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

For the three months ended
June 30, 2018

Dated August 23, 2018

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BCFerries

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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") for the three months ended June 30, 2018 that has been prepared with information available as of August 23, 2018. This discussion and analysis should be read in conjunction with our unaudited condensed interim financial statements and related notes for the three months ended June 30, 2018 and 2017, and our audited consolidated financial statements and related notes for the years ended March 31, 2018 ("fiscal 2018") and March 31, 2017 ("fiscal 2017"), together with our Management's Discussion and Analysis for fiscal 2018. 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. In the three months ended June 30, 2018 (the first quarter of fiscal 2019), we provided transportation service with 35 vessels operating on 24 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 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 two regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island. In the fall of fiscal 2019, we plan to start service on a new route directly connecting Port Hardy and Bella Coola. 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.

During the three months ended June 30, 2018, we provided an average of 482 sailings per day for our customers. We delivered over 43,000 sailings, 734 or 1.7% more than in the same period in the prior year. We carried 5.7 million passengers and 2.3 million vehicles, an increase of 2.1% and 2.6%, respectively, compared to the same quarter in the prior year. The passenger traffic levels experienced in the first quarter of fiscal 2019 are the highest we have experienced in over 20 years and vehicle traffic levels were the highest we have ever experienced. For a discussion of our traffic levels, see "Financial and Operational Overview" below.

Significant events during or subsequent to the first quarter of fiscal 2019 include the following:

Tariffs

- 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 value of these initiatives over two years is approximately $98 million. We reached an agreement with the Province whereby we will contribute $39 million in foregone revenue and the Province will, over two years, contribute $59 million towards the fare reductions and the increase to the BC seniors' discount.

Vessels

- On June 6, 2018, the *Spirit of British Columbia* returned to service on our Tsawwassen – Swartz Bay route following its mid-life upgrade. The mid-life upgrade, which will enable the vessel to be in service for another 25 years, included the conversion of the vessel to dual-fuel so it can operate on liquefied natural gas ("LNG") or ultra-low sulphur marine diesel, as well as major upgrades to the customer amenities.

- On July 10, 2018, we confirmed the introduction of the direct service between Port Hardy and Bella Coola using the *Northern Adventure* beginning on September 16 through to October 11, 2018. The entry into service of the *Northern Sea Wolf*, the vessel acquired for this service, has been delayed. The 75-metre used vessel is at a local shipyard undergoing the extensive upgrades necessary to bring it up to our and Transport Canada's standards of safety and reliability. (See "Investing in Our Capital Assets" for more detail.)

- On July 26, 2018, we issued two Requests for Expressions of Interest ("RFEOI") for the procurement of five new vessels to replace aging fleet assets with the bidding process open to local, national and international shipyards. The first RFEOI is for the construction of four 81-metre Island Class ferries, each with a capacity of 450 passengers and 47 vehicles. The expected delivery date of the first of these two vessels is in 2020, with the following two ships delivered in 2021. The second RFEOI is for the construction of one 107-metre Salish Class vessel with a capacity of 600 passengers and 138 vehicles and an expected delivery date in 2021. The Island Class vessels will be electric hybrid, including batteries, and the Salish Class vessel will be fuelled with LNG. The five new vessels will allow for the retirement of the *Bowen Queen*, *Mayne Queen* and *Powell River Queen* and for the redeployment of some assets around the fleet.

FINANCIAL AND OPERATIONAL OVERVIEW

This section provides an overview of our financial and operational performance for the three month periods ended June 30, 2018 and 2017.

	Three months ended June 30			
			Variance	
($ millions)	**2018**	**2017**	**$**	**%**
Total revenue	229.7	226.2	3.5	1.5%
Operating expenses	209.9	194.7	(15.2)	(7.8%)
Operating profit	19.8	31.5	(11.7)	(37.1%)
Net finance and other	13.8	14.2	0.4	2.8%
Net earnings	6.0	17.3	(11.3)	(65.3%)
Other comprehensive income (loss)	7.9	(5.7)	13.6	238.6%
Total comprehensive income	13.9	11.6	2.3	19.8%

Our net earnings in the three months ended June 30, 2018 were $11.3 million lower than the same period in the prior year, primarily as a result of a 7.8% increase in operating expense described below.

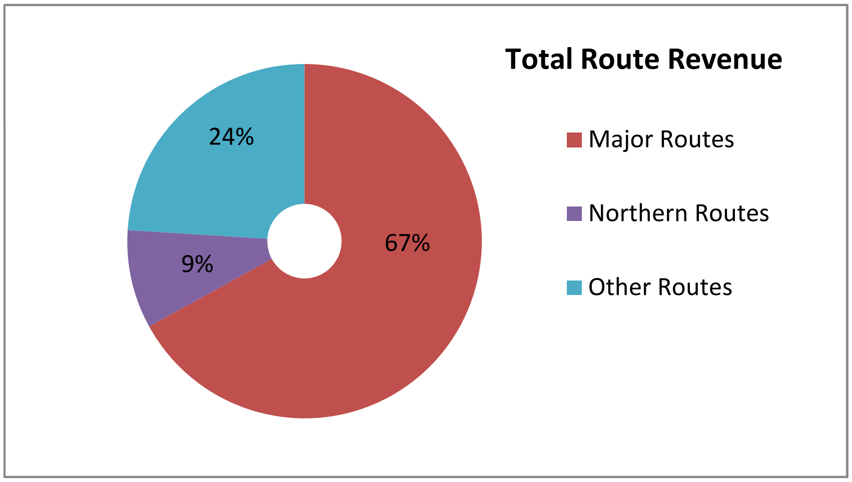
In the first quarter of fiscal 2019, revenues increased by 1.5% compared to the first quarter of the previous fiscal year primarily as a result of the increased traffic volumes, partially offset by a decrease in the average tariff revenue per passenger and vehicle. On April 1, 2018, we applied a fare 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. In the three months ended June 30, 2018, $6.8 million received from the Province was recorded towards the fare reductions and the increase to the BC seniors' discount. (See "Revenue and Operational Statistics" for more detail.)

In the first quarter of fiscal 2019, operating expenses increased by 7.8% compared to the first quarter of the previous fiscal year. To improve our customer experience and to accommodate the higher traffic volumes, we provided 352 additional round trips and adjusted the schedule for the routes operating out of Horseshoe Bay terminal. We also re-introduced the upgraded *Spirit of British Columbia* into service. These actions resulted in an increase in labour, fuel consumption, and training related costs. The increase in operating expense also included the impact of higher fuel prices, wage rate increases in accordance with the Collective Agreement with the BC Ferry & Marine Workers' Union (the "Union") and higher depreciation. (See "Expenses" for more detail.)

In the three months ended June 30, 2018, total comprehensive income increased $2.3 million over the same period in the prior year, comprised of a decrease in net earnings of $11.3 million and an increase in other comprehensive income of $13.6 million. The increase in other comprehensive income from a loss of $5.7 million in the first quarter of fiscal 2017 to a gain of $7.9 million in the first quarter of fiscal 2018 reflects a $13.6 million change in the fair value of our fuel swap contracts.

Revenue and Operational Statistics

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 two 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.



In the three months ended June 30, 3018, the greatest portion of our revenue (67%) was earned on our Major Routes. Revenue from the Northern Routes contributed 9% and revenue from Other Routes contributed 24%.

Select operational statistics and total revenues for the three months ended June 30, 2018 compared to the same period in the prior year are shown in the tables below.

	Three months ended June 30	
Operational Statistics	**2018**	**2017**
Vehicle traffic	2,301,697	2,242,499
Passenger traffic	5,705,316	5,588,994
On-time performance	86.7%	86.4%
Number of round trips	19,887	19,535
Capacity provided (AEQs)	3,873,846	3,822,217
AEQs carried	2,623,196	2,552,637
Capacity utilization	67.7%	66.8%

In the three months ended June 30, 2018, vehicle traffic increased 2.6% and passenger traffic increased 2.1% compared to the same quarter in the prior year. Overall, we believe traffic continued to be positively impacted by favourable economic activity in British Columbia and the lower Canadian dollar. We believe fare reductions and our vehicle fare pricing promotion also 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 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 time. In each case, on-time performance can be impacted by delays due to weather, vessel substitution, 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, 2018, overall on-time performance was on par with the same period in the prior year. The Major Routes' on-time performance improved but was offset by a decrease on both the Northern and Other Routes primarily due to the impact of increased traffic demand and delays due to weather.

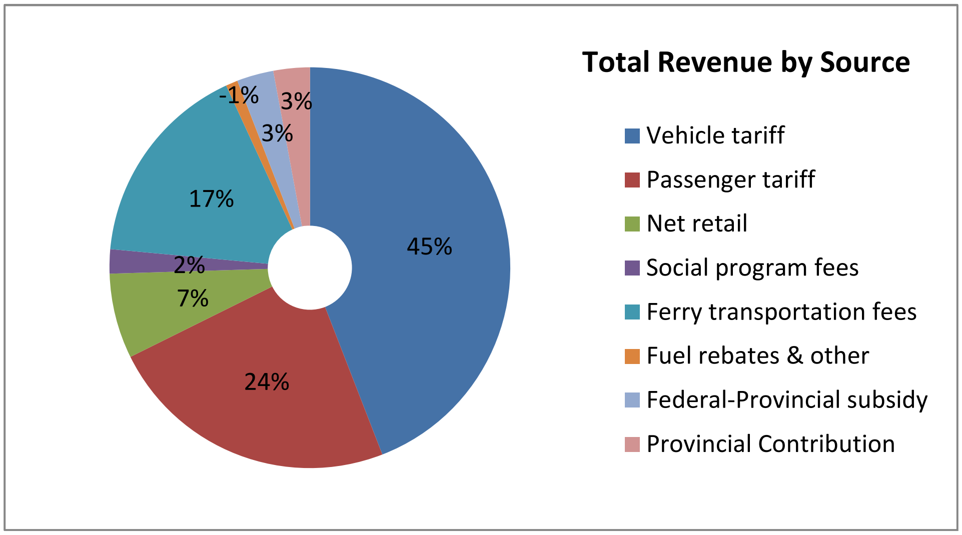
An automobile equivalent ("AEQ") is our standard unit of measure for an approximation of one car length. AEQs are calculated by using a conversion factor for each vehicle type. For example, a passenger vehicle would be one AEQ while a bus would be three AEQs. The change in AEQs from one period to the 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 ferry transportation fees. The number of round trips provided can be positively or negatively impacted by cancellations due to weather, vessel substitution, terminal dock closures and extra round trips made in response to high demand, or by changes to the number of trips stipulated by the CFSC. In the three months ended June 30, 2018, we provided 352 additional round trips compared to the same period in the prior year, resulting in an increase in capacity provided.

These metrics include the impact of schedule modifications required to accommodate the temporary removal of the *Queen of Cumberland* from service because of a mechanical failure which resulted in physical injuries to two employees. We applied for authorization to temporarily reduce service below the core services levels included in the CFSC for two ferry routes (Swartz Bay to the Southern Gulf Islands and Tsawwassen to the Southern Gulf Islands). The Commissioner approved our request and service was modified from April 18 through to May 18, 2018 when the *Queen of Cumberland* returned to regular service.

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. Capacity utilization increased from 66.8% to 67.7% for the three months ended June 30, 2018, compared to the same quarter in the prior year, as a result of a higher number of AEQs carried due to higher traffic levels, partially offset by an increase in capacity provided from additional round trips.

Revenue	**Three months ended June 30**			
($ millions)			**Increase (Decrease)**	
	2018	**2017**	**$**	**%**
Direct Route Revenue				
Vehicle tariff	102.3	102.6	(0.3)	(0.3%)
Passenger tariff	56.2	60.5	(4.3)	(7.1%)
Fuel rebates	(4.5)	(4.9)	0.4	8.2%
Net retail	15.0	14.3	0.7	4.9%
Social program fees	4.5	4.9	(0.4)	(8.2%)
Other revenue	2.8	2.8	-	-
Total Direct Route Revenue	176.3	180.2	(3.9)	(2.0%)
Indirect Route Revenue				
Ferry transportation fees	38.5	38.0	0.5	1.3%
Federal-Provincial subsidy	7.6	7.5	0.1	1.3%
Provincial contribution	6.8	-	6.8	-
Total Route Revenue	229.2	225.7	3.5	1.6%
Other general revenue	0.5	0.5	-	-
Total Revenue	229.7	226.2	3.5	1.5%



Vehicle tariffs (which include reservation fee revenue) and passenger tariffs account for the majority of our revenues. Our year to 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, 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 value of these initiatives over two years is approximately $98 million, of which the Province will contribute $59 million. In fiscal 2019, the Province will contribute a total of $26.5 million comprised of $9.8 million for the increased BC seniors' discount and $16.7 million towards fare reductions. In the three months ended June 30, 2018, $6.8 million of the $26.5 million was recorded into revenue. In the three months ended June 30, 2018, the number of BC seniors travelling with the discount increased 21.8% compared to same period in the prior year.

Surcharges and/or rebates are implemented as a direct result of rising and declining fuel prices. A fuel rebate of 1.9% on the Northern Routes and 2.9% on our Major and regulated Other Routes was in place throughout fiscal 2018. These fuel rebates were discontinued, effective June 27, 2018 due to the rise in fuel prices. 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.)

Year to year changes in revenue and operational statistics for the three months ended June 30, 2018 and 2017 for the Major, Northern and Other Routes are discussed separately below.

Year to Year Comparison of Revenues and Operational Statistics 2018 – 2017

Major Routes

Our Major Routes are our four busiest routes, carrying approximately 60% of our total vehicle traffic and 65% of our total passenger traffic and generating approximately 83% of our total customer revenues.

Operational Statistics	Three months ended June 30 2018	2017
Vehicle traffic	1,350,748	1,330,193
Passenger traffic	3,642,716	3,604,138
On-time performance	83.4%	78.0%
Number of round trips	3,401.0	3,306.5
Capacity provided (AEQs)	2,118,084	2,070,372
AEQs carried	1,601,633	1,573,758
Capacity utilization	75.6%	76.0%

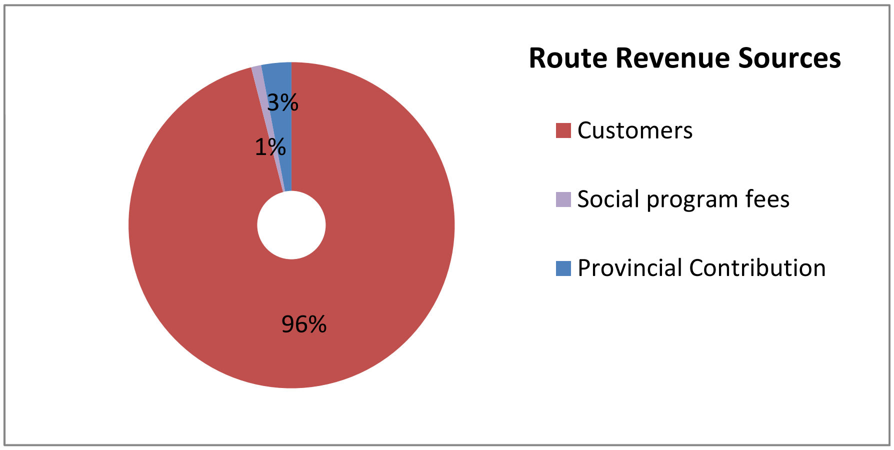
In the three months ended June 30, 2018, vehicle traffic increased 1.5% and passenger traffic increased 1.1% compared to the same period in the prior year. We believe traffic continued to be positively impacted by favourable economic activity in British Columbia and the lower Canadian dollar. We believe our vehicle fare pricing promotions also had a positive impact on both passenger and vehicle traffic.

Our initiatives to improve on-time performance at Horseshoe Bay terminal, where we have had challenges, included 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, 2018 compared to the same period in the prior year, on-time performance on the routes using the Horseshoe Bay terminal improved 4.6% (from 77.6% to 82.2%) on the Horseshoe Bay – Departure route and 21.7% (from 57.3% to 79.0%) on the Horseshoe Bay – Langdale route.

During the first quarter of fiscal 2019, overall on-time performance on the Major Routes improved 5.4% compared to the same period in the prior year. On-time performance on all of the Major Routes improved with the exception of the route connecting Duke Point and Tsawwassen, which declined 6.7% (from 88.8% to 82.1%), while vehicle traffic increased 4.8% on this route, primarily from the extra time required to safely load as many vehicles as possible on each sailing.

Capacity utilization on these routes during the three months ended June 30, 2018 declined 0.4% compared to the same period in the prior year, as a result of an increase in capacity provided from additional round trips, substantially offset by the higher number of AEQs carried due to higher traffic levels.

Major Routes cont'd



In the three months ended June 30, 2018, revenue from our Major Routes consisted of 96% from customers and 4% from the Province (3% Provincial contribution and 1% social program fees).

Revenue ($ thousands)	Three months ended June 30			
	2018	**2017**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	87,857	86,681	1,176	1.4%
Passenger tariff	46,910	49,210	(2,300)	(4.7%)
Fuel rebates	(3,757)	(3,982)	225	5.7%
Net retail	13,478	12,849	629	4.9%
Social program fees	2,363	2,501	(138)	(5.5%)
Parking	1,737	1,632	105	6.4%
Other revenue	904	1,021	(117)	(11.5%)
Total Direct Route Revenue	149,492	149,912	(420)	(0.3%)
Indirect Route Revenue				
Provincial contribution	4,060	-	4,060	100.0%
Total Route Revenue	153,552	149,912	3,640	2.4%

On April 1, 2018, we applied a fare reduction of 15% on our Major Route connecting Horseshoe Bay and Langdale. Fares were held constant on our 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 our Major Routes.

In the three months ended June 30, 2018, average tariff revenue (tariff revenue divided by traffic volume) per vehicle was $65.04, which is 0.2% lower than the same period in the prior year. Passenger tariff revenue in the three months ended June 30, 2017, included $1.5 million in revenue for BC seniors. In the three months ended June 30, 2018, average tariff revenue per passenger decreased $0.78 or 5.7% compared to the same period in the prior year, primarily as a result of the increase in the BC seniors' discount. The decrease in average tariff revenue was partially offset by the increase in traffic levels during the first quarter of fiscal 2019, and resulted in a total tariff revenue decrease of $1.1 million compared to the same period in the prior year.

A fuel rebate of 2.9% on our Major Routes was in place throughout fiscal 2018. This fuel rebate was discontinued, effective June 27, 2018 (fiscal 2019), due to the rise in fuel prices.

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, 2018, net retail sales increased 4.9% compared to the same period in the prior year as a result of both higher passenger traffic and higher average sales per passenger. Food sales remain strong, providing approximately 73% of total retail revenue. Sales of quality apparel continue to grow and comprise over 11% of total retail revenue. Cost of goods sold is approximately 40% of total 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, 2018 decreased compared to the same period in the prior year, mainly as a result of a decrease in the usage of the MTAP program.

Revenue from parking increased 6.4% in the three months ended June 30, 2018 compared to the same period in the prior year, as a result of an increase in parking rates and higher usage.

Other revenue decreased 11.5% in the three months ended June 30, 2018 compared to the prior year, mainly as a result of a decrease in commissions received from vendors.

The provincial contribution of $4.1 million in the three months ended June 30, 2018 consisted of $2.0 million towards the increased BC seniors' discount and $2.1 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).

Northern Routes

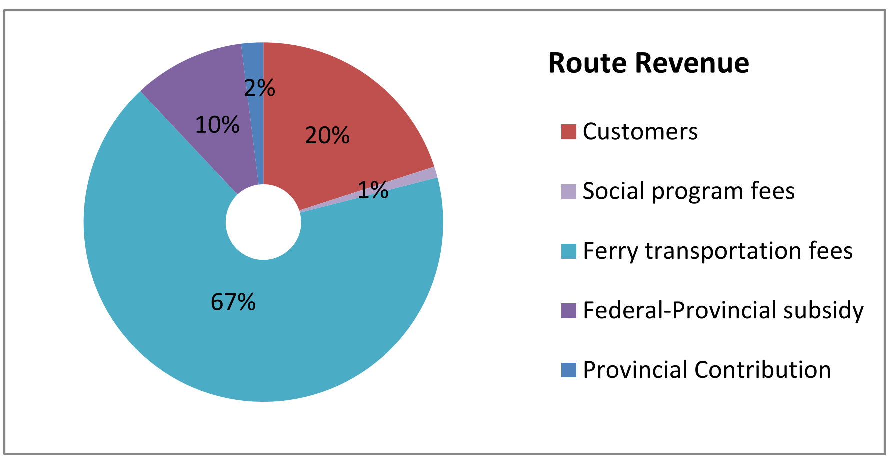
Our Northern Routes currently consist of two regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island. In the fall of 2018, we plan to start service on a new route directly connecting Port Hardy and Bella Coola.

Operational Statistics	Three months ended June 30 2018	2017
Vehicle traffic	7,848	7,574
Passenger traffic	20,272	20,373
On-time performance	80.9%	85.3%
Number of round trips	59.0	58.5
Capacity provided (AEQs)	11,826	11,787
AEQs carried	9,738	9,485
Capacity utilization	82.3%	80.5%

In the three months ended June 30, 2018, vehicle traffic increased 3.6% and passenger traffic decreased 0.5% compared to the same period in the prior year.

On-time performance in the three months ended June 30, 2018 decreased from 85.3% to 80.9% over the same period in the prior year, primarily due to the increased traffic demand and delays due to weather.

Capacity utilization on these routes during the three months ended June 30, 2018 was 1.8% higher than the same period in the prior year, primarily as a result of a higher number of AEQs carried slightly offset by increased capacity provided.



In the three months ended June 30, 2018, revenue from our Northern Routes consisted of 20% from customers and 80% from the Province (2% Provincial contribution, 1% social program fees, 67% ferry transportation fees, and 10% from payments under the Federal-Provincial subsidy agreement).

Northern Routes cont'd

Revenue ($ thousands)	**Three months ended June 30**			
	2018	**2017**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	1,892	2,173	(281)	(12.9%)
Passenger tariff	1,372	1,635	(263)	(16.1%)
Fuel rebates	(63)	(80)	17	21.3%
Net retail	268	245	23	9.4%
Social program fees	284	295	(11)	(3.7%)
Stateroom rental	446	415	31	7.5%
Hostling & other	64	78	(14)	(17.9%)
Total Direct Route Revenue	4,263	4,761	(498)	(10.5%)
Indirect Route Revenue				
Ferry transportation fees	12,959	12,826	133	1.0%
Federal-Provincial subsidy	1,957	1,910	47	2.5%
Provincial contribution	298	-	298	100.0%
Total Route Revenue	19,477	19,497	(20)	(0.1%)

In the three months ended June 30, 2018, average tariff revenue (tariff revenue divided by traffic volume) per vehicle decreased $45.82 or 16.0% and average tariff revenue per passenger decreased $12.57 or 15.7% compared to the same period in the prior year, mainly as a result of the 15% fare reduction applied on April 1, 2018. Average tariff revenues also reflect a change in the proportion of traffic on routes with lower versus higher tariffs. The changes in traffic levels and changes in average tariff revenue during the first quarter of fiscal 2019 resulted in a total tariff revenue decrease of $0.5 million compared to the same period in the prior year.

A fuel rebate of 1.9% on the Northern Routes was in place throughout fiscal 2018. This fuel rebate was discontinued, effective June 27, 2018 (fiscal 2019), due to the rise in fuel prices.

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.

Reimbursements from the Province for social program fees decreased compared to the same period in the prior year, mainly as a result of the 15% fare reduction.

Stateroom rental revenue increased due to higher utilization.

Ferry transportation fees received from the Province increased $0.1 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.

The Federal-Provincial subsidy has increased by the change in the annual CPI (Vancouver).

The provincial contribution of $0.3 million in the three months ended June 30, 2018 consisted of a contribution towards the 15% fare reductions.

Other Routes

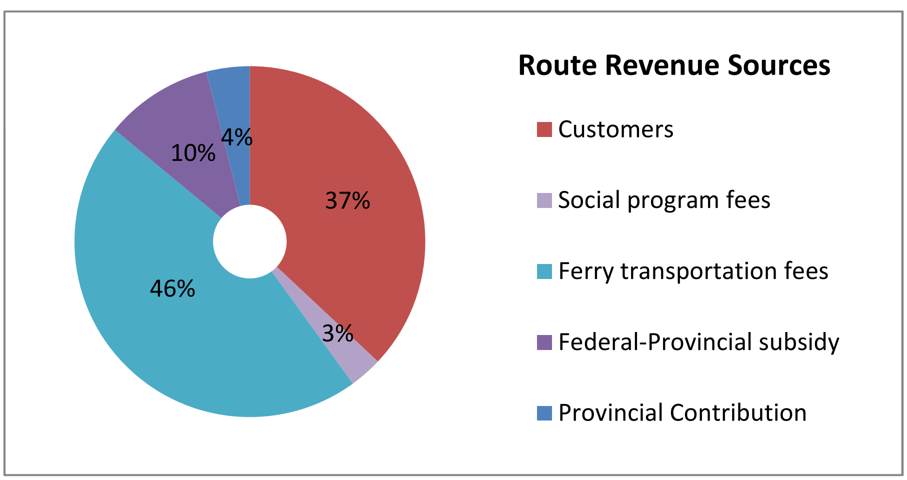
Our Other Routes primarily serve the northern and southern Gulf Islands and the northern Sunshine Coast. One of the 18 regulated routes and all eight of the unregulated routes are operated under contract by alternative service providers. We receive fees from the Province for the provision of contracted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

	Three months ended June 30	
Operational Statistics	**2018**	**2017**
Vehicle traffic	943,101	904,732
Passenger traffic	2,042,328	1,964,483
On-time performance	87.3%	88.0%
Number of round trips	16,427.0	16,170.0
Capacity provided (AEQs)	1,743,936	1,740,058
AEQs carried	1,011,825	969,394
Capacity utilization	58.0%	55.7%

In the three months ended June 30, 2018, vehicle traffic increased 4.2% and passenger traffic increased 4.0% compared to the same period in the prior year.

On-time performance in the three months ended June 30, 2018 decreased from 88.0% to 87.3% over the same period in the prior year, primarily due to the impact from increased traffic demand and delays due to weather.

Capacity utilization on these routes during the three months ended June 30, 2018 was higher compared to the same period in the prior year, primarily due to a higher number of AEQs carried, slightly offset by an increase in capacity provided.



In the three months ended June 30, 2018, revenue from our Other Routes consisted of 37% from customers and 63% from the Province (4% Provincial contribution, 3% social program fees, 46% ferry transportation fees, and 10% from payments under the Federal-Provincial subsidy agreement).

Other Routes cont'd

Revenue ($ thousands)	Three months ended June 30			
	2018	**2017**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	12,515	13,791	(1,276)	(9.3%)
Passenger tariff	7,881	9,630	(1,749)	(18.2%)
Fuel rebates	(697)	(806)	109	13.5%
Social program fees	1,824	2,080	(256)	(12.3%)
Net retail	827	806	21	2.6%
Parking & other	100	103	(3)	(2.9%)
Total Direct Route Revenue	22,450	25,604	(3,154)	(12.3%)
Indirect Route Revenue				
Ferry transportation fees	25,576	25,197	379	1.5%
Federal-Provincial subsidy	5,669	5,535	134	2.4%
Provincial contribution	2,434	-	2,434	100.0%
Total Route Revenue	56,129	56,336	(207)	(2.1%)

On April 1, 2018, we applied a fare reduction of 15% on our Other Routes. Also on April 1, 2018, the BC seniors' passenger discount increased from 50% to 100% for travel Monday to Thursday on these routes.

In the three months ended June 30, 2018, average tariff revenue per vehicle (tariff revenue divided by traffic volume) decreased $1.97 or 12.9%, reflecting the fare reduction and an increase in the proportion of traffic on routes with higher versus lower tariffs. In the three months ended June 30, 2018, average tariff revenue per passenger decreased $1.04 or 21.3%, reflecting the fare reduction of 15% and increased BC seniors' passenger discount implemented at April 1, 2018 on our Other Routes. The decrease in average tariff revenue, partially offset by the increase in traffic levels during the first quarter of fiscal 2019, resulted in a total tariff revenue decrease of $3.0 million compared to the same period in the prior year.

A fuel rebate of 2.9% on our Other Routes was in place throughout fiscal 2018. This fuel rebate was discontinued, effective June 27, 2018 (fiscal 2019), due to the rise in fuel prices.

Social program fees for the three months ended June 30, 2018 decreased compared to the same period in the prior year, primarily as a result of a decrease in the usage of the MTAP program and the 15% fare reduction.

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.

The Federal-Provincial subsidy has increased by the change in the annual CPI (Vancouver).

The provincial contribution of $2.4 million in the three months ended June 30, 2018 consisted of $0.6 million towards the increased BC seniors' discount and $1.8 million for fare reductions.

Expenses
Expenses for the three month periods ended June 30, 2018 and 2017 are summarized in the table below:

Operating expenses ($ millions)	**Three months ended June 30**			
			Increase (Decrease)	
	2018	**2017**	**$**	**%**
Operations	135.9	125.2	10.7	8.5%
Maintenance	22.2	20.9	1.3	6.2%
Administration	9.8	10.0	(0.2)	(2.0%)
Total operations, maintenance & administration	167.9	156.1	11.8	7.6%
Depreciation and amortization	42.0	38.6	3.4	8.8%
Total operating expenses	209.9	194.7	15.2	7.8%

To improve our customer experience and to accommodate the higher traffic volumes, we provided 352 additional round trips compared to the same period in the prior year and adjusted the schedule for the routes operating out of Horseshoe Bay terminal. We also re-introduced the upgraded *Spirit of British Columbia* into service. These actions resulted in an increase in labour, fuel consumption, and training related costs. The increase in operating expense also included the impact of higher fuel prices, wage rate increases in accordance with the Collective Agreement with the Union and higher depreciation. We continue to take proactive measures to contain and manage expenses while operating a sustainable, safe and reliable service.

In the three months ended June 30, 2018, operations expenses increased $10.7 million compared to the same period in the prior year due to:

- $7.0 million increase in wages and benefits costs, mainly due to staffing for the additional round trips provided and the schedule adjustments for the routes operating out of Horseshoe Bay terminal, a wage rate increase of 1.75% effective April 1, 2018 in accordance with the Collective Agreement with the Union, an increase in overtime, and an increase in hours spent on training activities;
- $3.7 million increase in fuel expense, reflecting a 3.5% or $0.9 million increase in fuel consumption primarily as a result of additional round trips provided and a 10.8% or $2.8 million increase due to higher fuel prices;
- $1.9 million increase in contracted services, which includes feasibility costs related to projects currently in the planning stage and expenses related to the *Spirit of British Columbia* re-entering service; partially offset by:
- $1.6 million decrease primarily due to an emergency drydocking in the prior year of the *Spirit of Vancouver Island.*; and
- $0.3 million decrease in other costs including insurance, and materials and supplies.

The $1.3 million increase in maintenance costs compared to the prior year is primarily as a result of unplanned repairs on the *Coastal Inspiration* and the cyclical nature of vessel refit activity.

Depreciation and amortization increased $3.4 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	**Three months ended June 30**			
($ millions)			**(Increase) Decrease**	
	2018	**2017**	**$**	**%**
Finance expense	15.0	15.2	0.2	1.3%
Less: finance income	(1.3)	(1.1)	0.2	(18.2%)
Net finance expense	13.7	14.1	0.4	2.8%
Loss on disposal and revaluation of property, plant and equipment, and intangible assets	0.1	0.1	0.0	-
Total net finance and other expenses	13.8	14.2	0.4	2.8%

In the three months ended June 30, 2018, net finance and other expenses decreased by $0.4 million compared to the same period in the prior year mainly due to:

- $0.2 million increase in interest expense capitalized on projects; and
- $0.2 million increase in interest income on investments.

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.

We expect our cash requirements, in the near term, will be met through operating cash flows, funding under government programs and by accessing our credit facility from time to time. At June 30, 2018, our unrestricted cash and cash equivalents and other short-term investments totalled $51 million and $88 million, respectively (at March 31, 2018 - $70 million and $114 million, respectively).

On March 21, 2017, the Government of Canada approved funding of up to $15.1 million under the New Building Canada Fund towards a new seasonal direct ferry service between Port Hardy and Bella Coola. In addition to the $15.1 million, in fiscal 2017, the Government of Canada also approved funding of up to $45.4 million under the New Building Canada Fund towards the purchase of two new Island Class vessels and major upgrade of our Langdale terminal. In total, up to $60.5 million in funding under the New Building Canada Fund has been approved.

Our $155 million credit facility, with a syndicate of Canadian banks, was renewed on March 19, 2018 to extend the maturity date of the facility from April 2022 to April 2023. The facility is available to fund capital expenditures and for other general corporate purposes. At June 30, 2018, 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, 2018, 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 the credit agreement. We must also ensure that our leverage ratio (total borrowings as a percentage of total borrowings plus shareholders equity) does not exceed 85%. At June 30, 2018, we achieved a debt service coverage ratio of 2.72 and a leverage ratio of 72.2%.

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 fiscal 2018 and 2017 are summarized in the table below:

	Three months ended June 30		
($ millions)	**2018**	**2017**	**Increase (Decrease)**
Cash and cash equivalents, beginning of period	69.9	72.0	(2.1)
Cash from operating activities:			
Net earnings	6.0	17.3	(11.3)
Items not affecting cash	58.6	54.4	4.2
Changes in non-cash operating working capital	(11.5)	6.9	(18.4)
Net interest paid	(18.1)	(17.9)	(0.2)
Cash generated by operating activities	35.0	60.7	(25.7)
Cash (used in) generated by financing activities	(7.1)	36.8	(43.9)
Cash used in investing activities	(46.5)	(97.4)	50.9
Net (decrease) increase in cash and cash equivalents	(18.6)	0.1	(18.7)
Cash and cash equivalents, end of period	51.3	72.1	(20.8)

For the three months ended June 30, 2018, cash generated by operating activities decreased $25.7 million compared to the prior year, primarily due to a decrease in net earnings and changes in working capital (receivables, payables and deferred revenue).

Cash used in financing activities in the three months ended June 30, 2018 was $7.1 million. This amount consisted of $6.6 million repayment of other KfW loans and $0.5 million in repayment of finance lease obligations.

Cash generated by financing activities in the three months ended June 30, 2017 was $36.8 million. This amount consisted of our new $45.3 million loan from KfW IPEX-Bank GmbH partially offset by $7.0 million in repayment of KfW loans and finance lease obligations and $1.5 million in deferred financing costs.

Cash used in investing activities in fiscal 2018 decreased by $50.9 million compared to the prior year, mainly due to a $24.6 million decrease in cash used for capital expenditures; a $25.8 million decrease in cash used for short-term investing; and a $0.5 million change in debt service reserves. (See “Investing in Our Capital Assets” below for detail of significant capital expenditures.)

SUMMARY OF QUARTERLY RESULTS

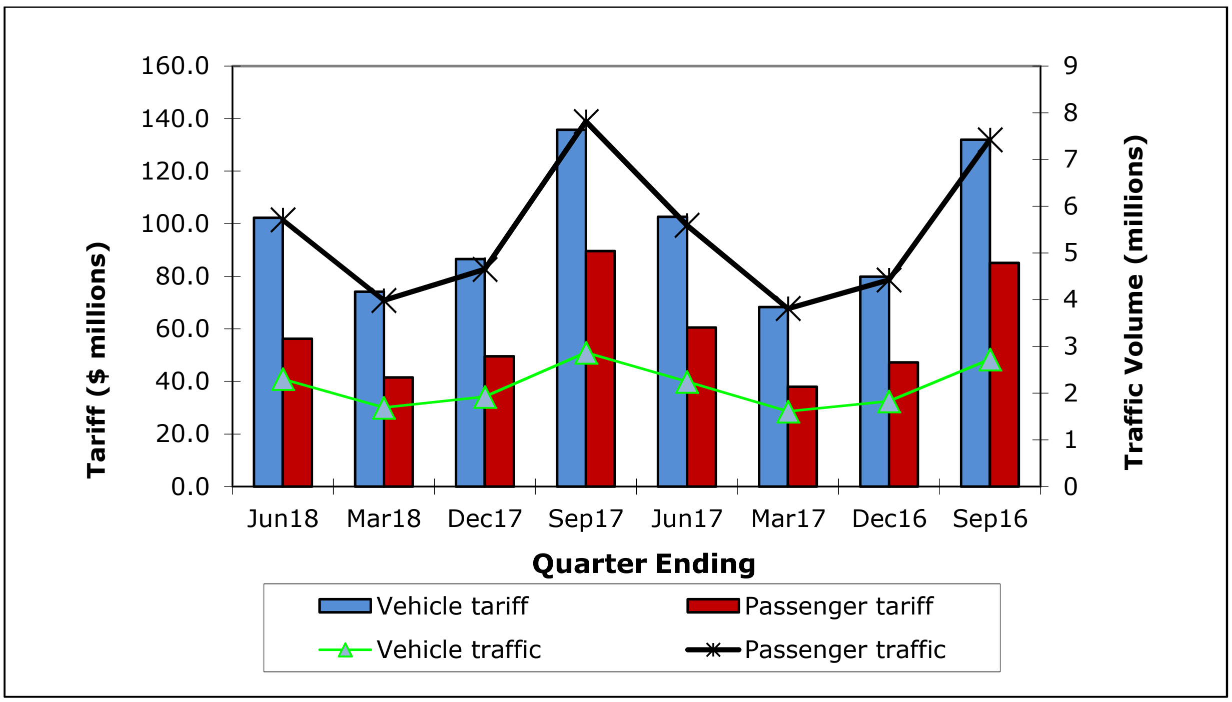
The table below compares earnings by quarter for the most recent eight quarters:

	Quarter Ended (unaudited)							
($ millions)	**Jun 18**	**Mar 18**	**Dec 17**	**Sep 17**	**Jun 17**	**Mar 17**	**Dec 16**	**Sep 16**
Total revenue *	229.7	168.7	195.7	309.9	226.2	157.9	184.0	299.2
Operating profit (loss)	19.8	(27.8)	-	112.6	31.5	(25.8)	9.8	108.5
Net earnings (loss)	6.0	(41.0)	(14.8)	98.4	17.3	(40.8)	(4.0)	95.2

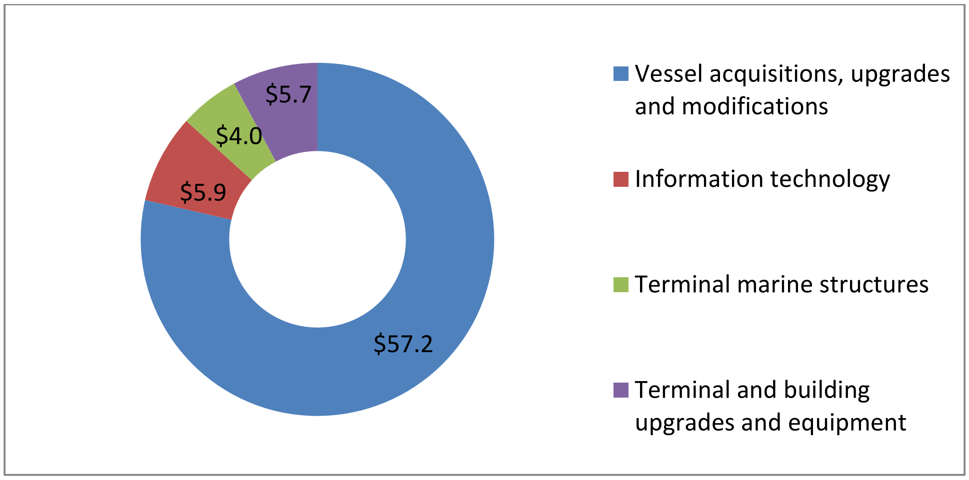
*Previous quarters have been restated for consistency to reflect gross parking revenues, rather than net of parking expenses.

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 federal funding, in the three months ended June 30, 2018 totalled $72.8 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 federal funding, in the three months ended June 30, 2018, included the following:

($ millions)	**June 30, 2018 3 months**
Spirit Class mid-life upgrades	24.4
Major overhauls and inspections	14.3
Northern Sea Wolf and terminal modifications	12.9
New Island Class vessels	6.6
Customer experience program	3.4
Hardware upgrades	1.7
Departure Bay-holding compound remediation	1.6
Tsawwassen-shoreline stabilization	1.2
Various other projects	6.7
	72.8

Spirit Class mid-life upgrades

In March 2016, we awarded contracts totalling $140 million 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* returned to service, after undergoing its mid-life upgrade. The *Spirit of Vancouver Island* is expected to depart for Gdansk, Poland for its mid-life upgrade after the 2018 summer season. 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 ultra-low sulphur marine diesel. We also expect the conversion to result in significant environmental benefits, such as reducing carbon 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.

Major overhauls and inspections

In the three months ended June 30, 2018, we had capital expenditures of $14.3 million in respect of major overhauls and inspections of components of hull, propulsion and generators for four vessels were completed or underway.

Northern Sea Wolf

On April 7, 2017, we finalized an agreement to acquire a 75-metre used vessel to provide a new seasonal direct ferry service between Port Hardy and Bella Coola. 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 of up to $15.1 million from the New Building Canada Fund, of which we recorded $11.8 million in fiscal 2018 and $3.1 million in the three months ended June 30, 2018. On December 15, 2017, the *Northern Sea Wolf* arrived in British Columbia after a 10,097 nautical mile journey from Athens, Greece. The vessel is undergoing extensive upgrades at Esquimalt Drydock Company, a local shipyard, necessary to bring it up to our and Transport Canada's standards of safety and reliability. The *Northern Sea Wolf*, built in 2000, will accommodate approximately 35 vehicles and 150 passenger and crew. Capital expenditures consisted primarily of payments to upgrade the vessel and modify our terminal marine structures.

Island Class vessels

On April 13, 2017, we entered into design and build contracts with Damen Shipyard Group of Netherlands, totalling $60 million 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 $3.1 million in fiscal 2018 and $5.7 million in the three months ended June 30, 2018. The first steel cut for the first and second vessels took place on April 2, 2018 and on April 11, 2018, respectively, followed by the keel laying ceremonies on May 30, 2018. These vessels will each have a capacity of up to 300 passengers and approximately 47 vehicles. When these new vessels are placed into service in early 2020, it will allow us to retire the 60-year old *North Island Princess* and the 54-year old *Howe Sound Queen*. 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.

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. 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 flexible pricing initiatives. Our customer experience program will introduce improved transaction processing and online booking with more choices in fares. During fiscal 2018, we implemented our new 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.

Departure Bay terminal

At Departure Bay, a project to reinstate the structural integrity of the terminal holding compound and the underground utilities completed in May 2018.

Tsawwassen terminal

At Tsawwassen, a project to prevent shoreline erosion and increase stability and drainage on both sides of the causeway is underway and expected to complete in the fall of 2018.

OUTLOOK

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. We are committed to being a company worthy of the public's trust and valued for the services we provide.

Major Investments
In fiscal 2019, our capital spending is projected to be $360 million, excluding external funding, and includes the second of two mid-life upgrades on the Spirit Class vessels, other ongoing vessel replacement projects, and the upgrade of the *Northern Sea Wolf* and modifications to minor terminals for the new seasonal ferry service between Port Hardy and Bella Coola. Our 12-year capital plan addresses the lack of resiliency in our fleet, particularly on the Major Routes where we do not have a spare vessel. With the exception of one minor route vessel, during peak periods, all vessels are either in-service or undergoing refit.

On July 26, 2018, we issued two RFEOIs for the procurement of five new vessels to replace aging fleet assets with the bidding process open to local, national and international shipyards. The first RFEOI is for the construction of four 81-metre Island Class ferries, each with a capacity of 450 passengers and 47 vehicles. The expected delivery date of the first of these two vessels is in 2020, with the following two ships delivered in 2021. The second RFEOI is for the construction of one 107-metre Salish Class vessel with a capacity of 600 passengers and 138 vehicles and an expected delivery date in 2021. The Island Class vessels will be electric hybrid, including batteries, and the Salish Class vessel will be fuelled with LNG. The five new vessels will allow for the retirement of the *Bowen Queen*, *Mayne Queen* and *Powell River Queen* and for the redeployment of some assets around the fleet.

Financial
We expect an increase in total revenue in fiscal 2019, reflecting higher traffic levels, net catering and retail revenues and ferry transportation fees, partially offset by fare reductions.

Our forecast incorporates the introduction of the Fare Flexibility and Digital Experience Initiative. This initiative 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 2019, reflecting higher wage and benefit costs resulting from the implementation of the Collective Agreement, introduction of service on a new route and other service plan changes, partially offset by lower vessel maintenance costs and savings from operating the *Spirit of British Columbia* and the Salish Class vessels on liquefied natural gas. We continue to manage our costs prudently without compromising safe operations.

We expect positive net earnings in fiscal 2019, reflecting increases in discretionary traffic due to favourable economic conditions including the low Canadian dollar and tourism, partially offset by fare reductions.

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 49 through 50 of our fiscal 2018 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2018. Our 2018 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 51 through 54 of our fiscal 2018 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2018. Our 2018 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 consolidated financial statements, which have been prepared in accordance with IFRS.

Our significant accounting policies are contained in note 1 to our March 31, 2018 audited consolidated financial statements and our June 30, 2018 condensed interim 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 55 and 56 of our fiscal 2018 Management's Discussion & Analysis. The following describes the changes to critical accounting policies we have used in the preparation of our condensed interim financial statements for the three months ended June 30, 2018, 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, 2018:

IFRS 15 *Revenue from Contracts with Customers* replaces IAS 18 *Revenue* and IAS 11 *Construction Contracts*, providing guidance on the amount and/or timing of recognition of revenue. We adopted IFRS 15, effective April 1, 2018 using the modified retrospective with cumulative effect method. We have assessed the recognition of our revenues under IFRS 15, using the five-step model. There is no change in our revenue recognition for the majority of our revenues. IFRS 15 requires us to recognize revenue from the expected breakage (a customer's unexercised, contractual rights to receive future services which have not been exercised but for which the customer has made a non-refundable prepayment) when the likelihood of the customer exercising their remaining rights becomes remote. At April 1, 2018, we recognized breakage revenue of $1.2 million from our prepaid stored value card as an increase to opening retained earnings and a decrease to deferred revenue. Also at April 1, 2018, we recognized a $0.3 million increase to deferred revenue and decrease to opening retained earnings to reflect a timing change in revenue recognition for a third party travel voucher. The application of IFRS 15 did not have a significant impact on our unaudited condensed interim financial statements.

IFRS 9 *Financial Instruments* (2014) introduces a new expected credit loss model for calculating impairment, and incorporates guidance on the classification and measurement of financial assets and the final general hedge accounting requirements originally published in IFRS 9 (2013). We adopted *IFRS 9 Financial Instruments* (2013) in fiscal 2015, and as such, were only impacted by the expected credit loss model as we adopted IFRS 9 (2014), effective April 1, 2018. This model applies to our financial assets measured at amortized cost. We have established an expected credit loss for our trade receivables. The application of IFRS 9 did not have a significant impact on our unaudited condensed interim financial statements, as we had an existing provision for impairment.

IFRS 16 *Leases* introduces a single lessee accounting model and 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. We have elected to early adopt IFRS 16, effective April

1, 2018, using the modified retrospective with cumulative effect method and applying 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, we 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.

We recognized nine leases, formerly classified as operating leases, with a total value of $2.9 million, as right-of use assets and with corresponding liabilities. We also reclassified our prepaid land lease and related structures as right-of-use assets.

Future Accounting Changes
The following is a discussion of accounting changes that will be effective for us in future accounting periods:

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. The amendments are effective for us on April 1, 2019. Early adoption is permitted. We are reviewing the amendments to determine the potential effects. We do not expect the application of this standard to have a significant impact on our consolidated financial statements.

The Effect of Rate Regulation

We are regulated by the British Columbia Ferries Commissioner to ensure, among other things, that our tariffs are fair and reasonable. Under the terms of the *Coastal Ferry Act*, the tariffs we charge our customers over a performance term are subject to price caps set by the Commissioner. 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. We are regulated by the Commissioner, and 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, 2018 unaudited condensed interim 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, 2018 and 2017 would be as follows:

($ millions)		**Three months ended June 30**	
		2018	**2017**
Net earnings		6.0	17.3
Changes in net earnings:			
Regulatory asset or liability	**Statement line item**		
Deferred fuel costs			
Fuel costs over (under) set price	Operations expense	0.5	(2.6)
Fuel rebates	Fuel rebates	4.5	4.9
Payments from the Province	Ferry service fees	-	0.1
Increase in total net earnings		5.0	2.4
Adjusted net earnings		11.0	19.7

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.

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, and fiscal 2019 net earnings; our short-term and long-range business plans, capital expenditure levels, asset renewal programs for vessels and terminals, our customer experience program, Fare Flexibility and Digital Experience Initiative, pricing promotions, Salish Class vessels, the agreement with FortisBC Energy Inc. regarding incentive funding, the New Building Canada Fund, alternative fuel options, Spirit Class mid-life upgrades, Island Class vessels, the Bowen Class vessel replacement project, and the direct ferry service between Port Hardy and Bella Coola; our expectations regarding food sales, and sales of quality apparel; total revenue and expense projections, and how our cash requirements will be met in the near term; and our expectations regarding the impact of amendments to IAS19 on our consolidated financial statements. 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 First Nation 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.