Management's Discussion & Analysis of Financial Condition and Financial Performance

For the three months ended
June 30, 2019

Dated August 14, 2019

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The following is our discussion and analysis of the financial condition and financial performance for British Columbia Ferry Services Inc. ("BC Ferries" or the "Company") for the three months ended June 30, 2019 that has been prepared with information available as of August 14, 2019. This discussion and analysis should be read in conjunction with our unaudited condensed interim consolidated financial statements and related notes for the three months ended June 30, 2019 and 2018, and our audited consolidated financial statements and related notes for the years ended March 31, 2019 ("fiscal 2019") and March 31, 2018 ("fiscal 2018"), together with our Management's Discussion and Analysis for fiscal 2019. These documents are available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html and on SEDAR at www.sedar.com.

Except where indicated, all financial information herein is expressed in Canadian dollars and determined on the basis of International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board (the "IASB").

BUSINESS OVERVIEW

British Columbia Ferry Services Inc. is an independent company, providing passenger and vehicle ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world. We provide frequent year-round transportation service, with 35 vessels operating on 25 routes out of 47 terminals spread over 1,600 kilometres of coastline. We also manage ferry transportation services on other remote routes through contracts with independent operators.

Our service is an integral part of British Columbia's coastal transportation system and has been designated by the Province of British Columbia (the "Province") as an essential service for purposes of the provincial Labour Relations Code. This designation means our services are considered necessary for the protection of the health, safety and welfare of the residents of British Columbia.

Our principal business of ferry transportation requires positive net earnings and ongoing access to capital in order to fund operations, satisfy outstanding long-term debt obligations and fulfill future capital asset obligations.

During the three months ended June 30, 2019 (the first quarter of fiscal 2020), we provided an average of 497 sailings per day for our customers. We delivered over 45,000 sailings during this period, an increase of 1,315 or 3.0% compared to the same period in the prior year. We carried 5.8 million passengers and 2.4 million vehicles during the quarter, an increase of 2.2% and 2.5%, respectively, compared to the same quarter in the prior year. These passenger and vehicle traffic levels are the highest we have ever experienced during the first quarter of a fiscal year. For a discussion of our traffic levels, see "Financial and Operational Overview" below.

Our Major Routes, which are our four busiest routes, consist of three regulated routes connecting Metro Vancouver with mid and southern Vancouver Island and one regulated route connecting Horseshoe Bay and Langdale. Our Northern Routes currently consist of three regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island. Our Other Routes consist of 18 regulated routes and 8 unregulated routes primarily serving the northern and southern Gulf Islands and the northern Sunshine Coast.

Significant events during or subsequent to the first quarter of fiscal 2020 include the following:

Tariffs

- On April 1, 2019, as agreed with and partially funded by the Province, fares on all routes for fiscal 2020 were held at the fiscal 2019 level. On April 1, 2018, we applied a fare reduction of 15% on the Northern Routes, the regulated Other Routes and on the Major Route connecting Horseshoe Bay and Langdale. Fares were held constant on the three Major Routes connecting Metro Vancouver with mid and southern Vancouver Island. Also on April 1, 2018, the BC seniors' passenger discount increased from 50% to 100% for travel Monday to Thursday on the Major and Other Routes. The total estimated value of these initiatives over fiscal 2019 and fiscal 2020 is approximately $98 million, of which BC Ferries will contribute $39 million in foregone revenue. In fiscal 2019, the Province contributed $26.5 million and in fiscal 2020 will contribute $32.5 million towards the increasing impact of the fare reductions and BC seniors' discount.

- On June 1, 2019, due to current fuel price market conditions, we implemented a fuel surcharge of 1.5% on average on all routes with the exception of the Northern Routes.

Vessels

- On April 18, 2019, the *Spirit of Vancouver Island* returned to service on our Tsawwassen – Swartz Bay route following its mid-life upgrade. This mid-life upgrade, which will enable the vessel to be in service for another 25 years, included major upgrades to the customer amenities, and the conversion to dual-fuel so the vessel can operate on liquefied natural gas ("LNG") or ultra-low sulphur marine diesel ("marine diesel").

- On May 18, 2019, the *Northern Sea Wolf* entered service in the mid-coast and on June 3 started the direct seasonal service between Port Hardy and Bella Coola. The *Northern Sea Wolf*, a 75-metre vessel built in 2000, underwent extensive upgrades necessary to bring it up to the standards of safety and reliability that we and Transport Canada require. The vessel accommodates approximately 35 vehicles and 150 passengers and crew. (See "Investing in Our Capital Assets" for more detail.)

General

- On April 1, 2019, the Commissioner released a preliminary decision on the price cap for Performance Term Five ("PT5"), the period commencing on April 1, 2020 and ending on March 31, 2024, for annual price cap increases of 2.3%. We have reviewed the preliminary decision and are providing additional information to the Commissioner for consideration in the determination of the final price cap, which is expected on or before September 30, 2019. (See "Accounting Practices – The Effect of Rate Regulation" for more details on price caps.)

- On May 16, 2019, the Province enacted legislation to amend the *Coastal Ferry Act* (the "Act") based on the recommendations from the review the Province had conducted of coastal ferry services in British Columbia. The amendments include:
  - requiring the Commissioner to consider public interest when regulating ferry operators and encouraging ferry operators to meet the Province's greenhouse gas emission targets;
  - authorizing the payment by the Commissioner of part or all costs incurred by an eligible organization participating in a proceeding under the Act, if the Commissioner considers it in the public interest;
  - removing as a regulatory principle the requirement for the Commissioner to encourage BC Ferries to adopt a commercial approach;
  - increasing the number of B.C. Ferry Authority ("Authority") directors appointed by government from two to four and eliminating the two director positions filled by the Authority from members of the community-at-large;

- mandating that the Authority oversee the strategic direction of BC Ferries in support of the public interest including the public's interest in safe, reliable and affordable coastal ferry services in British Columbia;
- requiring the Authority to set term limits when appointing directors to the BC Ferries board and limiting the consecutive years a director can serve on the Board to eight;
- expanding the definition of executive at BC Ferries to include vice-presidents of BC Ferries for the purposes of their remuneration being governed by an executive compensation plan approved by the Authority; and
- removing the requirement for ferry operators to seek alternative service providers for services on the designated ferry routes serviced by the ferry operator in an effort to reduce the costs of providing those services.

FINANCIAL AND OPERATIONAL OVERVIEW

This section provides an overview of our financial and operational performance for the three month periods ended June 30, 2019 and 2018.

	Three months ended June 30			
			Variance	
($ millions)	2019	2018	$	%
Total revenue	246.4	229.7	16.7	7.3%
Operating expenses	220.4	209.9	10.5	5.0%
Operating profit	26.0	19.8	6.2	31.3%
Net finance and other	13.8	13.8	0.0	-
Net earnings	12.2	6.0	6.2	103.3%
Other comprehensive (loss) income	(0.1)	7.9	(8.0)	(101.3%)
Total comprehensive income	12.1	13.9	(1.8)	(12.9%)

Our net earnings in the three months ended June 30, 2019 were $6.2 million higher than the same period in the prior year.

In the first quarter of fiscal 2020, revenues increased by $16.7 million or 7.3% compared to the first quarter of the previous fiscal year, primarily as a result of the increases to: traffic volumes; ferry transportation fees; and net retail sales. On April 1, 2019, fares on all routes were held at the fiscal 2019 level.

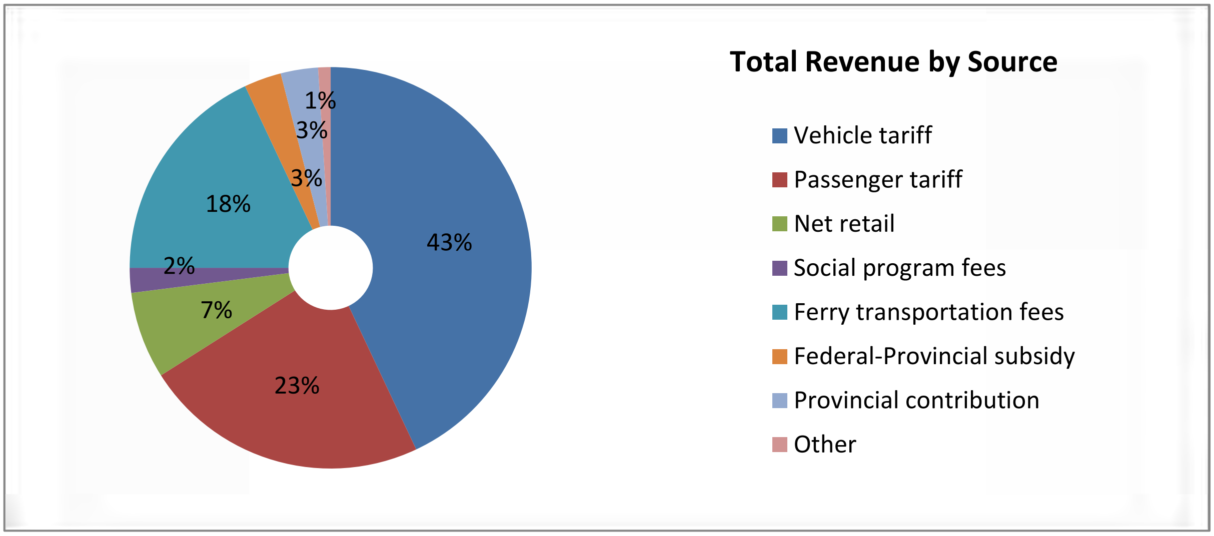
In addition, a fuel surcharge was implemented due to current fuel price market conditions.

In the first quarter of fiscal 2020, operating expenses increased by $10.5 million or 5.0% compared to the first quarter of the previous fiscal year. To improve our customer experience, accommodate the higher traffic volumes over the Easter holiday, and satisfy increased service levels agreed to with the Province, we provided 702.5 additional round trips compared to the same period in the prior year. We introduced the *Northern Sea Wolf* and re-introduced the upgraded *Spirit of Vancouver Island* into service. These actions resulted in an increase in labour costs and a decrease in marine diesel fuel consumption. The increase in operating expenses also included the impact of wage rate increases in accordance with the Collective Agreement with the BC Ferry & Marine Workers' Union (the "Union"), higher benefit costs (Employer Health Tax, Workers Compensation and pension), and higher depreciation.(See "Expenses" for more detail.)

During the three months ended June 30, 2019, total comprehensive income decreased $1.8 million or 12.9%, compared to the same period in the prior year, comprised of a decrease in other comprehensive income of $8.0 million and an increase in net earnings of $6.2 million. The decrease in other comprehensive income from a gain of $7.9 million in the first quarter of fiscal 2019 to a loss of $0.1 million in the first quarter of fiscal 2020 reflects an $8.0 million reduction in the change in fair value of our fuel swap contracts relating to future periods.

Revenue and Operational Statistics - Overall

The following discussions of revenue are based on IFRS results, with reference to the impacts of rate regulation (See "Accounting Practices - The Effect of Rate Regulation"). Our Major Routes, which are our four busiest routes, consist of three regulated routes connecting Metro Vancouver with mid and southern Vancouver Island and one regulated route connecting Horseshoe Bay and Langdale. Our Northern Routes consist of three regulated routes, including the new route connecting Port Hardy and Bella Coola which commenced in fiscal 2019, operating on the British Columbia coast north of Port Hardy on Vancouver Island. Our Other Routes consist of 18 regulated routes and 8 unregulated routes primarily serving the northern and southern Gulf Islands and the northern Sunshine Coast.



Fuel rebates and surcharges are not included in the above total revenue by source. Rebates and surcharges are recorded in our fuel deferral accounts for rate regulatory purposes as they are implemented as a direct result of rising and declining fuel prices.

Select operational statistics and total revenues for the three months ended June 30, 2019 compared to the same period in the prior year are shown in the tables below.

	Three months ended June 30	
Operational Statistics	2019	2018
Vehicle traffic	2,360,276	2,301,697
Passenger traffic	5,828,909	5,705,316
On-time performance	86.8%	86.7%
Number of round trips	20,589.5	19,887
Capacity provided (AEQs)	3,960,925	3,873,846
AEQs carried	2,683,711	2,623,196
Capacity utilization	67.8%	67.7%

During the three months ended June 30, 2019, vehicle traffic increased 2.5% and passenger traffic increased 2.2% compared to the same quarter in the prior year. We believe that holding fares at fiscal 2019 levels and two more days of Easter holidays falling in the first quarter of fiscal 2020 had a positive impact on both passenger and vehicle traffic.

On-time performance on the Major and regulated Other Routes is defined as the percentage of our sailings departing within 10 minutes of the scheduled departure time. On-time performance on the Northern Routes is defined as the percentage of our sailings arriving no later than 10 minutes after the scheduled arrival time. In each case, on-time performance can be impacted by delays due to weather, vessel substitution, mechanical issues, terminal dock maintenance or closures and periods of high traffic demand.

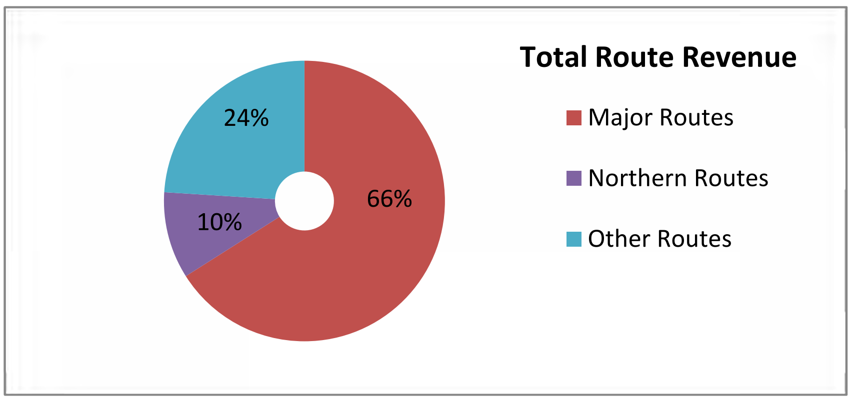
Meeting customer service expectations in a safe and reliable manner is the principal factor guiding our focus on on-time performance. Our initiatives to improve on-time performance include adjusting and/or expanding sailing schedules, adjusting crewing schedules and refining vehicle loading processes during peak periods. In the three months ended June 30, 2019, overall on-time performance was consistent with the same period in the prior year. The Major Routes' on-time performance declined primarily due to incidents and delays due to weather but was offset by an increase in on-time performance on both the Northern and Other Routes.

An automobile equivalent ("AEQ") is our standard unit of measure for an approximation of one car length. AEQs are calculated by using a conversion factor for each vehicle type. For example, a passenger vehicle would be one AEQ while a bus would be three AEQs. The change in AEQs from one period to the next may not be proportionate to the change in vehicle traffic, due to variations in the mix of vehicle types (the relative number of buses, commercial vehicles and passenger vehicles) and actual size of vehicles carried.

Vehicle capacity provided, measured in AEQs, is the available vehicle deck space on a vessel multiplied by the number of round trips. The Coastal Ferry Services Contract ("CFSC") stipulates, among other things, the minimum number of round trips to be provided for each regulated ferry service route in exchange for the payment of ferry transportation fees by the Province. The year over year change in the number of round trips provided can be impacted by cancellations and in response to changes in demand or the number of trips stipulated by the CFSC. In the three months ended June 30, 2019, we provided 702.5 additional round trips compared to the same period in the prior year, resulting in an increase in capacity provided.

Capacity utilization in a period is calculated by dividing the AEQs carried during the period by the AEQ capacity provided on the vessels. Capacity utilization is impacted by the number of vehicles carried, the mix of vehicle types, the size of the vessels utilized and the number of round trips in each period. Overall, capacity utilization for the three months ended June 30, 2019, was consistent with the same quarter in the prior year with capacity provided and AEQs carried both increasing.

Revenue ($ millions)	Three months ended June 30			
			Increase (Decrease)	
	2019	2018	$	%
Direct Route Revenue				
Vehicle tariff	105.2	102.3	2.9	2.8%
Passenger tariff	57.3	56.2	1.1	2.0%
Net retail	16.2	15.0	1.2	8.0%
Social program fees	4.5	4.5	-	-
Other revenue	3.0	2.8	0.2	7.1%
Fuel surcharge (rebate)	0.8	(4.5)	5.3	117.8%
Total Direct Route Revenue	187.0	176.3	10.7	6.1%
Indirect Route Revenue				
Ferry transportation fees	42.7	38.5	4.2	10.9%
Federal-Provincial subsidy	7.8	7.6	0.2	2.6%
Provincial contribution: Tariffs	5.7	4.2	1.5	35.7%
Provincial contribution: Seniors	2.6	2.6	-	-
Total Route Revenue	245.8	229.2	16.6	7.2%
Other general revenue	0.6	0.5	0.1	20.0%
Total Revenue	246.4	229.7	16.7	7.3%



In the three months ended June 30, 2019, the greatest portion of our revenues (66%) was earned on our Major Routes. Revenue from the Northern Routes contributed 10% and revenue from Other Routes contributed 24%.

Vehicle tariffs (which include reservation fee revenue) and passenger tariffs account for the majority of our revenues. Our year-over-year tariff revenues are impacted by factors such as changes in overall traffic levels, traffic types, and tariff rates.

Net retail sales is our second largest source of direct revenue and provides a gross margin of approximately 60%, which contributes favourably to our net earnings and helps to keep fares affordable. Catering, retail and other on-board services are impacted by traffic levels, price, service quality and product offerings.

On April 1, 2019, fares on all routes for fiscal 2020 were held at the fiscal 2019 level. For fiscal 2019, we applied a fare reduction of 15% on the Northern Routes, the regulated Other Routes and on the Major Route connecting Horseshoe Bay and Langdale. Fares were held constant on the three Major Routes connecting Metro Vancouver with mid and southern Vancouver Island. In addition, the BC seniors' passenger discount for fiscal 2019 increased from 50% to 100% for travel Monday to Thursday on the Major and Other Routes. The total value of these initiatives over two years is approximately $98 million, of which of which BC Ferries will contribute $39 million in foregone revenue. In fiscal 2019, the Province partially funded the fare reductions and the increase to the BC seniors' discount with a contribution of $26.5 million and in fiscal 2020 the Province will contribute $32.5 million. In the three months ended June 30, 2019, $8.3 million of the $32.5 million was recorded into revenue compared to $6.8 million in the same period in the prior year. In the three months ended June 30, 2019, the number of BC seniors travelling with the discount increased 6.2% compared to same period in the prior year.

From time to time, we implement fuel surcharges as a result of rising fuel prices or rebates as a result of falling fuel prices. Fuel rebates of 1.9% on the Northern Routes and 2.9% on our Major and regulated Other Routes were in place during the first quarter of fiscal 2019 until they were discontinued, effective June 27, 2018, due to the rise in fuel prices. On June 1, 2019, due to current fuel market conditions, we implemented a fuel surcharge of 1.5% on average on all routes with the exception of the Northern Routes. For the purpose of rate regulation, surcharges and/or rebates are applied to our deferred fuel cost accounts. (See "Accounting Practices - The Effect of Rate Regulation" for more detail.)

Effective April 1, 2019, we reached an agreement with the Province to amend the service levels to include over 2,700 additional trips for which the Province will contribute an incremental aggregate amount not to exceed $5.8 million per year. In fiscal 2020, over 1,700 additional trips will be provided and the Province is expected to pay an additional $3.8 million in ferry transportation fees. In the three months ended June 30, 2019, $0.6 million was recorded into revenue for 299 additional trips.

Year to year changes in revenue and operational statistics for the three months ended June 30, 2019 and 2018 for the Major, Northern and Other Routes are discussed separately below.

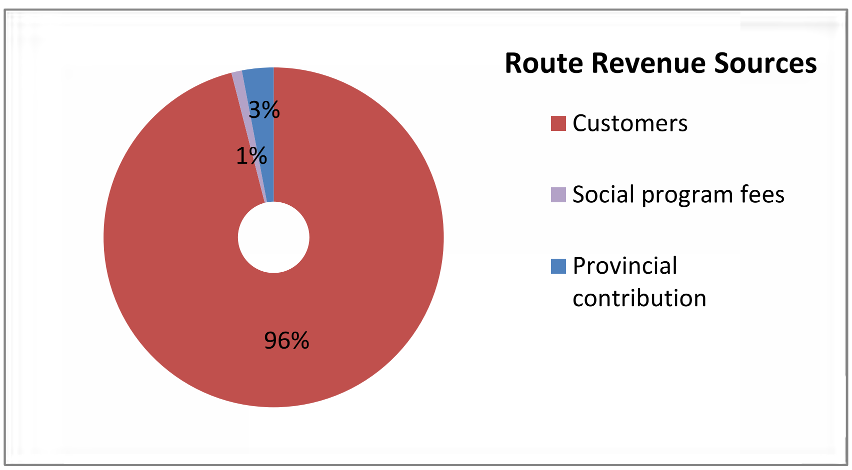
Revenue and Operational Statistics - Major Routes

Our Major Routes consist of our four busiest routes, carrying approximately 60% of our total vehicle traffic and 65% of our total passenger traffic, generating approximately 85% of our direct route revenue.

	Three months ended June 30	
Operational Statistics	2019	2018
Vehicle traffic	1,363,020	1,350,748
Passenger traffic	3,670,214	3,642,716
On-time performance	79.8%	83.4%
Number of round trips	3,445.0	3,401.0
Capacity provided (AEQs)	2,140,022	2,118,084
AEQs carried	1,611,334	1,601,633
Capacity utilization	75.3%	75.6%

Over the three months ended June 30, 2019, vehicle traffic increased 0.9% and passenger traffic increased 0.8% compared to the same period in the prior year. We believe passenger and vehicle traffic were positively impacted by holding fares at fiscal 2019 levels and two more days of Easter holidays falling in the first quarter of fiscal 2020.

During the first quarter of fiscal 2020, overall on-time performance on the Major Routes decreased 3.6% compared to the same period in the prior year. On-time performance on all of the Major Routes decreased, primarily due to the impact of delays due to incidents and weather. Our initiatives to improve on-time performance include adjusting and/or expanding sailing schedules, adjusting crewing schedules, changing operational procedures and refining vehicle loading processes during peak periods.



In the three months ended June 30, 2019, revenue from our Major Routes consisted of 96% from customers and the remaining 4% from the Province.

Major Routes (continued)

Revenue ($ thousands)	Three months ended June 30			
	2019	2018	Increase (Decrease)	
Direct Route Revenue				
Vehicle tariff	89,338	87,857	1,481	1.7%
Passenger tariff	47,348	46,910	438	0.9%
Net retail	14,404	13,478	926	6.9%
Social program fees	2,374	2,363	11	0.5%
Parking	1,872	1,737	135	7.8%
Other revenue	1,008	904	104	11.5%
Fuel surcharge (rebate)	719	(3,757)	4,476	119.1%
Total Direct Route Revenue	157,063	149,492	7,571	5.1%
Indirect Route Revenue				
Provincial contribution: Tariffs	2,842	2,122	720	33.9%
Provincial contribution: Seniors	1,960	1,938	22	1.1%
Total Route Revenue	161,865	153,552	8,313	5.4%

In the three months ended June 30, 2019, average tariff revenue per vehicle (tariff revenue divided by traffic volume) was $65.54, which is 0.8% higher than the same period in the prior year, mainly as a result of increased reservations and an increase in the proportion of traffic on routes with higher versus lower tariffs. In the three months ended June 30, 2019, average tariff revenue per passenger increased $0.02 or 0.2% compared to the same period in the prior year. The increase in average tariff revenue and the increase in traffic levels during the first quarter of fiscal 2020 resulted in a total tariff revenue increase of $1.9 million compared to the same period in the prior year.

All vessels that provide service on our Major Routes have a gift shop and options for food service. In the three months ended June 30, 2019, net retail sales increased 6.9% compared to the same period in the prior year as a result of both higher average sales per passenger and higher passenger traffic. Food sales remain strong, providing approximately 74% of total retail revenue. Sales of quality apparel comprise over 10% of total retail revenue. Cost of goods sold is approximately 40% of gross retail sales.

Social program fees are reimbursements from the Province of discounts provided on fares for students travelling to and from school, persons with disabilities and persons travelling under the Ministry of Health Travel Assistance Program ("MTAP"). Social program fees for the three months ended June 30, 2019 increased compared to the same period in the prior year, mainly due to an increase in the usage of the MTAP program, slightly offset by a reduction in the number of students travelling under the program.

Revenue from parking increased 7.8% in the three months ended June 30, 2019 compared to the same period in the prior year, as a result of higher usage. A fuel rebate of 2.9% on our Major Routes was in place during the first quarter of fiscal 2019 until it was discontinued, effective June 27, 2018, due to changes in fuel market conditions. On June 1, 2019, we implemented a fuel surcharge of 1.5% on our Major Routes.

The provincial contribution increased by $0.7 million compared to the same period in the prior year. The provincial contribution of $4.8 million in the three months ended June 30, 2019 consisted of $2.0 million towards the increased BC seniors' discount and $2.8 million for fare initiatives (a fare reduction of 15% on the Horseshoe Bay – Langdale route and fares held constant on the other three Major Routes).

Revenue and Operational Statistics - Northern Routes

Our Northern Routes currently consist of three regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island. In the fall of 2018, we started service on a new route directly connecting Port Hardy and Bella Coola.

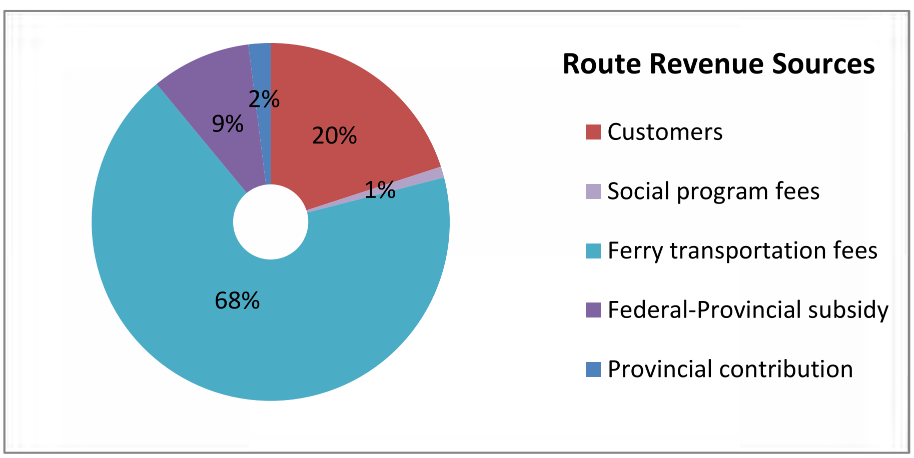
Operational Statistics	Three months ended June 30 2019	2018
Vehicle traffic	8,957	7,848
Passenger traffic	22,616	20,272
On-time performance	85.5%	80.9%
Number of round trips	87.0	59.0
Capacity provided (AEQs)	13,134	11,826
AEQs carried	11,100	9,738
Capacity utilization	84.5%	82.3%

In the three months ended June 30, 2019, vehicle traffic increased 14.1% and passenger traffic increased 11.6% compared to the same period in the prior year primarily as a result of:

- the impact of the introduction of the new seasonal route connecting Port Hardy and Bella Coola;
- maintaining the 15% reduction in fares introduced in the prior year; and
- two more days of Easter holidays falling in the first quarter of fiscal 2020.

On-time performance in the three months ended June 30, 2019 increased from 80.9% to 85.5% compared to the same period in 2018, primarily due to less weather-related delays.

Capacity utilization on these routes during the three months ended June 30, 2019 was 2.2% higher than the same period in the prior year, primarily as a result of the increase in the number of AEQs carried outpacing increased capacity provided.



In the three months ended June 30, 2019, revenue from our Northern Routes consisted of 20% from customers and the remaining 80% from the Province.

Northern Routes (continued)

Revenue ($ thousands)	Three months ended June 30			
	2019	2018	Increase (Decrease)	
Direct Route Revenue				
Vehicle tariff	2,279	1,892	387	20.5%
Passenger tariff	1,637	1,372	265	19.3%
Net retail	282	268	14	5.2%
Social program fees	264	284	(20)	(7.0%)
Stateroom rental	509	446	63	14.1%
Hostling & other	61	64	(3)	(4.7%)
Fuel surcharge (rebate)	-	(63)	63	100.0%
Total Direct Route Revenue	5,032	4,263	769	18.0%
Indirect Route Revenue				
Ferry transportation fees	15,889	12,959	2,930	22.6%
Federal-Provincial subsidy	2,010	1,957	53	2.7%
Provincial contribution: Tariffs	408	298	110	36.9%
Total Route Revenue	23,339	19,477	3,862	19.8%

In the three months ended June 30, 2019, average tariff revenue per vehicle (tariff revenue divided by traffic volume) increased $13.36 or 5.5% and average tariff revenue per passenger increased $4.70 or 6.9% compared to the same period in the prior year. Average tariff revenues reflect the impact of the introduction of the new seasonal route and a change in the proportion of traffic on routes with higher versus lower tariffs. The changes in traffic levels and changes in average tariff revenue during the first quarter of fiscal 2020 resulted in a total tariff revenue increase of $0.7 million compared to the same period in the prior year.

Revenue from net retail services increased in the quarter compared to the same period in the prior year, as a result of higher average sales per passenger and higher passenger traffic.

Reimbursements from the Province for social program fees decreased compared to the same period in the prior year, mainly as a result of a reduction in the usage of the MTAP program.

Stateroom rental revenue increased due to higher utilization.

No fuel rebate or surcharge was in place during the first quarter of fiscal 2020. A fuel rebate of 1.9% on the Northern Routes was in place during the first quarter of fiscal 2019 until it was discontinued, effective June 27, 2018 (fiscal 2019), due to the rise in fuel prices.

Ferry transportation fees received from the Province increased $2.9 million in the quarter compared to the same period in the prior year, mainly as a result of differences in the monthly schedule of round trips and additional funding from the Province for the provision of additional services.

The Federal-Provincial subsidy increased based on the percentage increase in the annual Consumer Price Index ("CPI") (Vancouver).

The provincial contribution increase of $0.1 million in the three months ended June 30, 2019 was due to a higher contribution towards the fare reduction initiative.

Revenue and Operational Statistics - Other Routes

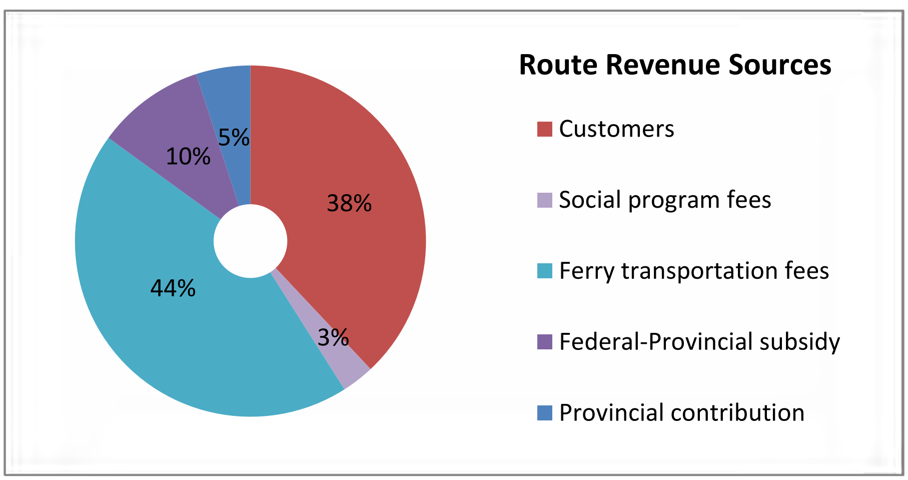
Our Other Routes primarily serve the northern and southern Gulf Islands and the northern Sunshine Coast. One of the 18 regulated routes and all eight of the unregulated routes are operated under contract by alternative service providers. We receive fees from the Province for the provision of contracted services on these routes, which are included in the ferry transportation fees discussed below. Unregulated routes are not incorporated in the following analysis.

Operational Statistics	Three months ended June 30	
	2019	2018
Vehicle traffic	988,299	943,101
Passenger traffic	2,136,079	2,042,328
On-time performance	88.1%	87.3%
Number of round trips	17,057.5	16,427.0
Capacity provided (AEQs)	1,807,769	1,743,936
AEQs carried	1,061,277	1,011,825
Capacity utilization	58.7%	58.0%

During the three months ended June 30, 2019, vehicle traffic increased 4.8% and passenger traffic increased 4.6% compared to the same period in the prior year. We believe passenger and vehicle traffic were positively impacted by maintaining the 15% reduction in fares introduced in the prior year. In addition there were less sailing disruptions and two more days of Easter holidays falling in the first quarter of fiscal 2020.

On-time performance in the three months ended June 30, 2019 increased 0.8% over the same period in the prior year, primarily due to adjustments and/or expansion of sailing schedules.

Capacity utilization on these routes during the three months ended June 30, 2019 was slightly higher compared to the same period in the prior year, primarily due to a higher number of AEQs carried, mostly offset by an increase in capacity provided.



In the three months ended June 30, 2019, revenue from our Other Routes consisted of 38% from customers and 62% from the Province.

Other Routes (continued)

Revenue ($ thousands)	Three months ended June 30			
	2019	2018	Increase (Decrease)	
Direct Route Revenue				
Vehicle tariff	13,547	12,515	1,032	8.2%
Passenger tariff	8,328	7,881	447	5.7%
Social program fees	1,816	1,824	(8)	(0.4%)
Net retail	1,023	827	196	23.7%
Parking & other	72	100	(28)	(28.0%)
Fuel surcharge (rebate)	119	(697)	816	117.1%
Total Direct Route Revenue	24,905	22,450	2,455	10.9%
Indirect Route Revenue				
Ferry transportation fees	26,772	25,576	1,196	4.7%
Federal-Provincial subsidy	5,825	5,669	156	2.8%
Provincial contribution: Tariffs	2,406	1,771	635	35.9%
Provincial contribution: Seniors	679	663	16	2.4%
Total Route Revenue	60,587	56,129	4,458	7.9%

During the three months ended June 30, 2019, average tariff revenue per vehicle (tariff revenue divided by traffic volume) increased $0.44 or 3.3% and average tariff revenue per passenger increased $0.04 or 1.03%, reflecting an increase in the proportion of traffic on routes with higher versus lower tariffs. The increase in average tariff revenue and the increase in traffic levels during the first quarter of fiscal 2020, resulted in a total tariff revenue increase of $1.5 million compared to the same period in the prior year.

Net retail services revenue increased in the quarter compared to the same period in the prior year as a result of both higher passenger traffic and higher average sales per passenger.

A fuel rebate of 2.9% on our Other Routes was in place during the first quarter of fiscal 2019 until it was discontinued, effective June 27, 2018, due to the rise in fuel prices. On June 1, 2019, due to current fuel market conditions, we implemented a fuel surcharge of 1.5% on our Other Routes.

Ferry transportation fees received from the Province increased $1.2 million in the quarter compared to the same period in the prior year, mainly as a result of differences in the monthly schedule of round trips and additional funding from the Province for the provision of additional services.

The Federal-Provincial subsidy increased based on the percentage increase in the annual CPI (Vancouver).

As previously agreed, the provincial contribution towards the fare reduction and increase to the BC seniors' discount increased by $0.6 million compared to the same period in the prior year. The provincial contribution of $3.1 million in the three months ended June 30, 2019 consisted of a $0.7 million contribution towards the increased BC seniors' discount and $2.4 million contribution towards the fare reduction initiative.

Expenses

Expenses for the three months ended June 30, 2019 and 2018 are summarized in the table below:

Operating expenses ($ millions)	Three months ended June 30			
			(Increase) Decrease	
	2019	2018	$	%
Operations	140.7	135.9	(4.8)	(3.5%)
Maintenance	26.3	22.2	(4.1)	(18.5%)
Administration	8.7	9.8	1.1	11.2%
Total operations, maintenance & administration	175.7	167.9	(7.8)	(4.6%)
Depreciation and amortization	44.7	42.0	(2.7)	(6.4%)
Total operating expenses	220.4	209.9	(10.5)	(5.0%)

To improve our customer experience, accommodate the higher traffic volumes over the Easter holiday, and deliver the increased service levels agreed to with the Province, we provided 702.5 additional round trips compared to the same period in the prior year. We introduced the *Northern Sea Wolf* and re-introduced the upgraded *Spirit of Vancouver Island* into service. These actions resulted in an increase in labour costs and a decrease in marine diesel fuel consumption. The increase in operating expenses also included the impact of wage rate increases in accordance with the Collective Agreement, higher benefit costs (Employer Health Tax, Workers Compensation and pension), and higher depreciation. We continue to take proactive measures to contain and manage expenses while operating a sustainable, safe and reliable service.

During the three months ended June 30, 2019, operations expense increased $4.8 million compared to the same period in the prior year due to:

- $5.4 million increase in labour costs, mainly due to staffing level changes for additional round trips provided and a wage rate increase of 1.9% effective April 1, 2019 in accordance with the Collective Agreement and benefits (Employer Health Tax, Workers Compensation and pension);
- $1.2 million increase mainly related to repairs for various vessels and terminals;
- $0.8 million increase in other costs including utilities, credit card fees and information technology;

partially offset by:

- $2.0 million decrease in fuel expense, mainly due to a reduction in marine diesel consumption and a move to lower-cost LNG; and
- $0.6 million decrease in contracted services.

The $4.1 million increase in maintenance costs compared to the prior year is a result of repairs due to incidents and the cyclical nature of vessel refit activity.

Expenses (continued)

The $1.1 million decrease in administration costs compared to the prior year is primarily a result of reduced costs for labour, contracted services for information technology, computer software and promotional advertising.

Depreciation and amortization increased $2.7 million, reflecting new capital assets that have entered service. (See "Investing in our Capital Assets" below for details of capital asset expenditures.)

Net finance and other expenses ($ millions)	Three months ended June 30			
			(Increase)	
	2019	2018	$	%
Finance expense	15.0	15.0	-	-
Less: finance income	(1.2)	(1.3)	(0.1)	(7.7%)
Net finance expense	13.8	13.7	(0.1)	(0.7%)
Gain on disposal and revaluation of property, plant and equipment, and intangible assets	-	0.1	0.1	100.0%
Total net finance and other expenses	13.8	13.8	-	-

In the three months ended June 30, 2019, net finance and other expenses were on par with the same period in the prior year.

Liquidity and Capital Resources

We fund our operations and capital acquisitions with cash flow generated from operations, as well as bank financing and debt issues. Our financial position could be adversely affected if we fail to arrange sufficient and cost-effective financing to fund, among other things, capital expenditures and the repayment of maturing debt. This is subject to numerous factors, including the results of our operations, our financial position, conditions in the capital and bank credit markets, ratings assigned by rating agencies and general economic conditions.

We expect that our cash requirements will be met through positive operating cash flows, accessing our existing credit facility from time to time, debt issuances, and other funding opportunities. Our cash forecasts indicate that, due to the significant capital expenditures planned, incremental long-term borrowing will be required. We are monitoring the capital markets for appropriate borrowing opportunities. At June 30, 2019, our unrestricted cash and cash equivalents and other short-term investments totalled $60 million and $58 million, respectively (at March 31, 2019 - $60 million and $75 million, respectively).

Under our credit agreement with a syndicate of Canadian banks, we have available a revolving facility in the amount of $155 million. Our $155 million credit facility was renewed on March 6, 2019 to extend the maturity date of the facility from April 2023 to April 2024. The facility is available to fund capital expenditures and for other general corporate purposes. At June 30, 2019, there were no draws on this credit facility.

We target maintaining a strong investment-grade credit rating to allow capital market access at reasonable interest rates. At June 30, 2019, our credit rating with Standard & Poor's was "AA-" with a positive outlook and with DBRS was "A (high)" with a stable trend.

Our debt service coverage (earnings before interest, taxes, depreciation, amortization, and rent) is required to be at least 1.25 times the debt service cost under our credit agreement. Under our Master Trust Indenture, securing this facility, we are subject to an additional indebtedness test that prohibits additional borrowing if our leverage ratio exceeds 85%. At June 30, 2019, we achieved a debt service coverage ratio of 2.94 and a leverage ratio of 69.9%.

In fiscal 2017, the Government of Canada approved funding of up to $15.1 million towards a new seasonal direct ferry service between Port Hardy and Bella Coola and funding of up to $45.4 million towards the purchase of two new Island Class vessels and a major upgrade of our Langdale terminal. In total, up to $60.5 million in funding under the New Building Canada Fund has been approved, of which $23.8 million had been received as of June 30, 2019.

Sources & Uses of Cash

Our liquidity needs are met through a variety of sources, including cash generated from operations, issuance of bonds, and borrowings under our credit facility. Our primary uses of funds are operational expenses, capital asset acquisitions and upgrades, and payments on our long-term debt.

Sources and uses of cash and cash equivalents for the first quarter of fiscal 2020 and 2019 are summarized in the table below:

	Three months ended June 30		
($ millions)	2019	2018	Increase (Decrease)
Cash and cash equivalents, beginning of period	59.9	69.9	(10.0)
Cash from operating activities:			
Net earnings	12.2	6.0	6.2
Items not affecting cash	61.2	58.6	2.6
Changes in non-cash operating working capital	(15.7)	(11.5)	(4.2)
Net interest paid	(17.9)	(18.1)	0.2
Cash generated by operating activities	39.8	35.0	4.8
Cash used in financing activities	(7.1)	(7.1)	0.0
Cash used in investing activities	(32.3)	(46.5)	14.2
Net increase (decrease) in cash and cash equivalents	0.4	(18.6)	19.0
Cash and cash equivalents, end of period	60.3	51.3	9.0

For the three months ended June 30, 2019, cash generated by operating activities increased $4.8 million primarily due to an increase in net earnings partially offset by changes in working capital.

Cash used in financing activities in the three months ended June 30, 2019 and June 30, 2018 was $7.1 million. This amounts consisted of $6.6 million repayment of loans from KfW IPEX-Bank GmbH and $0.5 million in repayment of finance lease obligations.

Cash used in investing activities for the three months ended June 30, 2019 decreased by $14.2 million, mainly due to a reduction in year over year capital expenditures. (See "Investing in Our Capital Assets" below for detail of significant capital expenditures.)

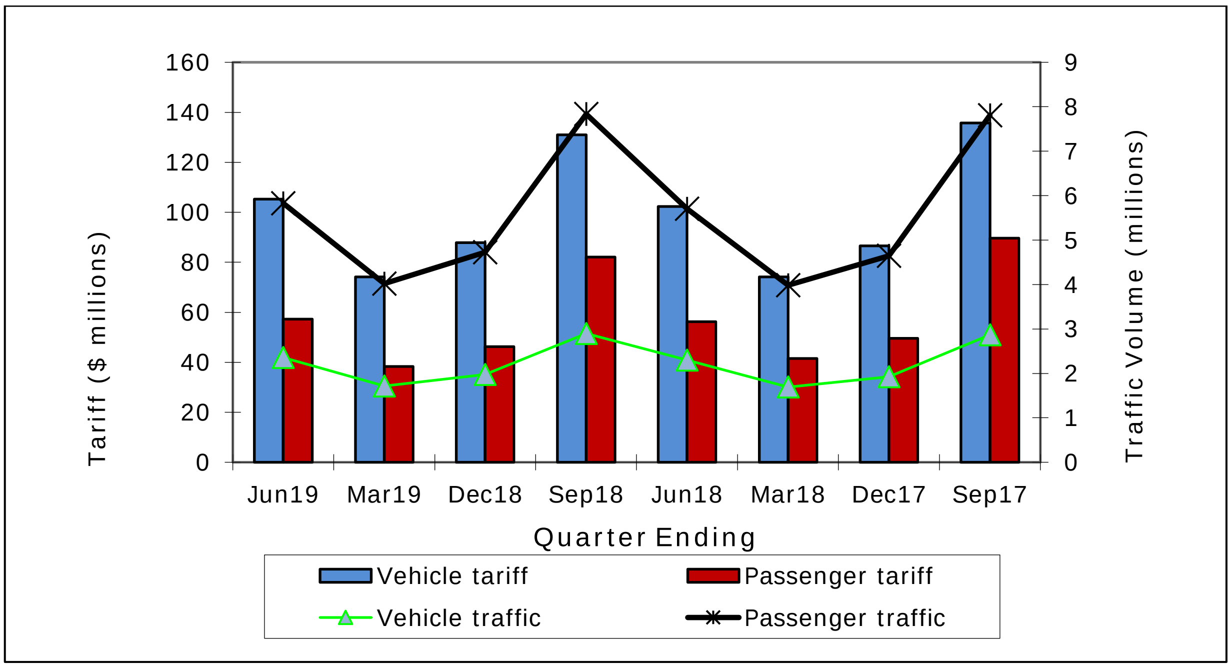
SUMMARY OF QUARTERLY RESULTS

The table below compares earnings by quarter for the most recent eight quarters:

	Quarter Ended (unaudited)							
($ millions)	Jun 19	Mar 19	Dec 18	Sep 18	Jun 18	Mar 18	Dec 17	Sep 17
Total revenue	246.4	172.5	207.7	315.8	229.7	168.8	195.7	309.9
Operating profit (loss)	26.0	(28.8)	9.4	104.6	19.8	(27.8)	-	112.6
Net earnings (loss)	12.2	(41.0)	(3.7)	90.9	6.0	(41.0)	(14.8)	98.4

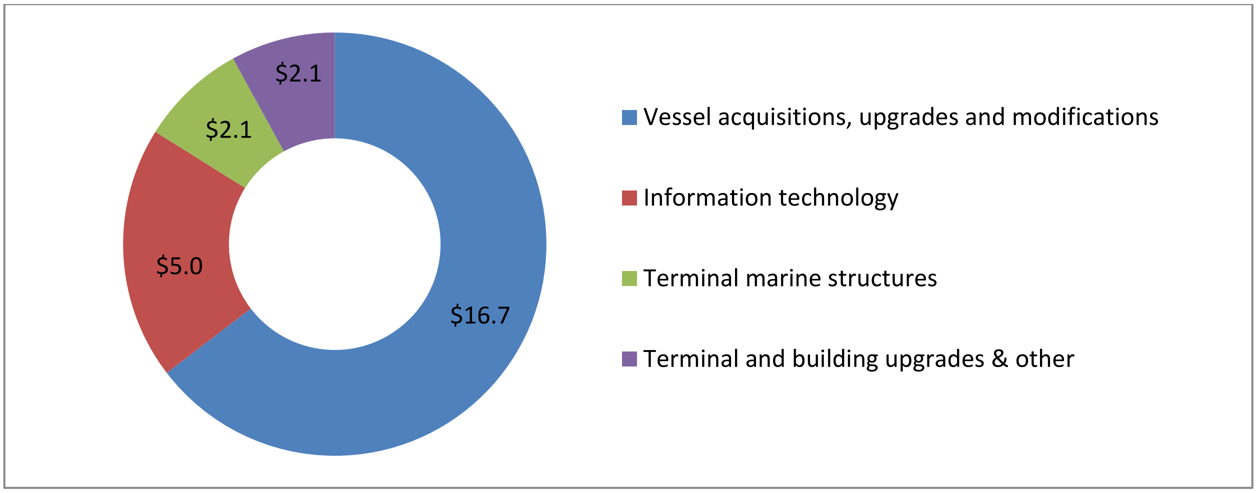
Quarterly results are affected by the seasonality of leisure travel patterns. The second quarter, covering the summer period, experiences the highest traffic levels and the highest net earnings. The third and fourth quarters reflect a seasonal reduction in traffic. We utilize these periods to perform upgrades and major maintenance and refit programs, as well as to undertake mandatory inspections on the majority of our vessels.

The following graph demonstrates the seasonality of our revenue and shows the relationship of traffic volume and tariff revenue over the most recent eight quarters:



Capital Expenditures

Capital expenditures, net of funding from the New Building Canada Fund and FortisBC, in the three months ended June 30, 2019 totalled $25.9 million.



In total, we have been approved for up to $60.5 million in funding under the New Building Canada Fund, consisting of $15.1 million for the *Northern Sea Wolf* project, $28.3 million for the new Island Class vessel project and $17.1 million for the Langdale terminal development project.

Capital expenditures, net of funding from the New Building Canada Fund and FortisBC, in the three months ended June 30, 2019, included the following:

($ millions)	June 30, 2019 3 months
Spirit Class mid-life upgrades	5.7
Mid-coast ferry service	2.8
Klitsa - three-quarter life upgrade	2.2
Major overhauls and inspections	1.8
Customer experience program	1.9
Hardware upgrades	1.5
Island Class vessels	1.2
Langdale upgrades	0.9
Fleet maintenance facility	0.6
Various other projects	7.3
	25.9

Spirit Class mid-life upgrades

In March 2016, we awarded contracts to Remontowa Ship Repair Yard S.A. to conduct the mid-life upgrades, including major upgrades to customer amenities and conversion to dual-fuel, of our two largest vessels, the *Spirit of Vancouver Island* and the *Spirit of British Columbia*. On June 6, 2018, the *Spirit of British Columbia* and on April 18, 2019, the *Spirit of Vancouver Island* returned to service on our Tsawwassen – Swartz Bay route and this project is now complete. The mid-life upgrades will enable the vessels to be in service for another 25 years. We expect the conversion of these vessels to result in substantial savings, as LNG costs are considerably less than marine diesel. We also expect the conversion to result in significant environmental benefits, such as reducing carbon, sulphur and nitrogen dioxide emissions from our vessels. FortisBC has committed to provide us with up to $10 million in incentive funding to help offset incremental capital costs associated with the conversion of the Spirit Class vessels to use LNG. The contribution ($4.4 million has been received as of June 30, 2019) is dependent upon the purchase of at least 10 million gigajoules of LNG over a 10-year period and will be applied to the capital costs as LNG is purchased. In the three months ended June 30, 2019, $0.2 million was recorded to reduce the capital costs. In fiscal 2019, $0.3 million was recorded to reduce the capital costs.

Mid-coast ferry service

On April 7, 2017, we finalized an agreement to acquire a 75-metre used vessel built in 2000, to provide the new seasonal direct ferry service between Port Hardy and Bella Coola. This project included the acquisition and upgrading of the used vessel as well as modifying our terminal marine structures as necessary. On April 5, 2017, the Province contributed an initial $15 million towards the provision of this service for the period up to March 31, 2020. On March 21, 2017, the Government of Canada approved funding, towards the capital costs of this vessel, of up to $15.1 million from the New Building Canada Fund, of which we recorded $11.8 million in fiscal 2018 and $3.3 million in fiscal 2019. The vessel underwent extensive upgrades necessary to bring it up to the standards of safety and reliability that we and Transport Canada require. On May 18, 2019, the *Northern Sea Wolf* entered service in the mid-coast and on June 3, 2019, started the direct seasonal service between Port Hardy and Bella Coola. The *Northern Sea Wolf* accommodates approximately 35 vehicles and 150 passengers and crew.

Klitsa three-quarter life upgrade

The three-quarter life upgrade of the *Klitsa*, including safety system upgrades, bridge equipment upgrades, interior modernization and replacement of electrical and mechanical components, completed in May 2019.

Major overhauls and inspections

In the three months ended June 30, 2019, we had capital expenditures of $1.8 million in respect of major overhauls and inspections of components of hull, propulsion and generators for three vessels that were completed or underway.

Customer experience program

Our customer experience program, which includes the Fare Flexibility and Digital Experience Initiative, will replace our aged website, reservation system and e-commerce platform and upgrade our point-of-sale. The main elements will be implemented in stages during fiscal 2020. This program will give customers an opportunity to purchase travel in advance at discounted rates on select sailings on reservable routes and will allow us to respond in a more timely fashion to changing business needs and to better support marketing, travel services and pricing initiatives. Our customer experience program will introduce improved transaction processing and online booking with more choices in fares. We have implemented our new internal reservations system as well as enhancements to our customer relationship management system and point of sale system.

Hardware upgrades

Hardware upgrades include the replacement of aged computers, servers, printers, routers, closed-circuit cameras, antennas, digital signage and handheld units for inventory management.

Island Class vessels

On April 13, 2017, we entered into design and build contracts with Damen Shipyard Group of Netherlands for the construction of two Island Class vessels. The Government of Canada has approved funding of up to $28.3 million under the New Building Canada Fund toward these vessels, of which we recorded $0.1 million in the three months ended June 30, 2019, $11.3 million in fiscal 2019 and $3.1 million in fiscal 2018. These vessels will each have a capacity of up to 450 passengers and crew and approximately 47 vehicles. These two Island Class vessels are expected to go into service in spring of 2020. We intend to deploy the first new vessel to provide service between Powell River and Texada Island and the second new vessel to provide service between Port McNeill, Alert Bay and Sointula. These new vessels will allow us to retire the 60-year old *North Island Princess* and the 54-year old *Howe Sound Queen*.

Langdale terminal

Our Langdale terminal redevelopment project includes an overhead passenger walkway, a new terminal building, parking lot and pick-up and drop-off area upgrades, as well as a ticketing plaza and is expected to commence later this year.

Fleet maintenance facility

In Richmond, a project to redevelop and modernize our ship repair and maintenance facility is in the design stage.

We continue to pursue strategies to create an affordable, sustainable and safe ferry system that meets the needs of our customers and the communities we serve for generations to come. We are committed to being a company worthy of the public's trust and valued for the services we provide.

Major Investments

Our 12-year capital plan for fiscal 2019 through fiscal 2030 is $3.9 billion. This plan addresses the need to replace our aged assets and for resiliency. It includes 17 new vessels and significant upgrades to our terminals and our fleet maintenance facility. The plan emphasizes system capacity, operational efficiency, resiliency and flexibility to ensure safe, reliable and efficient operations and to deliver an exceptional customer-focused travel experience. Our cash forecasts indicate that, due to the significant capital expenditures planned, incremental long-term borrowing will be required. We are monitoring the capital markets for appropriate borrowing opportunities. All major capital expenditures as defined by the Commissioner require approval.

In November 2018, we issued an RFP for a fourth Salish Class vessel, which will replace the 54-year old *Mayne Queen*. Our three existing Salish Class vessels, brought into service in fiscal 2018, are dual-fuel capable, running primarily on LNG using marine diesel as backup. The vessel design is part of our standardization strategy which we believe strengthens safety practises and improves interoperability with standardized bridges, engine rooms and life-saving equipment.

Construction for two Island Class vessels is nearing completion and the vessels are expected to enter into service in the spring of 2020. This will allow us to retire the 60-year old *North Island Princess* and the 54-year old *Howe Sound Queen.* The new vessels will be outfitted with hybrid diesel-electric propulsion. They will be built to be capable of conversion to all-electric propulsion as the technology permits and the necessary infrastructure is available. In December 2018, we issued an RFP for an additional four Island Class vessels, reinforcing our plan for operational efficiency, resiliency and flexibility.

The next phase of vessel renewal will include replacement of four major vessels that will have over an average age of 50 when their replacements are anticipated to begin service on our Major Routes. The new vessels will add capacity to the fleet, with vehicle and passenger capacity expected to be similar to the existing Spirit Class vessels. We also expect to introduce an additional vessel to accommodate future traffic and build resiliency in the fleet. In October 2018, we issued a RFEOI for the procurement of up to five new major vessels.

Our Langdale terminal redevelopment project includes an overhead passenger walkway, a new terminal building, parking lot and pick-up and drop-off area upgrades, as well as a ticketing plaza. This project is expected to commence later this year.

Our Richmond fleet maintenance facility is a strategic asset requiring upgrades and redevelopment to replace aged infrastructure. The multi-year project to seismically upgrade the site, modernize infrastructure and build a centralized shop and life raft servicing centre is in the design stage. The upgrades will improve operational efficiency and allow us continual and immediate access to ship repair facilities for both planned and unplanned maintenance.

Financial
We expect positive net earnings in fiscal 2020. Total revenue is expected to increase resulting from higher traffic levels, net catering and retail revenues and ferry transportation fees from the Province.

Our forecast incorporates the introduction of the Fare Flexibility and Digital Experience Initiative, which will change the way we price fares. It will give customers an opportunity to purchase travel in advance at discounted rates, on select less-popular sailings on reservable routes. We expect it will help shift traffic to sailings that typically run with lower capacity utilization.

We expect an increase in total expenses in fiscal 2020, reflecting an increase in labour costs, mainly due to higher staffing levels for increased service, a wage rate increase in accordance with the Collective Agreement and increased benefit costs. In addition, costs will increase from the introduction of service on a new route and other service plan changes, higher depreciation, partially offset by savings from operating the Spirit Class vessels and the Salish Class vessels on LNG. We continue to manage our costs prudently without compromising safe operations.

On April 1, 2019, the Commissioner released a preliminary decision on the price cap for PT5, the period commencing on April 1, 2020 and ending on March 31, 2024, for annual price cap increases of 2.3%. We have reviewed the preliminary decision and are providing additional information to the Commissioner for consideration in the determination of the final price cap, which is expected on or before September 30, 2019.

FINANCIAL RISKS

Exposure to credit risk, liquidity risk and market risk arises in the normal course of our business. We manage market risk arising from the volatility in foreign currency, interest rate, and fuel price exposures in part through the use of derivative financial instruments including forward contracts, swaps and options. We do not utilize derivative financial instruments for trading or speculative purposes.

A discussion of financial risks can be found on pages 50 through 51 of our fiscal 2019 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2019. Our 2019 Management's Discussion & Analysis is available at http://www.bcferries.com/investors/financial_reports.html on our investor webpage.

BUSINESS RISK MANAGEMENT

Understanding and managing operational risk is an important part of our business. We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business. A discussion of enterprise wide risk management can be found on pages 52 through 55 of our fiscal 2019 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2019. Our 2019 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

As part of our risk management strategies, we have considered many items such as level of earnings, cash generating potential, cash utilization requirements including debt repayment schedules and future capital expenditures, and working capital requirements. We have taken measures to allow us to adapt to changes in the economic environment and ensure a viable, sustainable future. We do not believe that material uncertainties exist in regard to our future as we believe our risk mitigation strategies are sufficient.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and financial performance is based upon our unaudited condensed interim consolidated financial statements, which have been prepared in accordance with IFRS.

Our significant accounting policies are contained in Note 1 to our March 31, 2019 audited consolidated financial statements and our June 30, 2019 condensed interim consolidated financial statements. Certain of these policies involve critical accounting estimates because they require us to make particularly subjective or complex judgements about matters that are inherently uncertain and because of the likelihood that materially different amounts could be reported under different conditions or using different assumptions. These judgements, estimates and assumptions are subject to change as new events occur, as more experience is acquired, as additional information is obtained, and as the general operating environment changes.

Discussion of the most critical accounting policies and estimates that we have used in the preparation of our consolidated financial statements can be found on pages 56 and 57 of our fiscal 2019 Management's Discussion & Analysis. The following describes the changes to critical accounting policies we have used in the preparation of our condensed interim consolidated financial statements for the three months ended June 30, 2019, or expect to use in the future.

Adoption of New Accounting Standards

The following is a discussion of changes in accounting standards that we adopted effective April 1, 2019:

On February 7, 2018, the IASB published Amendments to IAS 19 *Employee Benefits* which requires entities to use updated actuarial assumptions to determine current service cost and net interest for the remainder of the period after a plan amendment, curtailment or settlement. It also requires that any reduction in surplus, even amounts not previously recognized due to an asset ceiling limitation, be recognized in profit or loss as part of past service cost of a gain or loss on settlement. We adopted IAS 19 effective April 1, 2019. The application of this standard had no impact on our condensed interim consolidated financial statements.

The Effect of Rate Regulation

We are regulated by the Commissioner to ensure, among other things, that our tariffs are fair and reasonable. Under the terms of the Act, the tariffs we charge our customers over a performance term are subject to price caps set by the Commissioner. A price cap sets the ceiling on the weighted average level of fares that can be charged. The Commissioner may under certain circumstances, allow increases in price caps over the set levels. Certain decisions and orders of the Commissioner may give rise to regulatory assets or liabilities. Regulatory assets generally represent incurred costs that are probable of future recovery in tariffs or fuel surcharges. Regulatory liabilities represent obligations to customers which will be settled through future tariff reductions or fuel rebates.

We transitioned to IFRS effective April 1, 2011. At that time, IFRS did not provide any guidance with respect to accounting for rate-regulated activities.

In January 2014, the IASB issued an interim standard, IFRS 14 *Regulatory Deferral Accounts,* which addresses accounting for rate-regulated activities. However, it does not apply to entities, like ours, that transitioned to IFRS prior to that date. As a result, we are not permitted to recognize in our financial statements the assets and liabilities that result from the regulated price cap setting process, such as our deferred fuel cost accounts. Under IFRS, rather than being charged to regulatory asset or liability accounts on our consolidated statements of financial position, fuel surcharges collected or rebates granted are included in revenue, and increases or decreases in fuel prices from those approved in price caps are included in operating expenses. These items are treated as assets and liabilities for regulatory purposes. Reporting for rate-regulated activities provides additional information which we use to assess performance and to make operating decisions.

Regulatory assets and liabilities do not have standardized meaning within IFRS. Our regulatory assets and liabilities should be considered in addition to, but not as a substitute for, measures of financial performance in accordance with IFRS.

We continually assess whether our regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes. These regulatory assets and liabilities are considered supplemental disclosures and are detailed in Note 16 to our June 30, 2019 unaudited condensed interim consolidated financial statements.

If IFRS permitted us to report regulatory assets and liabilities in our financial statements, the effect on our net earnings for the three months ended June 30, 2019 and 2018 would be as follows:

($ millions)		Three months ended June 30	
		2019	2018
Net earnings		12.2	6.0
Changes in net earnings:			
Regulatory asset or liability	Statement line item		
Deferred fuel costs			
Fuel costs (under) over set price	Operations expense	(0.9)	0.5
Fuel (surcharge) rebates	Fuel surcharge (rebate)	(0.8)	4.5
Payments from the Province	Ferry service fees	-	-
(Decrease) increase in total net earnings		(1.7)	5.0
Adjusted net earnings		10.5	11.0

Deferred fuel costs: As prescribed by regulatory order, we defer differences between actual fuel costs and regulated fuel costs, which were used to develop the regulated price caps. The difference between actual fuel costs (including fuel hedge gains and losses) and the regulated fuel costs (set price) is deferred for settlement in future tariffs. In addition, as prescribed by regulatory order, we collect fuel surcharges or provide fuel rebates from time to time, which are applied against deferred fuel cost account balances. We may also receive payments from the Province to be applied against deferred fuel cost account balances.

On June 1, 2019, due to current fuel market conditions, we implemented a fuel surcharge of 1.5% on average on all routes with the exception of the Northern Routes. Fuel rebates were discontinued, effective June 27, 2018 (fiscal 2019), due to the rise in fuel prices.

FORWARD LOOKING STATEMENTS

This Management's Discussion and Analysis contains certain "forward looking statements". These statements relate to future events or future performance and reflect management's expectations regarding our growth, results of operations, performance, business prospects and opportunities and industry performance and trends. They reflect management's current internal projections, expectations or beliefs and are based on information currently available to management. Some of the market conditions and factors that have been considered in formulating the assumptions upon which forward looking statements are based include traffic, the Canadian Dollar relative to the US Dollar, fuel costs, construction costs, the state of the local economy, fluctuating financial markets, demographics, tax changes, and the requirements of the CFSC.

Forward looking statements included in this document include statements with respect to: economic conditions, traffic levels, fares, Performance Term Five, ferry transportation fees, and fiscal 2020 net earnings; our short-term and long-range business plans, capital expenditure levels, asset renewal programs for vessels and terminals, our customer experience program, and Fare Flexibility and Digital Experience Initiative; the agreement with FortisBC regarding incentive funding, the New Building Canada Fund, LNG costs and benefits, alternative fuel options, Spirit Class mid-life upgrades, the Langdale terminal redevelopment project, the fleet maintenance facility project, the major class vessel replacements, the Island Class vessels, and the Salish Class vessels; and our expectations regarding incremental long-term borrowing, total revenue and expense projections, and how our cash requirements will be met in the near term. In some cases, forward looking statements can be identified by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue" or the negative of these terms or other comparable terminology. A number of factors could cause actual events or results to differ materially from the results discussed in the forward looking statements. In evaluating these statements, prospective investors should specifically consider various factors including, but not limited to, the risks and uncertainties associated with: vendor non-performance; capital market access; interest rate, foreign currency, fuel price, and traffic volume fluctuations; the implementation of major capital projects; security, safety, and environmental incidents; confidential or sensitive information breaches; changes in laws; vessel repair facility limitations; economic regulatory environment changes; tax changes; and Aboriginal rights and title claims.

Actual results may differ materially from any forward looking statement. Although management believes that the forward looking statements contained in this Management's Discussion and Analysis are based upon reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward looking statements. These forward looking statements are made as of the date of this Management's Discussion and Analysis, and British Columbia Ferry Services Inc. assumes no obligation to update or revise them to reflect new events or circumstances except as may be required by applicable law.

Non-IFRS Measures

In addition to providing measures prepared in accordance with IFRS, we present certain financial measures that do not have any standardized meanings prescribed by IFRS and therefore are unlikely to be comparable to similar measures presented by other companies. These include, but are not limited to, net earnings adjusted for the effect of rate regulation and average tariff revenue per vehicle and per passenger. These supplemental financial measures are provided to assist readers in determining our ability to generate cash from operations and improve the comparability of our results from one period to another. We believe these measures are useful in assessing operating performance of our ongoing business on an overall basis.