact on the 2006 financial statements but the fair market value will continue to change as market prices change until settlement occurs in future periods.

**Centralia Gas Impairment**

During our annual impairment review, we concluded that the full book value of our Centralia Gas facility was unlikely to be recovered from future cash flows due to changes in TransAlta s outlook for the plant s profitability based on market dispatch rates and trading values. As a result, we recorded a $84.4 million after-tax ($0.42 per share) impairment charge to write the plant down to fair value.

**Notice of Preferred Securities Redemption**

On Nov. 22, 2006, we announced our intention to redeem all of our 7.75 per cent Preferred Securities which had an aggregate principal of $175.0 million. We redeemed these securities on Jan. 2, 2007.

**Designation of Eligible Dividends**

Under the legislation proposed by the Department of Finance, Canadian residents are entitled to a higher gross-up and dividend tax credit in 2006 and subsequent years if they receive eligible dividends. The dividends paid by us during 2006 are eligible dividends as defined in the draft legislation. The dividends expected to be paid in the 2007 are also expected to be eligible.

**Amendment to Dividend Reinvestment and Share Purchase (DRASP) Plan**

On Oct. 20, 2006, we announced that effective Jan. 1, 2007, the corporation will amend the DRASP plan. As a result, after Dec. 31, 2006, the five per cent discount on the price of shares purchased through the DRASP plan and issued from treasury will be suspended. After Dec. 31, 2006, shares purchased under the DRASP plan will be acquired in the open market at 100 per cent of the average purchase price of common shares acquired on the Toronto Stock Exchange on the investment dates. Shares issuable under the DRASP plan have not been registered under any U.S. Federal or State Securities laws and U.S. persons or residents are not eligible to participate in the DRASP plan.

**Wabamun Outage**

In 2005, an oil spill at Lake Wabamun, Alberta forced us to shut down unit four of our Wabamun coal-fired plant for 39 days. In the fourth quarter of 2006, we settled a portion of our outstanding claim for lost margin and incremental expenses. The terms of the settlement are subject to a confidentiality agreement. The settlement is included in merchant revenues.

**Sarnia Power Plant**

On Feb. 15, 2006, we signed a five-year contract with the Ontario Power Authority (OPA) for our Sarnia Regional Cogeneration Power Plant to supply an average of 400 megawatts (MW) of electricity to the Ontario electricity market. The contract was effective Jan. 1, 2006.

**Centralia Coal Reduced Production and Economic Dispatch**

Due to heavy rainfall in the Pacific Northwest in the first quarter of 2006, we derated Centralia Coal and started rebuilding our coal inventory. The impact of derating the plant during this time was partially offset by increasing coal imports and purchasing replacement power. We experienced 875 GWh of lower production during the first quarter of 2006 compared to the same period of 2005.

During the second quarter of 2006, lower market prices allowed us to purchase power at a price lower than our variable cost of production. As a result, Centralia Coal did not operate for the majority of the second quarter. We experienced 1,936 GWh of lower production during the second quarter compared to the same period of 2005.

In the third quarter of 2006, the 702 MW unit 2 experienced a turbine blade failure. As a result of the event, total production was reduced by 727 GWh. Also, in the third quarter of 2006, higher unplanned outages resulted in 232 GWh of lower production.

In the fourth quarter of 2006, 358 GWh of production at Centralia Coal was lost as a result of PRB coal test burns at the plant.

For the year ended Dec. 31, 2006, as a result of the above-mentioned events, total production at Centralia was 4,128 GWh lower than 2005.

**Purchase of Wailuku River Hydroelectric L.P.**

On Feb. 17, 2006 we purchased a 50 per cent interest in Wailuku River Hydroelectric L.P. through Wailuku Holding Company, LLC (Wailuku) for cash of US$1.0 million (Cdn$1.2 million). Wailuku had debt of US$19.2 million (Cdn$22.3 million) at the time of acquisition. Refer to *Note 20* of the consolidated financial statements for the year ended Dec. 31, 2006 for the purchase price allocation. Wailuku owns a run-of-river hydro facility with an operating capacity of 10 MW. MidAmerican Energy Holdings Company (MidAmerican) owns the other 50 per cent interest in Wailuku.

**Change in Depreciation Rate**

In the first quarter of 2006, we changed the depreciation method of the Windsor-Essex, Mississauga, Ottawa, Meridian and Fort Saskatchewan plants. Previously, these plants were amortized on a unit of production method over the life of the plants. After reviewing the estimated useful life and considering the uncertainty for the plants operations beyond the terms of the current sales contracts, we determined that it was more reasonable to allocate the remaining net book value of the plants on a straight-line basis over the remaining term of the respective contracts. This increase in depreciation is offset by a reduction in earnings attributable to the non-controlling interests in our consolidated statement of earnings.

**Keephills 3 Project**

On March 14, 2006, we signed a development agreement with EPCOR Utilities Inc. (EPCOR) to jointly examine the development of the Keephills 3 power project, a proposed 450 MW supercritical coal-fired plant adjacent to our existing Keephills facility.

**2006 Federal and Alberta Budgets**

On May 24, 2006, the Alberta budget received Royal Assent. As a result, the general corporate income tax rate for Alberta was reduced from 11.5 per cent to 10 per cent effective April 1, 2006. The federal budget received Royal Assent on June 22, 2006. As a result, the general corporate federal tax rate will be reduced from 21 per cent to 19 per cent by Jan. 1, 2010. The corporate surtax has been eliminated for taxation years ended after Dec. 31, 2007 and the federal capital tax has been eliminated effective Jan. 1, 2006. The carry-forward period for non-capital losses and investment tax credits earned after 2005 has been extended from 10 to 20 years. As a result of these changes, in the second quarter the corporation reduced income tax expense by $55.3 million which reflected the impact of these changes on prior years earnings.

***2005***

**Commissioning of Genesee 3**

On March. 1, 2005, we, jointly with EPCOR, commissioned the third unit of the Genesee coal-fired facility. We own a 50 per cent interest in this unit.

**Wabamun Outage**

On Aug. 3, 2005, a CN Rail train derailment resulted in an oil spill in Lake Wabamun, Alberta. We were forced to shut down unit four of our Wabamun coal plant as a result. The facility was restored to full operations on Sept. 11, 2005.

**Impairment of the Ottawa Facility**

In the fourth quarter of 2005, after completing our impairment reviews, we concluded that the carrying value of the Ottawa cogeneration facility exceeded its fair value in the accounts of TA Cogen, a subsidiary of TransAlta Corporation. Consequently, TA Cogen recorded an impairment provision of $78.3 million in the fourth quarter of 2005. In the accounts of the corporation, however, the carrying value of the Ottawa facility is lower than that of TA Cogen. TA Cogen purchased this facility from the corporation at a price that was higher than the cost the corporation paid to construct it. We recognized a $36.2 million charge to reflect the difference in carrying values between the accounts of the corporation and those of TA Cogen. This charge was offset by a reduction in the earnings attributable to the non-controlling interests in our consolidated statement of earnings. The net result is that the impairment of the plant in the accounts of TA Cogen had no impact on the net earnings of corporation.

***2004***

**Decommissioning of Wabamun Plant**

In the fourth quarter of 2002, we implemented a phased decommissioning of the Wabamun facility by removing the 139 MW unit three from service in 2002 and decommissioned units one and two (62 MW and 57 MW, respectively) on Dec. 31, 2004. We plan to retire unit four (279 MW) in 2010 when its operating license expires. The PPA for the plant expired on Dec. 31, 2003 and all production is therefore sold on the spot market.

**Sale of Meridian Cogeneration Facility**

On Dec. 1, 2004, we completed the sale of our 50 per cent interest in the 220 MW Meridian cogeneration facility located in Lloydminster, Saskatchewan, to TA Cogen for its fair value of $110.0 million. TA Cogen financed the acquisition through the use of $50.0 million of cash on hand, by issuance of $30.0 million of units to each of TA Power and TransAlta Energy Corporation (TEC) and the issue of an advance to TEC for $30.0 million. We recorded a pre-tax gain of $17.7 million (after-tax gain of $11.5 million) or $0.06 per common share.

**Sale of TA Power Units**

For the year ended Dec. 31, 2004, we recognized $44.8 million of dilution gains on the exercise of warrants and subsequent sale of units.

On Dec. 3, 2004, we sold our remaining 7.1 million units of TA Power at $9.00 each for net proceeds of $64.0 million, resulting in a pre-tax gain of $20.6 million (after-tax gain of $13.4 million) and including a dilution gain of $11.6 million. We purchased these units in connection with our sale of the Sheerness Generating Station to TA Cogen in 2003.

**Summerview Wind Farm**

In the third quarter of 2004, we commissioned the 68 MW Summerview wind farm.

**Prior Period Regulatory Decision**

In response to a complaint filed by San Diego Gas & Electric Company under Section 206 of the *Federal Power Act* (FPA), the Federal Energy Regulatory Commission (FERC) established a claim of approximately US$46 million in refunds owing by TransAlta for sales made by it in the organized markets of the California Power Exchange (PX) and the California Independent System Operator (ISO) during the Oct. 2, 2000 through June 20, 2001 period (the Main Refund Transactions). TransAlta has provided US$46 million to account for refund liabilities relating to Main Refund Transactions.

TransAlta filed a cost of service based petition for relief from these refund obligations. FERC rejected TransAlta s relief petition. On Dec. 1, 2006 TransAlta filed for rehearing of FERC s rejection. FERC has not yet issued a decision on rehearing.

During settlement negotiations, the complaintants have sought to obtain refunds for two sets of transactions beyond the Main Refund Transactions. The first set includes sales made by sellers in the PX and ISO markets in the period May to Oct. 1, 2001 (The Summer Transactions). The other set includes bilateral transactions between all sellers and a component of the California Department of Water Resources (CDWR) referred to as CERS (The CERS Transactions). FERC has specifically rejected attempts to introduce refunds for the Summer and

CERS Transactions. Nonetheless, the California parties have sought rehearing of FERC s refusal and appealed the refusal to the U.S. Court of Appeals for the Ninth Circuit. TransAlta does not presently believe the California parties will be successful in obtaining refunds alleged for the Summer and CERS transactions. TransAlta has not made any provision for such alleged refunds at this time.

**SUBSEQUENT EVENTS**

**Keephills 3 Power Plant**

On Feb. 14, 2007, the Alberta Energy and Utilities Board approved the development of the 450 MW Keephills 3 coal-fired power plant. The plant will be developed jointly by EPCOR and TransAlta. On Feb. 26, 2007, TransAlta and EPCOR announced that we will proceed with building the Keephills 3 project. The capital cost of the project is expected to be approximately $1.6 billion.

**Power Purchase Agreement with New Brunswick Power**

On Jan. 19, 2007, we announced a 25-year long-term contract with New Brunswick Power Distribution and Customer Service Corporation to provide 75 MW of wind power. We will construct, own and operate a wind power facility in New Brunswick with an estimated capital cost of $130 million. Natural Forces Technologies Inc. is our co-developer on this project and commercial operations are expected to begin by the end of 2008.

**SEGMENTED BUSINESS RESULTS**

**Generation**: ***Owns and operates hydro, wind, geothermal, gas- and coal-fired plants and related mining operations in Canada, the United States and Australia. At Dec. 31, 2006, Generation had 8,366 MW of gross generating capacity in operation (7,962 MW net ownership interest) and 353 MW net under construction.***

**We have strategic alliances with EPCOR, ENMAX Corporation (ENMAX) and MidAmerican. The EPCOR alliance provided the opportunity for us to acquire a 50 per cent ownership in the 450 MW Genesee 3 project and for the current development underway for the Keephills 3 project. ENMAX and TransAlta each own 50 per cent of the partnership in the McBride Lake wind project. MidAmerican owns the other 50 per cent interest in CE Generation LLC (CE Gen) and Wailuku.**

Our results are seasonal due to the nature of the electricity market and related fuel costs. Higher maintenance costs are ordinarily incurred in the second and third quarters when electricity prices are expected to be lower as electricity prices generally increase in the winter months in the Canadian market. Margins are also typically impacted in the second quarter due to the volume of hydro production resulting from spring runoff and rainfall in the Canadian and U.S. markets.

The results of the Generation segment were as follows:

| Year ended Dec. 31 | 2006 Total | 2006 Per MWh produced | 2005 (Restated, Note 1) Total | 2005 (Restated, Note 1) Per MWh produced | 2004 (Restated, Note 1) Total | 2004 (Restated, Note 1) Per MWh produced |
|---|---|---|---|---|---|---|
| Revenues | **$ 2,611.9** | **$ 54.17** | $ 2,607.5 | $ 50.33 | $ 2,341.7 | $ 45.56 |
| Fuel and purchased power | **(1,186.2)** | **(24.60)** | (1,222.4) | (23.59) | (1,035.2) | (20.14) |
| Gross margin | **1,425.7** | **29.57** | 1,385.1 | 26.73 | 1,306.5 | 25.42 |
| Operations, maintenance and administration | **458.3** | **9.51** | 481.1 | 9.29 | 450.0 | 8.76 |
| Depreciation and amortization | **396.9** | **8.23** | 354.9 | 6.85 | 343.5 | 6.68 |
| Taxes, other than income taxes | **21.1** | **0.44** | 21.3 | 0.41 | 20.5 | 0.40 |
| Intersegment cost allocation | **27.8** | **0.58** | 26.0 | 0.50 | 26.0 | 0.51 |
| Operating expenses | **904.1** | **18.75** | 883.3 | 17.05 | 840.0 | 16.34 |
| Mine closure charges | **191.9** | **3.98** | | | | |
| Asset impairment charges | **130.0** | **2.70** | 36.2 | 0.70 | | |
| Gain on sale of Meridian cogeneration facility | | | | | 17.7 | 0.34 |
| Gain on sale of TransAlta Power partnership units | | | | | 44.8 | 0.87 |
| Operating income | **$ 199.7** | **$ 4.14** | $ 465.6 | $ 8.99 | $ 529.0 | $ 10.29 |
| Production (GWh) | **48,213** | | 51,810 | | 51,396 | |
| Availability (%) | **89.0** | | 89.4 | | 89.2 | |

For the year ended Dec. 31, 2006, our availability was marginally lower at 89.0 per cent compared to 89.4 per cent in 2005 and 89.2 per cent recorded in 2004. In 2006, we experienced higher unplanned outages and derates at Centralia Coal which were mostly offset by lower planned outages at Poplar Creek, Alberta Thermal and Genesee 3 combined with lower planned and unplanned outages at Sarnia compared to 2005.

Generation s revenues are derived from the production of electricity and steam as well as ancillary services such as system support. In 2006, gas- and coal-fired facilities had exposure to market fluctuations in energy commodity prices representing six per cent and 23 per cent of our total generating capacity, respectively. We closely monitor the risks associated with these commodity price changes on our future operations and, where appropriate, use various physical and financial instruments to hedge our assets and operations from such price risk. These contracts are designated as effective hedge positions of future cash flows or fair values of the output and production of our owned assets. Under Canadian GAAP, settlement accounting is used for transactions that qualify for hedge accounting. Under U.S. GAAP, hedging activities are accounted for in accordance with Financial Accounting Standards Board (FASB) Statement 133.

For the year ended Dec. 31, 2006, 95 per cent of our total production was subject to contracted prices (2005 91 per cent, 2004 89 per cent), with the remaining production subject to market pricing. Revenues received under contractual arrangements are not subject to short-term fluctuations in the spot price for electricity.

Generation segment revenues are generated from the following revenue streams:

**Alberta PPAs** are arrangements under which we earn monthly capacity revenues, which are designed to recover fixed costs and provide a return on capital for our plants and mines. We also earn energy payments for the recovery of predetermined variable costs of producing energy, an incentive/penalty for achieving above/below the targeted availability and an excess energy payment for power production above committed capacity. Our Sundance, Keephills, Sheerness and the contracted portion of the Alberta hydro assets are included in this category.

**Long-term contracts** are similar to PPAs. We define a long-term contract as having an original term between 10 and 25 years. Long-term contracts are typically for gas-fired cogeneration plants and have between one and four customers per plant. Revenues are derived from payments for capacity and/or the production of electrical energy and steam. The results from our Mississauga, Windsor-Essex, Wailuku, Ottawa, Fort Saskatchewan and Meridian plants as well as the contracted portions of Sarnia, Poplar Creek and TransAlta Wind are included in this category.

**Merchant** revenue is derived from the sale of production only, with multiple customers per plant. Production is sold via: medium-term contract sales (typically two to 10 years), short-term asset-backed trading, and spot or short-term (less than one year) forward markets. The results from Centralia Coal, Centralia Gas, Genesee 3, Wabamun Binghamton; excess energy sales from Sundance, Keephills, Hydro, Sheerness and the uncontracted portions of TransAlta Wind, Poplar Creek and Sarnia are included in this category.



We have strategic alliances with EPCOR, ENMAX Corporation (ENMAX) and MidAmerican. The EPCOR alliance p

**CE Gen** earns revenues from 10 geothermal plants and three gas-fired facilities. Eight of the geothermal plants sell their output under long-term contracts expiring between 2016 and 2035. One facility is partially contracted while the remaining facility sells its output on the spot market but has an option to sell output under a 35-year contract based on market prices. The gas-fired facilities sell their output under fixed-price contracts ranging from three to 18 years of remaining contract life, with expiration dates of 2009 and 2024. All three facilities have gas supply arrangements in place for the duration of the electricity sales contracts.

Our production volumes, electricity and steam production revenues and fuel and purchased power costs from these four sources are presented below:

| **Year ended Dec. 31, 2006** | **Production (GWh)** | | **Revenue** | | **Fuel & purchased power** | | **Gross margin** | | **Revenue per MWh** | | **Fuel & purchased power per MWh** | | **Gross margin per MWh** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Alberta PPAs | **25,343** | **$** | **736.8** | **$** | **228.0** | **$** | **508.8** | **$** | **29.07** | **$** | **9.00** | **$** | **20.07** |
| Long-term contracts | **6,908** | | **635.4** | | **357.8** | | **277.6** | | **91.98** | | **51.80** | | **40.18** |
| Merchant | **13,140** | | **964.3** | | **535.7** | | **428.6** | | **73.39** | | **40.77** | | **32.62** |
| CE Gen | **2,822** | | **275.4** | | **64.7** | | **210.7** | | **97.59** | | **22.93** | | **74.66** |
| | **48,213** | **$** | **2,611.9** | **$** | **1,186.2** | **$** | **1,425.7** | **$** | **54.17** | **$** | **24.60** | **$** | **29.57** |

| Year ended Dec. 31, 2005 *(Restated, Note 1)* | Production (GWh) | | Revenue | | Fuel & purchased power | | Gross margin | | Revenue per MWh | | Fuel & purchased power per MWh | | Gross margin per MWh |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Alberta PPAs | 25,279 | $ | 682.1 | $ | 202.8 | $ | 479.3 | $ | 26.98 | $ | 8.02 | $ | 18.96 |
| Long-term contracts | 6,947 | | 647.9 | | 392.7 | | 255.2 | | 93.26 | | 56.53 | | 36.73 |
| Merchant | 16,630 | | 983.2 | | 554.6 | | 428.6 | | 59.12 | | 33.35 | | 25.77 |
| CE Gen | 2,954 | | 294.3 | | 72.3 | | 222.0 | | 99.63 | | 24.48 | | 75.15 |
| | 51,810 | $ | 2,607.5 | $ | 1,222.4 | $ | 1,385.1 | $ | 50.33 | $ | 23.59 | $ | 26.74 |

| Year ended Dec. 31, 2004 *(Restated, Note 1)* | Production (GWh) | | Revenue | | Fuel & purchased power | | Gross margin | | Revenue per MWh | | Fuel & purchased power per MWh | | Gross margin per MWh |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Alberta PPAs | 25,836 | $ | 679.2 | $ | 187.3 | $ | 491.9 | $ | 26.29 | $ | 7.25 | $ | 19.04 |
| Long-term contracts | 7,183 | | 581.9 | | 341.9 | | 240.0 | | 81.01 | | 47.60 | | 33.41 |
| Merchant | 15,676 | | 799.5 | | 439.3 | | 360.2 | | 51.00 | | 28.02 | | 22.98 |
| CE Gen | 2,701 | | 281.1 | | 66.7 | | 214.4 | | 104.07 | | 24.69 | | 79.38 |
| | 51,396 | $ | 2,341.7 | $ | 1,035.2 | $ | 1,306.5 | $ | 45.56 | $ | 20.14 | $ | 25.42 |

**Alberta PPAs**

In 2006, production of 25,343 GWh from our PPA facilities was 64 GWh higher than 2005 due to lower planned and unplanned outages at Alberta Thermal partially offset by lower customer demand.

Production in 2005 of 25,279 GWh from our PPA facilities was 557 GWh lower than 2004 primarily due to higher planned outages and lower customer demand.

For 2006, revenues were $54.7 million ($2.09 per MWh) higher than in 2005 due to lower planned and unplanned outages and higher net prices.

Revenues for 2005 were essentially flat compared to 2004 as the impact of higher prices was offset by the net penalties paid during both planned and unplanned outages.

For the year ended Dec. 31, 2006, fuel costs increased $25.2 million ($0.98 per MWh) over 2005 due to an increase in coal costs as a result of higher overburden removal and increased input costs.

For the year ended Dec. 31, 2005, fuel costs increased $15.5 million ($0.77 per MWh) over 2004 due to increased coal costs as a result of higher overburden removal and increased input costs.

**Long-Term Contracts**

In 2006, long-term contract volumes decreased 39 GWh from 2005 due to lower production at Ottawa primarily due to our decision to sell gas from that facility rather than produce electricity partially offset by increased production at other gas facilities.

Long-term contract volumes declined 236 GWh to 6,947 GWh in 2005 from 2004 due to higher planned outages and reduced customer demand at certain gas-fired facilities.

Revenues declined $12.5 million ($1.28 per MWh) in 2006 compared to 2005 due to the impact of lower natural gas prices on revenues charged to customers partially offset by incremental revenues from gas sales at Ottawa.

In 2005, our revenue increased $66.0 million ($12.25 per MWh) from 2004 due to the impact of higher natural gas prices on revenues charged to customers, increased thermal volumes at Sarnia and revised contract pricing at other gas plants.

Fuel and purchased power costs decreased by $34.9 million ($4.73 per MWh) for the year ended Dec. 31, 2006 compared to the same period in 2005 due to lower natural gas prices partially offset by incremental gas purchases at Ottawa.

For the year ended Dec. 31, 2005, fuel and purchased power costs increased $50.8 million ($8.93 per MWh) compared to 2004 primarily due to higher natural gas prices.

**Merchant Production**

In 2006, spot electricity prices were higher in Alberta but were lower in the Pacific Northwest and Ontario. Gas prices decreased in all three markets resulting in higher spark spreads in Alberta while spark spreads decreased in Ontario and the Pacific Northwest.

| | Alberta | | Mid-C | | Ontario | |
|---|---|---|---|---|---|---|
| | Electricity price | Spark spreads | Electricity price | Spark spreads | Electricity price | Spark spreads |
| **2006** | **$ 80.58** | **$ 34.95** | **$ 45.40** | **$ 3.31** | **$ 46.41** | **$ (7.93)** |
| 2005 | 70.01 | 8.91 | 58.52 | 6.82 | 68.40 | (5.23) |
| 2004 | 54.59 | 8.71 | 42.34 | 6.31 | 49.96 | (5.39) |

In 2006, merchant production decreased 3,490 GWh to 13,140 GWh due to reduced production at Centralia Coal and lower hydro production offset by increased production from Genesee 3, Centralia Gas, and Poplar Creek.

In 2005, merchant production increased 954 GWh to 16,630 GWh due to the commissioning of Genesee 3, increased hydro production, and lower planned outages at Alberta Thermal. These increases were partially offset by the lost production at Alberta Thermal due to the CN Rail train derailment, the decommissioning of units one and two of our Wabamun plant, and reduced production at Poplar Creek.

For the year ended Dec. 31, 2006, gross margins were flat (increase of $6.85 per MWh) compared to 2005. Gross margin on a per MWh basis was higher in 2006 due to lower production, as mentioned above.

At Centralia Coal, margins decreased as a result of higher coal costs, writedown of coal inventory, higher unplanned outages and derates, and the strengthening of the Canadian dollar partially offset by higher contract pricing, unrealized mark-to-market gains on contracts that no longer qualify for hedge accounting, and benefits due to economic dispatch.

Merchant margins also decreased due to lower hydro production partially offset by incremental revenue from Sarnia, favourable spark spreads and higher production at Poplar Creek, and favourable production at Genesee 3.

Merchant gross margins in 2005 increased $68.4 million ($2.79 per MWh) from 2004 due to the addition of Genesee 3, reduced planned outages at Alberta Thermal, and increased production and pricing at Centralia Coal and hydro. These increases were offset by higher fuel costs at Centralia Coal, lost margin due to the CN Rail train derailment at Wabamun, and the decommissioning of units one and two of the Wabamun plant.

**CE Gen**

During 2006, production from CE Gen decreased 132 GWh to 2,822 GWh from 2005 due to higher planned outages at the Imperial Valley, Power Resources, and Yuma plants.

During 2005, production from CE Gen increased by 253 GWh to 2,954 GWh primarily due to increased production at the Imperial Valley and Saranac facilities due to lower planned outages.

For the year ended Dec. 31, 2006, gross margin decreased $11.3 million ($0.49 per MWh) compared to the same period in 2005 primarily due to reduced production and the strengthening of the Canadian dollar partially offset by increased pricing at the gas-fired facilities.

In 2005, gross margins increased $7.6 million ($4.23 per MWh) from 2004 due to higher volume partially offset by higher gas prices and the strengthening of the Canadian dollar.

**OM&A Expense**

In 2006, our OM&A expenses decreased $22.8 million ($0.22 per MWh increase) from 2005 due to lower planned outages and general cost reductions.

Our OM&A costs increased $31.1 million ($0.53 per MWh) in 2005 to $481.1 million ($9.29 per MWh) from 2004 due to the addition of Genesee 3, increased incentive compensation costs, and cost escalations related to materials.

**Planned Maintenance**

The table below shows the amount of planned maintenance capitalized and expensed, excluding CE Gen:

| Year ended Dec. 31 | **2006** | 2005 | 2004 |
|---|---|---|---|
| Capitalized | **$ 84.2** | $ 119.1 | $ 88.1 |
| Expensed | **55.4** | 68.3 | 73.0 |
| | **$ 139.6** | $ 187.4 | $ 161.1 |

| | | | |
|---|---|---|---|
| GWh lost | **2,325** | 2,818 | 2,507 |

Production lost in the year ended Dec. 31, 2006 decreased by 493 GWh from 2005 due to reduced planned outages across the fleet. In 2005, production lost increased 311 GWh compared to 2004 due to the completion of four planned maintenance events at our gas units in the year.



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During the year ended Dec. 31, 2006, capitalized and expensed maintenance costs were lower compared to the same period in 2005 due to the benefits from multi-year maintenance plans. The increase in capitalized maintenance of $31.0 million in 2005 from 2004 relates to the completion of four planned maintenance events at our gas units during that year.

Annually, we purchase long-lead materials for future years outages as lead times on these items can extend well beyond one year. In 2006, we spent $5.3 million on such items compared to $6.2 million in 2005 and $19.8 million in 2004. These items are not included in the chart on the previous page.

**Depreciation and Amortization**

Depreciation and amortization increased $42.0 million in 2006 ($1.38 per MWh) compared to 2005 primarily due the change in depreciation rates at the Windsor, Mississauga, Ottawa, Meridian, and Fort Saskatchewan plants, revised ARO estimates at Alberta Thermal, and the impairment recorded on turbines held in inventory. The change in depreciation rates at the above-mentioned plants resulted in an increase in depreciation expense which was offset by a decrease in non-controlling interests.

Depreciation and amortization increased by $11.4 million in 2005 due to the addition of Genesee 3 and equipment retired during planned outages.

**Taxes Other than Income Taxes**

In 2006, taxes other than income taxes were consistent with both 2005 and 2004.

**Intersegment Cost Allocations**

In 2006, intersegment cost allocations were consistent with both 2005 and 2004.

**Corporate Development & Marketing:** ***Derives revenue and earnings from the wholesale trading of electricity and other energy-related commodities and derivatives not supported by TransAlta owned generation assets. CD&M also utilizes contracts of various durations for the forward sales of electricity and purchases of natural gas, coal and transmission capacity to effectively manage available generating capacity and fuel and transmission needs on behalf of Generation. These results are included in the Generation segment. Key performance indicators for CD&M s proprietary trading include margins and value at risk.***

CD&M acts to maximize margins from the production and sale of electricity, minimize the cost of natural gas used to generate electricity and steam, and to reduce the risk to the corporation from unplanned outages by acquiring

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replacement power at the lowest possible price.

CD&M uses commodity derivatives to manage risk, earn trading revenue, and gain market information. The portfolio of derivatives consists of physical and financial instruments including forwards, swaps, futures, and options in various commodities. These contracts meet the definition of trading activities and have been accounted for using fair values for both Canadian and U.S. GAAP. Changes in the fair values of the portfolio are recognized in income in the period they occur.

In compliance with FASB Emerging Issues Task Force (EITF) 03-11, *Reporting Realized Gains and Losses on Derivative Instruments that are Subject to FASB Statement 133, Accounting for Derivative Instruments and Hedging Activities, and Not Held for Trading Purposes as defined in Issue No. 02-3*, we have concluded that CD&M contracts settled in the real-time physical markets meet the definition of derivative contracts held for delivery and therefore revenues from these contracts are reported on a gross basis (trading revenues and trading purchases are shown separately) in the consolidated statement of earnings.

The results of the CD&M segment are as follows:

| Years ended Dec. 31 | | **2006** | | 2005 | | 2004 |
|---|---|---|---|---|---|---|
| Revenues | **$** | **184.6** | $ | 231.0 | $ | 244.5 |
| Trading purchases | | **(118.9)** | | (174.1) | | (197.7) |
| Gross margin | | **65.7** | | 56.9 | | 46.8 |
| Operations, maintenance and administration | | **36.9** | | 38.5 | | 31.3 |
| Depreciation and amortization | | **1.3** | | 1.7 | | 2.0 |
| Intersegment cost allocations | | **(27.8)** | | (26.0) | | (26.0) |
| Operating expenses | | **10.4** | | 14.2 | | 7.3 |
| Prior period regulatory decision | | | | | | 22.9 |
| Operating income | **$** | **55.3** | $ | 42.7 | $ | 16.6 |

For the year ended Dec. 31, 2006, gross margins increased $8.8 million compared to 2005 due to timing and management of positions in the western region partially offset by lower margins in the eastern region.

Gross margins increased $10.1 million in 2005 compared to the same period in 2004 primarily due to strong results from trading activities in the western region and gains on gas positions throughout the year.

For the year ended Dec. 31, 2006, OM&A decreased $1.6 million compared to the same period in 2005 due to fewer projects resulting in lower consulting costs partially offset by increased trading staff levels.

In 2005, OM&A costs increased over the same period in 2004 due to higher incentive costs as a result of increased margins as well as project consulting expenses incurred during the year.

Depreciation and amortization in 2006 was relatively consistent with 2005 and 2004.

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**Value at risk (VAR) and Trading Positions**

VAR is a measure to manage earnings exposure for CD&M activities. VAR is the most commonly used metric employed to track the risk of trading positions. A VAR measure gives, for a specific confidence level, an estimated maximum loss over a specified period of time.

VAR is the primary measure used to manage CD&M s exposure to market risk resulting from trading activities. VAR is monitored on a daily basis, and is used to determine the potential change in the value of the corporation s marketing portfolio over a three-day period within a 95 per cent confidence level resulting from normal market fluctuations. Stress tests are performed weekly on both earnings and VAR to measure the potential effects of various market events that could impact financial results, including fluctuations in market prices, volatilities of those prices, and the relationships between those prices.

We estimate VAR using the historical variance/covariance approach. Currently, there is no uniform energy industry methodology for estimating VAR. An inherent limitation of historical variance/covariance VAR is that historical information used in the estimate may not be indicative of future market risk. See additional discussion under commodity price risk in the Risk Factors and Risk Management section.

TransAlta s fixed price trading positions were as follows:

| Units (thousands) | Electricity (MWh) | Natural gas (GJ) |
|---|---|---|
| Fixed price payor, notional amounts, Dec. 31, 2006 | **13,944** | **20,289** |
| Fixed price payor, notional amounts, Dec. 31, 2005 | 19,315 | 11,126 |
| Fixed price receiver, notional amounts, Dec. 31, 2006 | **21,536** | **26,231** |
| Fixed price receiver, notional amounts, Dec. 31, 2005 | 19,047 | 12,158 |
| Maximum term in months, Dec. 31, 2006 | **33** | **16** |
| Maximum term in months, Dec. 31, 2005 | 24 | 12 |

Proprietary trading encompasses a range of contractual terms spanning from short-term trading of one to 24 months to longer-term marketing transactions with potential terms greater than 24 months. Changes in trading positions from Dec. 31, 2005 to Dec. 31, 2006 are due to changing market conditions and corresponding regional strategy positioning.

In accordance with EITF 02-03, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities*, physical transmission and physical gas in storage are accounted for using accrual accounting. At Dec. 31, 2006, TransAlta recorded prepaid transmission contract assets of $1.6 million compared to approximately $0.8 million at Dec. 31, 2005. The transmission contracts relate to the period from April 2006 to March 2007 and are amortized over this period. Physical transmission is widely used in the California market with a maximum contract term of 12 months. At Dec. 31, 2006, physical gas in storage was recorded at $4.8 million (2005 - $5.2 million). Forward power and gas transactions utilizing physical transmission and gas in storage are accounted for on a mark-to-market basis. While the physical and forward positions economically offset, some unrealized earnings exposure may result in the interim period prior to settlement.

In response to a complaint filed by San Diego Gas & Electric Company under Section 206 of the Federal Power Act (FPA), Federal Energy Regulatory Commission (FERC) established a claim of approximately US$46 million in refunds owing by TransAlta for sales made by it in the organized markets of the California Power Exchange (PX) and the California Independent System Operator (ISO) during the Oct. 2, 2000 through June 20, 2001 period (the Main Refund Transactions). TransAlta has provided US$46 million to account for refund liabilities relating to Main Refund Transactions.

TransAlta filed a cost of service based petition for relief from these refund obligations. FERC rejected TransAlta s relief petition. On Dec. 1, 2006 TransAlta filed for rehearing of FERC s rejection. FERC has not yet issued a decision on rehearing.

During settlement negotiations, the complaintants have sought to obtain refunds for two sets of transactions beyond the Main Refund Transactions. The first set includes sales made by sellers in the PX and ISO markets in the period May to Oct. 1, 2001 (The Summer Transactions). The other set includes bilateral transactions between all sellers and a component of the California Department of Water Resources (CDWR) referred to as CERS (The CERS Transactions). FERC has specifically rejected attempts to introduce refunds for the Summer and CERS Transactions. Nonetheless, the California parties have sought rehearing of FERC s refusal and appealed the refusal to the U.S. Court of Appeals for the Ninth Circuit. TransAlta does not presently believe the California parties will be successful in obtaining refunds alleged for the Summer and CERS transactions. TransAlta has not made any provision for such alleged refunds at this time.

**NET INTEREST EXPENSE AND FOREIGN EXCHANGE**

| Year ended Dec. 31 | **2006** | 2005 | 2004 |
|---|---|---|---|
| Interest on long-term debt | **$ 155.5** | $ 169.3 | $ 181.4 |
| Interest on short-term debt | **12.7** | 14.9 | 11.4 |
| Interest on preferred securities | **13.6** | 16.5 | 44.5 |
| Interest income | **(13.3)** | (8.7) | (9.9) |
| Capitalized interest | | (3.4) | (20.0) |
| Net interest expense | **$ 168.5** | $ 188.6 | $ 207.4 |

For the year ended Dec. 31, 2006, net interest expense was $20.1 million lower than the comparable period in 2005 due to lower debt levels, higher cash deposits, the impact of the strengthening of the Canadian dollar, the settlement of net investment hedges partially offset by lower capitalized interest and higher interest rates.

For the year ended Dec. 31, 2005, net interest expense was $18.8 million lower than the same period in 2004 as we redeemed $300.0 million of our preferred securities and replaced them with lower interest rate borrowings. In addition, we reduced overall net debt positions further reducing our interest costs. Capitalized interest declined as a result of the commissioning of Genesee 3 in March 2005.

**EQUITY LOSS**

As required under Accounting Guideline 15, *Variable Interest Accounting*, of the Canadian Institute of Chartered Accountants (CICA) our Mexican operations are accounted for as equity subsidiaries. However, these plants are owned and managed as part of the Generation segment. The table below summarizes availability, production, and equity loss from these operations.

| Year ended Dec. 31 | **2006** | 2005 | 2004 |
|---|---|---|---|
| Availability (%) | **90.8** | 93.4 | 88.2 |
| Production (GWh) | **2,918** | 2,751 | 3,164 |
| Equity loss | **$ (17.0)** | $ (0.9) | $ (8.5) |

Availability decreased for the year ended Dec. 31, 2006 compared to the same period in 2005 as a result of higher planned outages at the Chihuahua plant. In 2005, availability increased compared to the same period in 2004 due to lower unplanned outages at the Chihuahua facility.

In 2006, production increased 167 GWh compared to 2005 due to increased customer demand, partially offset by higher planned and unplanned outages. In 2005, production decreased 413 GWh compared to 2004 due to lower customer demand.

For the year ended Dec. 31, 2006, equity loss increased $16.1 million compared to 2005 due to recognition of the deferred financing fees resulting from the repayment of non-recourse debt and settlement of interest rate swaps by our equity investees.

For the year ended Dec. 31, 2005, equity loss declined from $8.5 million in 2004 to $0.9 million in 2005 as a result of the strengthening of the Canadian dollar, partially offset by the benefit of higher availability.

**INCOME TAXES**

| Year ended Dec. 31 | **2006** | 2005 *(Restated, Note 1)* | 2004 *(Restated, Note 1)* |
|---|---|---|---|
| (Loss) earnings before income taxes | **$ (80.9)** | $ 213.9 | $ 206.2 |
| Adjustments: | | | |
| Coal inventory writedown | **44.4** | | |
| Mine closure charges | **191.9** | | |
| Asset impairment charges | **130.0** | | |
| Turbine impairment | **9.6** | | |
| Prior period regulatory decision | | | 22.9 |
| Total adjustments | **375.9** | | 22.9 |
| Earnings before income taxes and adjustments[1] | **$ 295.0** | $ 213.9 | $ 229.1 |
| Income tax expense | **61.2** | 52.6 | 69.2 |
| Resolution of uncertain tax positions | | (13.0) | (6.8) |
| Income tax recovery on adjustments | **(131.7)** | | (8.0) |
| Change in tax rate related to prior periods | **(55.3)** | | (7.8) |
| Income tax (recovery) expense per financial statements | **$ (125.8)** | $ 39.6 | $ 46.6 |
| Effective tax rate (%) | **20.7** | 24.6 | 30.2 |

*1 Earnings before income taxes and adjustments is not defined under GAAP. Refer to the Non-GAAP Measures section on page 61 of this MD&A for a further discussion.*

Tax expense decreased $165.4 million in the year ended Dec. 31, 2006 compared to the same period in 2005 due to the reduction in the Canadian corporate tax rate, a change in the mix of jurisdictions in which pre-tax income is earned, and a reduction in pre-tax earnings as a result of impairment and mine closure charges.

Income tax expense for 2005 was $7.0 million lower than the comparable period in 2004 due to the inclusion of $13.0 million in income tax recovery related to a favorable settlement of outstanding disputes with income tax authorities in 2005. In 2004 a $6.8 million tax settlement at our New Zealand operations was also included in income.

Adjusting for these above-mentioned items, our effective income tax rate was 20.7 per cent for 2006, compared to 24.6 per cent in 2005 and 30.2 per cent in 2004.

**NON-CONTROLLING INTERESTS**

| Year ended Dec. 31 | **2006** | 2005 | 2004 |
|---|---|---|---|
| Non-controlling interests | **$ 51.5** | $ 18.5 | $ 46.0 |

In 2006, non-controlling interests increased $33.0 million from the same period in 2005. Excluding the impairment charge recorded in 2005, non-controlling interests decreased $3.2 million compared to the same period in 2005 due to higher earnings at TA Cogen in 2005. Non-controlling interests for the year ended Dec. 31, 2005, was $27.5 million lower than for the same period in 2004 due to the impairment of the Ottawa facility mentioned above. Adjusting for this amount, non-controlling interests increased $8.7 million from 2004 due to the reduction in our ownership in TA Power and in the Meridian cogeneration facility.

**CONSOLIDATED BALANCE SHEETS**

The following chart outlines significant changes in the consolidated balance sheets between Dec. 31, 2006 and Dec. 31, 2005:

| | Increase/ (Decrease) | Explanation |
|---|---|---|
| Cash and cash equivalents | $ (13.7) | Refer to Consolidated Statements of Cash Flows |
| Accounts receivable | 24.9 | Timing of collections in Generation |
| Inventory | 29.9 | Higher inventory balances at Centralia Coal |
| Restricted cash | 341.5 | Investment in Notes held in trust |
| Investments | (259.8) | Reduction in investments due to increase in external debt by equity investee |
| Long-term receivables | 32.2 | Revised ARO estimate |
| Property, plant and equipment, net | (509.6) | Reclassification of Centralia Coal mine assets to Assets held for sale, impairment of Centralia Gas assets, increased depreciation, and impact of strengthening of the Canadian dollar compared to the U.S. dollar, partially offset by capital additions |
| Assets held for sale, net | 109.8 | Centralia Coal mine assets |
| Intangible assets | (51.6) | Normal amortization and strengthening of the Canadian dollar compared to the U.S. dollar |
| Net price risk management assets (including current portion) | 40.9 | Change in mark-to-market values |
| Other assets (including current portion) | (63.0) | Realized gain on settlement of net investment hedges and mark-to-market changes on hedging derivatives |
| Short-term debt | 348.8 | Net increase in short-term debt |
| Accounts payable and accrued liabilities | (148.4) | Timing of major maintenance activities offset by increased CD&M activities |

| | | |
|---|---|---|
| Recourse long-term debt (including current portion) | (354.7) | Debt repayments and stronger Canadian dollar compared to the U.S. dollar |
| Non-recourse long-term debt (including current portion) | (29.5) | Scheduled debt repayments |
| Deferred credits and other long-term liabilities (including current portion) | 108.1 | Revised ARO estimates and Centralia mine closure charges |
| Net future income tax liabilities (including current portions) | (161.6) | Reduction in tax rates and net losses from the period |
| Non-controlling interests | (23.6) | Distributions in excess of earnings |
| Shareholders equity | (69.1) | Net earnings for the period and dividends offset by dividend reinvestment program and share issuances |

**PRICE RISK MANAGEMENT**

Our price risk management assets and liabilities represent the value of unsettled (unrealized) proprietary trading transactions and certain asset-backed trading transactions accounted for on a fair value basis. With the exception of transmission contracts, the fair value of all energy trading activities is based on quoted market prices. The fair value of financial transmission contracts is based upon statistical analysis of historical data. All transmission contracts are accounted for in accordance with EITF 02-03. The following tables show the balance sheet classifications for price risk management assets and liabilities as well as the changes in the fair value of the net price risk management assets for the period:

| Year ended Dec. 31 | **2006** | 2005 |
|---|---|---|
| **Balance Sheet** | | |
| Price risk management assets | | |
| Current | **$ 61.0** | $ 63.8 |
| Long-term | **21.9** | 13.8 |
| Price risk management liabilities | | |
| Current | **(30.3)** | (58.3) |
| Long-term | **(1.0)** | (8.6) |
| Net price risk management assets outstanding | **$ 51.6** | $ 10.7 |

| | Mark-to-market | Mark-to-model | Total |
|---|---|---|---|
| **Change in fair value of net assets** | | | |
| Net price risk management assets outstanding at Dec. 31, 2005 | $ 7.4 | $ 3.3 | $ 10.7 |
| Contracts realized, amortized, or settled during the period | (3.8) | (4.8) | (8.6) |
| Changes in values attributable to market price and other market changes | (6.0) | 0.3 | (5.7) |
| New contracts entered into during the current calendar year | 10.4 | 0.1 | 10.5 |
| Changes in values attributable to discontinued hedge treatment of certain contracts | 44.7 | | 44.7 |
| Net price risk management assets outstanding at Dec. 31, 2006 | **$ 52.7** | **$ (1.1)** | **$ 51.6** |

At Dec. 31, 2006, our net price risk management assets and liabilities increased $40.9 million compared to Dec. 31, 2005 primarily due to certain contracts at Centralia Coal no longer receiving hedge accounting treatment.

The anticipated timing of settlement of the above contracts over each of the next five calendar years and thereafter is as follows:

| | 2007 | 2008 | 2009 | 2010 | 2011 and thereafter | Total |
|---|---|---|---|---|---|---|
| Prices actively quoted | $ 32.9 | $ 17.2 | $ 1.7 | $ 0.9 | $ | $ 52.7 |
| Prices based on models | (2.2) | 1.1 | | | | (1.1) |
| | $ 30.7 | $ 18.3 | $ 1.7 | $ 0.9 | $ | $ 51.6 |

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

The following chart outlines significant changes in the consolidated statements of cash flows between Dec. 31, 2006 and Dec. 31, 2005:

| Year ended Dec. 31 | **2006** | 2005 | Explanation |
|---|---|---|---|
| Cash and cash equivalents, beginning of period | **$ 79.3** | $ 101.2 | |
| Provided by (used in): | | | |
| Operating activities | **489.6** | 619.8 | Increased cash earnings more than offset by timing of collections from customers. |
| Investing activities | **(261.3)** | (242.5) | Capital expenditures of $223.7 million and increase in restricted cash of $333.1 million, partially offset by decrease in equity investments of $226.4 million, realized gains on net investment hedges of $53.9 million and proceeds on sale of assets of $29.4 million.<br><br>In 2005, cash outflows were primarily due to additions to property, plant and equipment of $325.9 million, partially offset by realized foreign exchange gains on net investments of $89.8 million. |
| Financing activities | **(243.2)** | (396.3) | Cash used in financing activities increased due to repayment of long-term debt of $396.7 million, distributions to the subsidiaries non-controlling interests of $74.4 million, dividend payments of $133.9 million and offset by an increase in short-term debt of $348.1 million.<br><br>In 2005, cash outflows were due to the redemption of preferred securities of $300.0 million, dividends on common shares of $99.2 million, distribution to subsidiaries non-controlling interests of $77.5 million, repayment of long-term debt of $139.3 million and repayment of short-term debt of $23.6 million, partially offset by the issuance of long-term debt of $200.0 million. |
| Translation of foreign currency cash | **1.2** | (2.9) | |
| Cash and cash equivalents, end of period | **$ 65.6** | $ 79.3 | |

The following chart outlines significant changes in the consolidated statements of cash flows between Dec. 31, 2005 and Dec. 31, 2004:

| Year ended Dec. 31 | 2005 | 2004 | Explanation |
|---|---|---|---|
| Cash and cash equivalents, beginning of period | $ 101.2 | $ 123.8 | |

| | | | |
|---|---|---|---|
| Provided by (used in): | | | |
| Operating activities | 619.8 | 591.2 | Increased cash earnings offset by higher working capital requirements. |
| Investing activities | (242.5) | (57.4) | In 2005, capital expenditures of $325.9 million were offset by realized gains on net investment hedges of $89.8 million.<br><br>In 2004, cash outflows were primarily due to additions to property, plant and equipment of $345.7 million, partially offset by proceeds on the sale of TA Power partnership units of $116.5 million, long-term receivables of $90.8 million and realized foreign exchange gains on net investments of $47.8 million. |
| Financing activities | (396.3) | (549.3) | In 2005, cash outflows were due to the redemption of preferred securities of $300.0 million, dividends on common shares of $99.2 million, distribution to subsidiaries non-controlling interests of $77.5 million, repayment of long-term debt of $139.3 million and repayment of short-term debt of $23.6 million, partially offset by the issuance of long-term debt of $200.0 million.<br><br>In 2004, cash outflows were due to the net repayment of debt of $367.4 million, dividends on common shares of $135.4 million, and distributions to subsidiaries non-controlling limited partner of $48.4 million. |
| Translation of foreign currency cash | (2.9) | (7.1) | |
| Cash and cash equivalents, end of period | $ 79.3 | $ 101.2 | |

**LIQUIDITY AND CAPITAL RESOURCES**

At the corporate level, we raise substantially all capital to be invested in the various business units and affiliated or subsidiary companies from external markets. This strategy allows us to gain access to sufficient capital at the lowest overall cost. Historically, external financing has been obtained from borrowings under credit facilities, proceeds from the disposal of non-core assets and the issuance of debt, preferred securities and equity. Internally, capital is raised through cash flow from operations.

TransAlta s dividends per common share were $1.00 in 2006, 2005 and 2004.

**FINANCING ARRANGEMENTS**

TransAlta raises capital in the Canadian and U.S. markets. TransAlta has the following financing arrangements in place:

USD$1.0 billion shelf registration program; no amount has been issued since its renewal in July 2004. This program was renewed in October 2006 and is valid until November 2008;

$1.0 billion medium-term note program; $200.0 million was drawn under this program in December 2005. This program remains valid until December 2007;

A $200.0 million commercial paper program of which $200.0 million was issued at Dec. 31, 2006;

$1.5 billion committed syndicated bank credit facility, with $556.4 million utilized at Dec. 31, 2006. The facility was renewed in May 2006 and expires in June 2011; and

$335.0 million of additional bank credit facilities, with $239.2 million utilized at Dec. 31, 2006. All of these bank credit facilities are non-committed.

At Dec. 31, 2006, the corporation had approximately $840 million of credit available from its committed and uncommitted credit facilities.

At Dec. 31, 2006, TransAlta had a working capital ratio of 0.64 compared to 0.73 at Dec. 31, 2005. This decrease in working capital ratio is attributable to an increase in current liabilities as a result of the reclassification of $175.0 million preferred securities to current liabilities which were redeemed in January 2007, offset by an increase in accounts receivable.

TransAlta expects to have sufficient sources of internal and external capital to finance operations and growth.

Long-term funding is provided through the maintenance of investment grade credit ratings and a carefully managed capital structure, which together creates a strong balance sheet and ready access to capital markets at competitive rates. Our objective is to manage the maturities of the various securities on issue so that no more than 15 per cent of the total outstanding securities mature in any one year. Our target is to maintain a capital structure and coverage ratios consistent with investment grade credit ratings. Our capital structure consisted of the following components at Dec. 31, 2006, 2005, and 2004:

**2006**