Condensed Interim Consolidated Financial Statements

BRITISH COLUMBIA FERRY SERVICES INC.

Six months ended September 30, 2018 and 2017
(Unaudited)

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Financial Position (Unaudited)
(Expressed in thousands of Canadian dollars)

	September 30, 2018	March 31, 2018
Assets		
Current assets		
Cash and cash equivalents	88,415	69,913
Restricted short-term investments (note 6(b))	31,966	32,276
Other short-term investments	112,633	114,259
Trade and other receivables	43,015	26,258
Prepaid expenses	12,681	8,434
Inventories	32,128	31,584
Derivative assets (note 9)	14,279	12,530
	335,117	295,254
Non-current assets		
Loan receivable	24,515	24,515
Land lease	-	29,771
Property, plant and equipment (note 3)	1,787,266	1,713,080
Intangible assets (note 4)	100,117	99,802
	1,911,898	1,867,168
Total assets	2,247,015	2,162,422
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	75,377	77,233
Interest payable on long-term debt (note 5)	18,563	18,537
Deferred revenue	29,541	32,034
Derivative liabilities (note 9)	13	-
Current portion of long-term debt (notes 5,6)	34,638	34,594
Current portion of accrued employee future benefits	3,000	3,000
Current portion of lease liability (note 5)	2,178	1,652
Provisions	62,715	60,372
	226,025	227,422
Non-current liabilities		
Accrued employee future benefits	20,792	21,299
Long-term debt (notes 5,6)	1,262,578	1,279,775
Lease liability (note 5)	40,111	38,769
Other liabilities (note 7)	10,375	7,750
	1,333,856	1,347,593
Total liabilities	1,559,881	1,575,015
Equity		
Share capital	75,478	75,478
Contributed surplus	25,000	25,000
Retained earnings	575,751	477,955
Total equity before reserves	676,229	578,433
Reserves (note 10(a))	10,905	8,974
Total equity including reserves	687,134	587,407
Total liabilities and equity	2,247,015	2,162,422

Commitments (note 3)

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Comprehensive Income (Unaudited)
(Expressed in thousands of Canadian dollars)

	Three months ended September 30		Six months ended September 30	
	2018	**2017**	**2018**	**2017**
Revenue				
Vehicle and passenger fares	213,187	225,307	371,614	388,426
Net retail (note 11)	23,061	21,880	38,620	36,803
Fuel rebates (note 16)	(67)	(6,746)	(4,585)	(11,614)
Other income	3,433	3,502	6,240	6,217
Revenue from customers	239,614	243,943	411,889	419,832
Ferry service fees	68,581	58,595	118,380	101,494
Federal-Provincial Subsidy Agreement	7,626	7,446	15,252	14,891
Total revenue	315,821	309,984	545,521	536,217
Expenses (note 12)				
Operations	142,664	134,354	278,535	259,620
Maintenance	15,713	13,697	37,934	34,566
Administration	9,955	9,265	19,694	19,223
Depreciation and amortization	42,921	40,008	84,946	78,648
Total operating expenses	211,253	197,324	421,109	392,057
Operating profit	104,568	112,660	124,412	144,160
Net finance and other expenses (note 13)				
Finance expenses	15,268	15,420	30,240	30,588
Finance income	(1,610)	(1,365)	(2,867)	(2,428)
Net finance expense	13,658	14,055	27,373	28,160
Loss on disposal and revaluation of property, plant and equipment and intangible assets	54	206	143	249
Net finance and other expenses	13,712	14,261	27,516	28,409
NET EARNINGS	**90,856**	**98,399**	**96,896**	**115,751**
Other comprehensive income (loss) (note 10(b))				
Items not to be reclassified to net earnings	-	(1,943)	-	(1,943)
Items to be reclassified to net earnings	1,445	6,526	9,324	810
Total other comprehensive income (loss)	1,445	4,583	9,324	(1,133)
Total comprehensive income	92,301	102,982	106,220	114,618

See accompanying notes to the condensed interim consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Cash Flows (Unaudited)
(Expressed in thousands of Canadian dollars)

	Six months ended September 30	
	2018	2017
Cash flows from operating activities		
Net earnings	96,896	115,751
Items not affecting cash		
Net finance expense	27,373	28,160
Depreciation and amortization	84,946	78,648
Other non-cash changes to property, plant and equipment	(24)	286
Changes in:		
Accrued employee future benefits	(507)	(802)
Derivative assets and liabilities recognized in net earnings	71	45
Provisions	2,343	1,732
Long-term land lease	-	230
Accrued financing costs	(276)	59
Total non-cash items	113,926	108,358
Movements in operating working capital		
Trade and other receivables	(16,757)	(7,381)
Prepaid expenses	(4,247)	(4,407)
Inventories	(544)	(856)
Accounts payable and accrued liabilities	(1,856)	(20,698)
Deferred revenue	(1,593)	13,039
Change in non-cash working capital	(24,997)	(20,303)
Change attributable to capital asset acquisitions	18,456	12,418
Change in non-cash operating working capital	(6,541)	(7,885)
Cash generated from operating activities	204,281	216,224
Interest received	3,149	2,200
Interest paid	(32,891)	(32,776)
Net cash generated by operating activities	174,539	185,648

See accompanying notes to the condensed interim consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.
Condensed Interim Consolidated Statements of Cash Flows (Unaudited)
(Expressed in thousands of Canadian dollars)

	Six months ended September 30	
	2018	**2017**
Cash flows from financing activities		
Proceeds from long-term debt	-	45,264
Repayment of long-term debt	(17,641)	(17,641)
Repayment of lease liabilities	(1,064)	(783)
Deferred financing costs incurred	-	(1,470)
Net cash (used in) generated by financing activities	(18,705)	25,370
Cash flows from investing activities		
Proceeds from disposal of property, plant and equipment	41	34
Purchase of property, plant and equipment and intangible assets	(139,309)	(150,350)
Changes in debt service reserve	310	(160)
Net proceeds from (purchase of) short-term investments	1,626	(35,416)
Net cash used in investing activities	(137,332)	(185,892)
Net increase in cash and cash equivalents	18,502	25,126
Cash and cash equivalents, beginning of period	69,913	72,032
Cash and cash equivalents, end of period	88,415	97,158

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Changes in Equity (Unaudited)
(Expressed in thousands of Canadian dollars)

	Share capital	Contributed surplus	Retained earnings	Total equity before reserves	Reserves (note 10(a))	Total equity including reserves
Balance as at March 31, 2017	75,478	25,000	424,020	524,498	(3,066)	521,432
Net earnings	-	-	115,751	115,751	-	115,751
Other comprehensive loss	-	-	-	-	(1,133)	(1,133)
Realized hedge losses recognized in fuel swaps	-	-	-	-	1,737	1,737
Hedge losses on interest rate forward contract reclassified to net earnings	-	-	-	-	124	124
Balance as at September 30, 2017	**75,478**	**25,000**	**539,771**	**640,249**	**(2,338)**	**637,911**
Balance as at March 31, 2018	75,478	25,000	477,955	578,433	8,974	587,407
Impact of adoption of new accounting standard – IFRS 15	-	-	900	900	-	900
Balance as at April 1, 2018	75,478	25,000	478,855	579,333	8,974	588,307
Net earnings	-	-	96,896	96,896	-	96,896
Other comprehensive income	-	-	-	-	9,324	9,324
Realized hedge gains recognized in fuel swaps	-	-	-	-	(7,517)	(7,517)
Hedge losses on interest rate forward contract reclassified to net earnings	-	-	-	-	124	124
Balance as at September 30, 2018	**75,478**	**25,000**	**575,751**	**676,229**	**10,905**	**687,134**

See accompanying notes to the condensed interim consolidated financial statements.

British Columbia Ferry Services Inc. (the "Company") was incorporated under the *Company Act (British Columbia)* by way of conversion on April 2, 2003, and now validly exists under the *Business Corporations Act (British Columbia)*. The Company's primary business activity is the provision of coastal ferry services in British Columbia.

The Company is subject to the *Coastal Ferry Act* (the "Act") as amended, which came into force on April 1, 2003. Its common share is held by the B.C. Ferry Authority (the "Authority"), a corporation without share capital, and it is regulated by the British Columbia Ferries Commissioner (the "Commissioner") to ensure that rates are fair and reasonable and to monitor service levels.

The Company's business is seasonal in nature, with the highest activity in the summer (second quarter) and the lowest activity in the winter (fourth quarter), due to the high number of leisure travellers and their preference for travel during the summer months. The Company also takes advantage of the low activity during the winter months to perform a significant portion of the required annual maintenance on vessels and terminals.

1. Accounting policies:

These condensed interim consolidated financial statements do not include all disclosures normally provided in annual financial statements and should be read in conjunction with the Company's audited consolidated financial statements and the related notes for the year ended March 31, 2018, as they follow the same accounting policies. For changes in accounting policies effective April 1, 2018, refer to note 2.

(a) Basis of preparation:

British Columbia Ferry Services Inc. is a company domiciled in Canada. The address of the Company's registered office is Suite 500, 1321 Blanshard Street, Victoria, BC Canada, V8W 0B7. These condensed interim consolidated financial statements as at and for the three and six months ended September 30, 2018 and 2017 comprise the Company and its subsidiaries (together referred to as the "Group").

These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and its interpretations and comply with International Accounting Standard ("IAS") 34 *Interim Financial Reporting*.

These condensed interim consolidated financial statements were approved by the Board of Directors on November 20, 2018.

These condensed interim consolidated financial statements have been prepared using the historical cost method, except for land and certain financial assets and liabilities including derivatives.

These condensed interim consolidated financial statements are presented in Canadian dollars ("CAD") which is the Group's functional currency. All tabular financial data is presented in thousands of Canadian dollars.

1. Accounting policies (continued):

(b) Leases:

At the inception of a contract, the Group assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Group assesses whether:

- the supplier has a substantive substitution right;
- the Group has the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use; and
- the Group has the right to direct the use of the asset. The Group has the right when it has the decision-making rights that are most relevant to changing how and for what purpose the asset is used.

For contracts that contain a lease the Group recognizes a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. The estimated useful lives of right-of-use assets are determined on the same basis as those of property, plant and equipment. In addition, the right-of-use asset is subsequently reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are unpaid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Group's incremental borrowing rate. The lease liability is subsequently measured at amortized cost using the effective interest rate method. It is remeasured when there is a change in the Group's estimate of the amount expected to be payable under a residual value guarantee, when there is a change in future lease payments arising from a change in a rate to determine those payments, or if the Group changes its assessment of whether it will exercise a purchase, extension or termination option.

The Group does not recognize right-of-use assets and lease liabilities for short-term leases that have a lease term of 12 months or less and leases of low-value assets. The Group recognizes the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

1. Accounting policies (continued):

(c) Financial assets and liabilities:

Financial assets include cash and cash equivalents, trade and other receivables, restricted and other short-term investments, derivatives with a positive market value and loan receivables.

Financial liabilities include trade payables, long-term debt, interest on long-term debt and derivatives with a negative market value.

(i) Recognition and measurement of non-derivative financial instruments

Financial instruments are initially recognized at fair value. If the financial instrument is not classified at fair value through profit or loss, then the initial measurement includes directly attributable transaction costs.

Subsequent to initial recognition, financial assets are measured at either amortized cost or at fair value through other comprehensive income ("OCI") or at fair value through net earnings or loss.

Financial liabilities are measured at either amortized cost or at fair value through net earnings or loss.

Classification depends on the nature and objective of each financial instrument and is determined when first recognized.

(ii) Provision for impairment

Financial assets carried at amortized cost include short-term investments, restricted short-term investments, trade and other receivables, loan receivables and loans and advances. The Group assesses the lifetime expected credit losses ("ECL") associated with its assets carried at amortized cost. ECL represents the expected credit loss that will result from all possible default events over the expected life of the financial instrument. The amount of ECL is updated at each reporting date to reflect changes in credit risk. To assess whether there is a significant increase in credit risk, the Group compares the risk of a default occurring as at the reporting date with the risk of default as at the date of initial recognition based on all information available, including reasonable and supportive forward-looking information. When a financial instrument is uncollectable, it is written off against the provision for impairment.

(iii) Loans and advances

Loans and advances are initially recognized at fair value plus directly attributable transaction costs. Subsequently, loans and advances are measured at amortized cost using the effective interest rate method, less any recognized impairment loss. They are subject to recoverable value tests, carried out at each statement of financial position date and whenever there are objective indicators that the recoverable value of these assets would be lower than the carrying value.

1. Accounting policies (continued):

(c) Financial assets and liabilities (continued):

(iv) Trade and other receivables

Trade and other receivables are initially recorded at fair value (in most cases the same as nominal value) less provision for impairment. Subsequently, trade and other receivables are measured at amortized cost. The provision established represents lifetime ECL and is updated at each reporting date. Any increase in the provision is recognized in net earnings or loss. When a trade receivable is uncollectible, it is written off against the provision for impairment. Subsequent recoveries of amounts previously written off are credited in net earnings or loss. As receivables are due in less than one year, they are not discounted.

(v) Cash and cash equivalents

Cash includes bank deposits, cash on hand and short-term deposits with an initial maturity of three months or less. Cash equivalents are short-term investments with a term of three months or less. Due to the nature and/or short-term maturity of these financial instruments, carrying value approximates fair value. The instruments held in this category can be liquidated or sold on short notice, and do not bear any significant risk of loss in value. Cash equivalents invested in pooled funds are recorded at fair value through net earnings or loss.

(vi) Borrowings and other financial liabilities

Trade and other debts are initially recorded at fair value, which is generally the same as nominal value plus or minus any premiums or discounts. Bank borrowings and other financial liabilities are subsequently measured at amortized cost calculated using the effective interest rate method. Interest accrued on short-term borrowings is included in “accounts payable and accrued liabilities” on the statement of financial position. Cash flows linked to short-term payable amounts are not discounted. Long-term cash flows are discounted whenever the impact is significant. The Group derecognizes a financial liability when its contractual obligations are discharged, cancelled or expired.

(vii) Derivatives

The Group may use derivative financial instruments to hedge its exposure to fluctuations in fuel prices, interest rates and foreign currency exchange rates. The Group does not utilize derivatives for trading or speculative purposes. At the inception of each hedge, the Group determines whether it will or will not apply hedge accounting. Derivatives are initially recorded at fair value and any associated transaction costs are recognized in net earnings or loss when incurred. After initial recognition, derivatives are measured at fair value based on market prices at each statement of financial position date. Changes in the fair value of these instruments are recorded in net earnings or loss except where the instrument has been designated as a hedging item in a cash flow hedge.

1. Accounting policies (continued):

(c) Financial assets and liabilities (continued):

(viii) Fair value hierarchy

In estimating fair value, the Group uses quoted market prices when available. Models incorporating observable market data along with transaction specific factors are also used in estimating fair value. Financial assets and liabilities are classified in the fair value hierarchy according to the lowest level of observability of inputs that are significant to the fair value measurement. Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect placement within the following fair value hierarchy levels:

- level 1 – quoted prices in active markets for identical assets or liabilities;
- level 2 – techniques (other than quoted prices included in level 1) that are observable for the asset or liability, either directly (as prices), or indirectly (as derived from prices); and
- level 3 – techniques which use inputs that are both significant to the overall fair value measurement of the asset or liability and are not based on observable market data (unobservable inputs).

(d) Revenues:

Revenue from vehicle fares, including reservation fees, passenger fares and fuel surcharges (rebates), is recognized when transportation is provided. Payments for fares sold in advance of providing transportation are included in the statement of financial position as deferred revenue.

Ferry service fees and federal-provincial subsidies are recognized as revenue as services specified in the related agreements with the Province of British Columbia (the “Province”) are provided.

Net retail revenue consists primarily of food services and gift shop sales less the cost of goods sold and is recognized when the customer receives the goods.

2. Adoption of new and amended standards:

(a) Changes in accounting policies:

The Group has adopted the following new standards effective April 1, 2018:

IFRS 9 *Financial Instruments (2014):*

The Group adopted IFRS 9 (2013) in the year ended March 31, 2015, and IFRS 9 (2014) effective April 1, 2018. IFRS 9 (2014) introduces a single, forward-looking ECL model for assessing impairment of financial assets, and incorporates the guidance on the classification and measurement of financial assets and the final general hedge accounting requirements originally published in IFRS 9 (2013).

The application of IFRS 9 *Financial Instruments (2014)* did not have a significant impact on the Group's consolidated financial statements as the Group had an existing provision for impairment.

IFRS 15 *Revenue from Contracts with Customers:*

The Group adopted IFRS 15 *Revenue from Contracts with Customers* effective April 1, 2018. IFRS 15 provides a single, principle based five-step model to be applied to all contracts with customers. The Group has applied IFRS 15 using a modified retrospective approach by recognizing the cumulative effect on initial adoption as an increase of $0.9 million to the opening balance of Retained earnings and a corresponding reduction in Deferred revenue. The comparative information has not been restated and continues to be presented in accordance with IAS 18 *Revenue* and IAS 11 *Construction Contracts*.

The majority of the Group's revenue is recognized at the time the travel or service is provided.

Previously, the Group did not recognize revenue from the expected breakage relating to its prepaid stored value card. Under IFRS 15, the Group recognizes revenue from the expected breakage in Vehicle and passenger fares when the likelihood of the customer exercising their remaining rights becomes remote.

IFRS 16 *Leases*:

The Group early adopted IFRS 16 effective April 1, 2018. The standard introduces a single lessee accounting model that requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments.

(Tabular amounts expressed in thousands of Canadian dollars)

2. Adoption of new and amended standards (continued):

(a) Changes in accounting policies (continued):

IFRS 16 *Leases* (continued):

The Group applied the following practical expedients on initial application:

- use of the modified retrospective approach with no restatement of prior periods. For contracts previously classified as operating leases, the Group has elected for the right-of-use asset to equal the lease liability, adjusted for any prepaid amount; and
- electing to not recognize leases for which the underlying asset is of low value.

The Group's assessment of non-cancellable operating lease commitments indicated that nine arrangements met the definition of a lease under IFRS 16. The Group recognized a $2.9 million right-of-use asset and a corresponding liability in respect of these leases at April 1, 2018.

When measuring lease liabilities, the Group discounted lease payments using the incremental borrowing rate of 5.21% at April 1, 2018.

On April 1, 2018, the Group's land lease and structures were reclassified to right-of-use assets and are reported under "Property, plant and equipment" in the condensed interim consolidated statements of financial position. The Group's land and structures comprising its terminals were transferred by the Group to the BC Transportation Financing Authority, a British Columbia Crown Corporation and related party on April 1, 2003. In exchange, the Group received recognition of a prepayment for leases of the transferred terminal structures and land. The structures, having lives of less than the lease term, were considered a finance lease and as such were capitalized and included with property, plant and equipment and depreciated in accordance with the Group's depreciation policy. The prepayment of the land lease is being amortized on a straight-line basis over eighty years, being the initial sixty year lease period plus an additional twenty year bargain renewal option.

The application of IFRS 16 did not have any impact on the amounts recognized in the Group's consolidated financial statements for finance leases where the Group is a lessor.

Lease liabilities	
Operating lease commitments as at March 31, 2018 as disclosed in the Group's consolidated financial statements	2,284
Commitments reclassified as right-of-use assets on transition to IFRS 16	(1,749)
Operating lease commitments as at April 1, 2018	535
Lease liabilities as at April 1, 2018	1,749
Extension options reasonably certain to be exercised	1,822
Total lease liabilities as at April 1, 2018	3,571
Discount using the incremental borrowing rate of 5.21%	(639)
Lease liabilities recognized as at April 1, 2018 (note 5)	**2,932**

2. Adoption of new and amended standards (continued):

(b) Future changes in accounting policies:

Amendments to IAS 19 *Employee Benefits*:

On February 7, 2018, the IASB published Amendments to IAS 19 *Employee Benefits.*

The amendments to IAS 19 require entities to use the updated actuarial assumptions to determine current service cost and net interest for the remainder of the annual reporting period after a plan amendment, curtailment or settlement. The amendments also clarify how the requirements for accounting for a plan amendment, curtailment or settlement affect the asset ceiling requirements. The amendments are effective for annual reporting periods beginning on or after January 1, 2019. Early application is permitted. The Group is reviewing the amendments to determine the potential impact, if any, on its consolidated financial statements. The Group does not expect the application of these amendments to have a significant impact on its consolidated financial statements.

(Tabular amounts expressed in thousands of Canadian dollars)

3. Property, plant and equipment:

	Vessels	Berths, buildings and equipment under finance lease	Berths, buildings and equipment	Land under finance lease*	Right-of-use assets	Land*	Construction in progress	Total
Cost:								
Balance as at March 31, 2018	1,514,798	682,827	115,548	7,177	-	19,936	163,550	2,503,836
Impact of adoption of new accounting standard – IFRS 16	-	(682,827)	512,493	(7,177)	210,214	-	-	32,703
Balance as at April 1, 2018	1,514,798	-	628,041	-	210,214	19,936	163,550	2,536,539
Additions	-	-	-	-	-	-	118,485	118,485
Disposals	(21,702)	-	(82)	-	-	-	-	(21,784)
Transfers from construction in progress	119,995	-	16,645	-	-	-	(136,640)	-
Balance as at September 30, 2018	**1,613,091**	**-**	**644,604**	**-**	**210,214**	**19,936**	**145,395**	**2,633,240**
Accumulated depreciation:								
Balance at as March 31, 2018	552,990	177,252	60,514	-	-	-	-	790,756
Impact of adoption of new accounting standard – IFRS 16	-	(177,252)	117,177	-	60,075	-	-	-
Balance as at April 1, 2018	552,990	-	177,691	-	60,075	-	-	790,756
Depreciation for the period	56,304	-	16,812	-	3,868	-	-	76,984
Disposals	(21,702)	-	(64)	-		-	-	(21,766)
Balance as at September 30, 2018	**587,592**	**-**	**194,439**	**-**	**63,943**	**-**	**-**	**845,974**
Net carrying value:								
As at March 31, 2018	**961,808**	**505,575**	**55,034**	**7,177**	**-**	**19,936**	**163,550**	**1,713,080**
As at April 1, 2018	**961,808**	**-**	**450,350**	**-**	**150,139**	**19,936**	**163,550**	**1,745,783**
As at September 30, 2018	**1,025,499**	**-**	**450,165**	**-**	**146,271**	**19,936**	**145,395**	**1,787,266**

*Land is measured at fair value.

3. Property, plant and equipment (continued):

During the six months ended September 30, 2018, financing costs capitalized during construction amounted to $2.9 million (September 30, 2017: $2.6 million) with an average capitalization rate of 5.01% (September 30, 2017: 5.05%).

Contractual commitments as at September 30, 2018, for assets to be constructed totalled $87.8 million (March 31, 2018: $122.0 million). These contractual commitments include $35.7 million (March 31, 2018: $45.5 million) of the original contract value of $149.5 million for the mid-life upgrade and conversion to dual fuel of the two Spirit class vessels and $30.6 million (March 31, 2018: $54.2) of the original contract value of $60 million for the construction of two minor class vessels.

The Government of Canada, through the New Building Canada Fund, agreed to provide funding of up to $43.4 million to help offset the costs of the newly established route connecting Port Hardy and Bella Coola and the replacement of two minor vessels. During the six months ended September 30, 2018, the Group recorded $10.5 million as a reduction of the cost of property, plant and equipment. Funding of $14.9 million was recorded as a reduction in the cost of the property, plant and equipment in fiscal 2018.

During the six months ended September 30, 2018, the Group received $0.5 million (September 30, 2017: $0.5 million) of rental income earned from buildings held for leasing purposes. These buildings have a cost and accumulated depreciation of $11.9 million and $3.3 million, respectively, as at September 30, 2018.

The *Queen of Burnaby* (decommissioned during the year ended March 31, 2018) is classified as held for sale and has no carrying value.

(Tabular amounts expressed in thousands of Canadian dollars)

4. Intangible assets:

	Acquired software, licenses and rights	Internally developed software and website	Assets under development	Total
Cost:				
Balance as at March 31, 2018	124,719	16,418	15,712	156,849
Additions	-	-	8,277	8,277
Disposals	-	-	-	-
Transfers from assets under development	1,540	535	(2,075)	-
Balance as at September 30, 2018	**126,259**	**16,953**	**21,914**	**165,126**
Accumulated amortization:				
Balance as at March 31, 2018	44,744	12,303	-	57,047
Amortization for the period	7,574	388	-	7,962
Balance as at September 30, 2018	**52,318**	**12,691**	**-**	**65,009**
Net carrying value:				
As at March 31, 2018	**79,975**	**4,115**	**15,712**	**99,802**
As at September 30, 2018	**73,941**	**4,262**	**21,914**	**100,117**

Capitalized financing costs during construction for intangible assets with an average capitalization rate of 5.01% for the six months ended September 30, 2018 totalled $0.4 million (September 30, 2017: $0.6 million).

During the six months ended September 30, 2018, intangible assets totalling $3.7 million (September 30, 2017: $4.6 million) were acquired and $4.6 million (September 30, 2017: $4.0 million) were internally developed.

(Tabular amounts expressed in thousands of Canadian dollars)

5. Liabilities arising from financing activities:

Continuity of liabilities arising from financing activities:

	Long-term debt	Lease liabilities	Interest payable on long-term debt
Balance as at March 31, 2018			
Current	34,594	1,652	18,537
Non-current	1,279,775	38,769	-
	1,314,369	40,421	18,537
Adjustment to opening balance (note 2)	-	2,932	-
Balance as at April 1, 2018	1,314,369	43,353	18,537
Additions	-	-	31,564
Payments	(17,641)	(1,064)	(31,538)
Amortization of debt issue costs	488	-	-
Balance as at September 30, 2018	**1,297,216**	**42,289**	**18,563**
Current	34,638	2,178	18,563
Non-current	1,262,578	40,111	-
Balance as at September 30, 2018	**1,297,216**	**42,289**	**18,563**

During the six months ended September 30, 2018, the Group recorded $0.9 million (September 30, 2017: $0.9 million) of interest expense related to lease liabilities.

(Tabular amounts expressed in thousands of Canadian dollars)

6. Loans:

	As at	
Long-term debt:	**September 30, 2018**	**March 31, 2018**
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (effective interest rate of 6.41%)	250,000	250,000
5.02% Senior Secured Bonds, Series 07-1, due March 2037 (effective interest rate of 5.06%)	250,000	250,000
5.58% Senior Secured Bonds, Series 08-1, due January 2038 (effective interest rate of 5.62%)	200,000	200,000
4.70% Senior Secured Bonds, Series 13-1, due October 2043 (effective interest rate of 4.75%)	200,000	200,000
4.29% Senior Secured Bonds, Series 14-1, due April 2044 (effective interest rate of 4.45%)	200,000	200,000
12 Year Loan, maturing March 2020		
Tranche A (effective interest rate of 5.17%)	11,250	15,000
Tranche B (floating interest rate of 2.29% at September 30, 2018)	22,500	22,500
12 Year Loan, maturing June 2020		
Tranche A (effective interest rate of 5.18%)	13,125	16,875
Tranche B (floating interest rate of 2.30% at September 30, 2018)	22,500	22,500
2.95% Loan, maturing January 2021 (effective interest rate of 3.08%)	22,500	27,000
2.09% Loan, maturing October 2028 (effective interest rate of 2.70%)	38,306	40,175
2.09% Loan, maturing January 2029 (effective interest rate of 2.68%)	39,596	41,482
2.09% Loan, maturing January 2029 (effective interest rate of 2.70%)	39,596	41,482
	1,309,373	1,327,014
Less: Unamortized deferred financing costs and bond discounts	(12,157)	(12,645)
Balance as at September 30, 2018	**1,297,216**	**1,314,369**
Current portion	34,638	34,594
Non-current portion	1,262,578	1,279,775
Balance as at September 30, 2018	**1,297,216**	**1,314,369**

(Tabular amounts expressed in thousands of Canadian dollars)

6. Loans (continued):

(a) Credit facility:

The Group has a credit facility with a syndicate of Canadian banks, secured by pledged bonds. This revolving facility, in the amount of $155.0 million, was renewed on March 19, 2018 to extend the maturity date to April 20, 2023. There were no draws on this credit facility as at September 30, 2018 and as at March 31, 2018. There was no interest expensed during the six months ended September 30, 2018 and September 30, 2017. Letters of credit outstanding against this facility as at September 30, 2018 totalled $0.1 million (March 31, 2018: $0.1 million).

(b) Debt service reserves:

Long-term debt agreements require the Group to maintain debt service reserves equal to a minimum of six months of interest payments, to be increased under certain conditions. As at September 30, 2018, debt service reserves of $32.0 million (March 31, 2018: $32.3 million) were held in short-term investments and have been classified as restricted short-term investments on the statements of financial position.

(c) Debt service coverage:

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 the credit facility agreement. As at September 30, 2018, the debt service coverage ratio was 2.67.

In addition, there are other covenants contained in the Master Trust Indenture (“MTI”) (May 2004) available at www.SEDAR.com. The Group was in compliance with all of its covenants at September 30, 2018 and at March 31, 2018.

7. Other liabilities:

FortisBC Energy Inc. has committed to provide the Group with funding as part of the Natural Gas for Transportation (“NGT”) incentive funding.

During the six months ended September 30, 2018, the Group recorded $2.6 million of the total contribution of up to $10.0 million to be applied towards the mid-life upgrade, including conversion to natural gas (“NG”), of the two Spirit class vessels.

The contributions are dependent upon the purchase of NG and will be used to offset the incremental capital costs of the vessels.

NGT incentive funding as at September 30, 2018 of which $7.0 million has been received:

	Salish Class	Spirit Class	Total
Balance as at March 31, 2018	6,000	1,750	7,750
Additions	-	2,625	2,625
Balance as at September 30, 2018	**6,000**	**4,375**	**10,375**

(Tabular amounts expressed in thousands of Canadian dollars)

8. Financial instruments:

The carrying values of the Group's financial instruments approximate fair value as at September 30, 2018 and March 31, 2018 for all financial instruments except for long-term debt.

	As at September 30, 2018		As at March 31, 2018	
	Carrying Value	**Approximately Fair Value**	**Carrying Value**	**Approximately Fair Value**
Long-term debt, including current portion [1]	1,297,216	1,559,682	1,314,369	1,614,108

[1] Classified in Level 2 as the significant measurement inputs used in the valuation models are indirectly observable in active markets (derived from prices).

Carrying value is measured at amortized cost using the effective interest rate method. Fair value is calculated by discounting the future cash flows of each debt issue at the estimated yield to maturity for the same or similar issues at the date of the statements of financial position, or by using available quoted market prices.

The following items shown in the consolidated statements of financial position as at September 30, 2018 and March 31, 2018 are carried at fair value on a recurring basis using Level 1 or 2 inputs. There were no financial assets and liabilities at September 30, 2018, or at March 31, 2018, valued using Level 3 inputs.

	As at September 30, 2018		As at March 31, 2018	
	Level 1	**Level 2**	**Level 1**	**Level 2**
Asset (liability):				
Cash [1]	87,946	-	69,443	-
Cash equivalents [1]	469	-	470	-
Derivatives [2]	-	14,266	-	12,530
	88,415	**14,266**	**69,913**	**12,530**

[1] Classified in Level 1 as the measurement inputs are derived from observable, unadjusted quoted prices in active markets for identical assets.
[2] Classified in Level 2 as the significant measurement inputs used in the valuation models are indirectly observable in active markets (derived from prices).

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment. Where market prices are not available, fair values are estimated using discounted cash flow analysis. No amounts have been reclassified into or out of fair value classifications in the six months ended September 30, 2018 or September 30, 2017.

8. Financial instruments (continued):

During the three months ended September 30, 2018 and September 30, 2017, gains or losses related to Level 2 derivatives have been recorded in OCI. There were no Level 3 instruments outstanding during the period.

The Group may use derivative instruments to hedge its exposure to fluctuations in fuel prices, interest rates and foreign currency exchange rates. The fair value of commodity derivatives reflects only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel. These fair values reflect the estimated amounts that the Group would receive or pay should the derivative contracts be terminated at the period end dates.

9. Financial risk management:

Credit risk:

The Group is using the lifetime ECL (expected credit loss) simplified approach as the method to determine the provision for impairment. The Group reviews for changes in circumstances at each reporting date.

Based on the historical default experience, the Group has established a lifetime ECL allowance of 1% of the trade receivables. Amounts due from the Government of Canada and the Province are considered low credit risk and are excluded. As at March 31, 2018, the provision for impairment was $0.1 million. During the six months ended September 30, 2018, the Group recorded an additional provision of $0.1 million for a total of $0.2 million.

Based on historical default experience and financial position of the counterparties and estimating the probability of default, the lifetime ECL equals zero for the Group’s restricted and other short-term investments.

The Group has a loan receivable with a term of 15 years, secured by a second mortgage. The collateral is expected to exceed the amount of the loan and be available while the loan is outstanding.

9. Financial risk management (continued):

Fuel price risk:

The Group is exposed to risks associated with changes in the market price of marine diesel fuel and NG fuel. In order to reduce price volatility and add a fixed component to the inherent floating nature of fuel prices, the Group may manage its exposure by entering into hedging instruments with certain financial intermediaries. Fuel price hedging instruments are used to reduce fuel price risk and to minimize fuel surcharges, not for generating trading profits. Gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs. The Group's Financial Risk Management Policy limits hedging, to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period; 90% of anticipated monthly fuel consumption thereafter to the end of the fourth performance term.

The Group is also allowed by regulatory order to use deferred fuel cost accounts to mitigate the impact of changes in fuel price on its earnings (note 16).

The Group hedges using CAD denominated ultra-low sulfur diesel (“ULSD”) to reduce its exposure to changes in ULSD and foreign exchange risk components associated with forecast diesel fuel purchases. The notional value of all fuel swap contracts outstanding as at September 30, 2018 was $32.6 million CAD (March 31, 2018: $54.6 million). Hedge accounting was applied to these contracts. No ULSD fuel and NG swap contracts were entered into during the six months ended September 30, 2018.

An economic relationship exists between the hedged item and the hedging instruments as the fair values of both the hedged item and the hedging instrument move in opposite directions in response to the same risk. The inclusion of credit risk in the fair value of the hedging instrument which is not replicated in the hedged item is a potential source of ineffectiveness, however, the Group does not consider this risk to be material.

During the six months ended September 30, 2018, the total change in the value of fuel swap contracts was $1.8 million (September 30, 2017: $2.5 million). The realized fair value change of $9.3 million was recognized in OCI. The net realized hedging gain of $7.5 million was reclassified from reserves and included in the Group’s fuel expense during the six months ended September 30, 2018. There was no hedge ineffectiveness during the six months ended September 30, 2018.

9. Financial risk management (continued):

	Fiscal 2019	Fiscal 2020	Total
Cash flow hedges:			
Fuel price risk:			
Fuel contracts (litres in thousands)	29,100	30,180	59,280
Contract price range ($/litre)	$0.5446 - $0.5680	$0.5308 - $0.5599	

(a) As at September 30, 2018, the Group's derivative assets of $14.3 million, of which $13.2 million will mature within twelve months, included foreign exchange forward contracts and fuel swap contracts, and derivative liabilities of $12.5 thousand included foreign exchange forward contracts.

Fuel swap contracts as at September 30, 2018:

					Fair value changes used for calculating hedge ineffectiveness	
	Notional value of the hedging instrument	Carrying value of the hedging instrument	Item location	Cash flow hedge reserve	Hedging instruments	Hedged items
Cash flow hedges:						
Fuel price risk	32,621	14,279	Derivative assets	14,279	14,279	14,315

(b) Cash flow hedge reserve:

	Three months ended September 30		Six months ended September 30	
	2018	2017	2018	2017
Hedging gains recognized in cash flow hedge reserve:				
Fuel swap contracts (note 10(a))	1,445	6,526	9,324	810
Hedging (gains) losses reclassified from cash flow hedge reserve:				
Interest rate forward contract – amortization of hedge loss	62	62	124	124
Fuel swap contracts – (gain) loss recognized in net earnings (note 10(a))	(4,196)	942	(7,517)	1,737
Net change in cash flow hedge reserve	**(2,689)**	**7,530**	**1,931**	**2,671**

(Tabular amounts expressed in thousands of Canadian dollars)

10. Other comprehensive income (loss):

(a) Continuity of reserves:

	Land revaluation reserves	Employee future benefit revaluation reserves	Fuel swaps reserves	Interest rate forward contracts reserves	Total
Balance as at March 31, 2018	8,934	(5,969)	12,471	(6,462)	8,974
Derivatives designated as cash flow hedges (note 9(b))					
Net change in fair value	-	-	9,324	-	9,324
Realized gains (note 9(b))	-	-	(7,517)	-	(7,517)
Amortization of losses (note 9(b))	-	-	-	124	124
Balance as at September 30, 2018	**8,934**	**(5,969)**	**14,278**	**(6,338)**	**10,905**

(b) Other comprehensive income (loss):

	Three months ended September 30		Six months ended September 30	
	2018	**2017**	**2018**	**2017**
Items not to be reclassified to net earnings:				
Actuarial losses on defined benefit plans	-	(1,943)	-	(1,943)
Items to be reclassified to net earnings:				
Hedge gains on fuel swaps (note 9(b))	1,445	6,526	9,324	810
Total other comprehensive income (loss)	**1,445**	**4,583**	**9,324**	**(1,133)**

(Tabular amounts expressed in thousands of Canadian dollars)

11. Net retail:

	Three months ended September 30		Six months ended September 30	
	2018	**2017**	**2018**	**2017**
Retail revenue	36,431	34,993	61,544	59,474
Cost of goods sold	(13,370)	(13,113)	(22,924)	(22,671)
Net retail	**23,061**	**21,880**	**38,620**	**36,803**

12. Operating expenses:

	Three months ended September 30		Six months ended September 30	
	2018	**2017**	**2018**	**2017**
Salaries, wages and benefits	100,019	95,830	199,499	189,721
Fuel	32,019	30,878	60,956	56,239
Materials, supplies and contracted services	19,527	14,246	42,719	35,108
Other operating expenses	16,767	16,362	32,989	32,341
Depreciation and amortization	42,921	40,008	84,946	78,648
Total operating expenses	**211,253**	**197,324**	**421,109**	**392,057**

13. Net finance expense:

	Three months ended September 30		Six months ended September 30	
	2018	**2017**	**2018**	**2017**
Finance expenses:				
Long-term debt	15,819	16,046	31,564	31,939
Short-term debt	48	47	399	283
Lease financing	471	452	948	908
Amortization of deferred financing costs and bond discounts	305	335	613	638
Interest capitalized in the cost of qualifying assets	(1,375)	(1,460)	(3,284)	(3,180)
Total finance expenses	15,268	15,420	30,240	30,588
Finance income	(1,610)	(1,365)	(2,867)	(2,428)
Net finance expense	**13,658**	**14,055**	**27,373**	**28,160**

14. Accrued employee future benefits:

During the six months ended September 30, 2018, the Group recognized total defined benefit costs of $1.3 million (September 30, 2017: $1.0 million).

(Tabular amounts expressed in thousands of Canadian dollars)

15. Related party transactions:

In accordance with the Act, the Group is responsible for paying any expenses that are incurred by the Authority, without charge. During the six months ended September 30, 2018, the Group paid $79,772 (September 30, 2017: $82,342) of such expenses.

The Province owns the Group's 75,477 non-voting preferred shares, but has no voting interest in either the Group or the Authority.

16. Economic effect of rate regulation:

The Group is regulated by the Commissioner to ensure, among other things, that tariffs are fair and reasonable. Under the terms of the Act, the tariffs the Group charges its customers are subject to price caps. The Commissioner may, in extraordinary situations, allow increases in price caps over the set levels.

In January 2014 the IASB issued IFRS 14, *Regulatory Deferral Accounts*. IFRS 14 is an interim standard that addresses the accounting for regulatory deferral accounts; however, it does not allow the recognition of regulatory assets and regulatory liabilities that result from the regulated price cap setting process for entities that had already transitioned to IFRS. The Group transitioned to IFRS effective April 1, 2011. As a result, the Group is not permitted to recognize its regulatory assets and regulatory liabilities in its consolidated statements of financial position.

Regulatory assets generally represent incurred costs that have been deferred for purposes of rate regulation because they 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. Management continually assesses whether the Group's regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes. Management believes that the regulatory assets at September 30, 2018, are probable of future recovery in tariff or fuel surcharges.

If the Group was permitted under IFRS to recognize the effects of rate regulation, the following regulatory assets would be shown on the consolidated statements of financial position:

	As at	
Regulatory accounts	**September 30, 2018**	**March 31, 2018**
Deferred fuel costs:		
Balance, beginning of year	(239)	4,450
Fuel costs under set price	(1,116)	(8,630)
Rebates	4,585	19,386
Fuel price risk recoveries payable to the Province	-	291
Corporate contribution	-	(15,736)
Balance, end of period	3,230	(239)
Total long term regulatory assets (liabilities)	**3,230**	**(239)**

The Act contains provisions which ensure that if tariffs charged by the Group exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. At September 30, 2018 and March 31, 2018, tariffs charged to customers were below established price caps.

(Tabular amounts expressed in thousands of Canadian dollars)

16. Economic effect of rate regulation (continued):

If the Group was permitted under IFRS to recognize the effects of rate regulation and to record regulatory assets and regulatory liabilities, net earnings for the three months ended September 30, 2018 would have been $1.5 million lower (September 30, 2017: $3.3 million higher) and during the six months ended September 30, 2018, net earnings would have been $3.5 million higher (September 30, 2017: $5.6 million higher) as detailed below:

	Three months ended September 30		Six months ended September 30	
Effect of rate regulation on net earnings	**2018**	**2017**	**2018**	**2017**
Regulatory accounts:				
Deferred fuel costs	(1,536)	3,271	3,469	5,631
Total (decrease) increase in net earnings	**(1,536)**	**3,271**	**3,469**	**5,631**