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

For the three months ended
June 30, 2016

Dated August 18, 2016

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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, 2016 and has been prepared with the information available as of August 18, 2016. This discussion and analysis should be read in conjunction with our unaudited consolidated financial statements and related notes for the three months ended June 30, 2016 and 2015, and our audited consolidated financial statements and related notes for the years ended March 31, 2016 ("fiscal 2016") and March 31, 2015 ("fiscal 2015"), together with our Management's Discussion & Analysis for fiscal 2016. These documents are available on SEDAR at www.sedar.com and on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

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

BUSINESS OVERVIEW

British Columbia Ferry Services Inc. is an independent company providing passenger and vehicle ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world. We provide frequent year-round transportation service with 34 vessels operating on 24 routes out of 47 terminals spread over 1,000 miles of coastline. We also manage ferry transportation service 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.

We provide a wide range of ferry services for our customers. During the three months ended June 30, 2016 (the first quarter of fiscal 2017), we provided over 42,000 sailings (1,194 more than the same period in the prior year), carrying over five million passengers and two million vehicles. During the three months ended June 30, 2016, passenger traffic increased 2.5% and vehicle traffic increased 5.1% compared to the same quarter in the prior year, and contributed to strong financial performance in the first quarter of fiscal 2017. For a more detailed discussion of our traffic levels, see "Financial and Operational Overview" below.

Significant events during or subsequent to the first quarter of fiscal 2017 include the following:

- On April 1, 2016, certain amendments to the Coastal Ferry Services Contract ("CFSC") became effective. These amendments include the establishment of ferry transportation fees for performance term four ("PT4"), being the four year period ending on March 31, 2020, and changes in the structure for the funding of BC seniors' discounts.

- On April 1, 2016, we implemented average tariff increases in accordance with the Commissioner's Order 15-03 dated September 16, 2015. Tariff increases were 1.9% on average. Also on April 1, 2016, due to lower fuel prices, coupled with the fact that we have, through our fuel hedging program, locked in pricing for a significant portion of our forecast fuel consumption to the end of 2017, a fuel rebate increase of 1.9% was implemented across the system. This completely offset the 1.9% average tariff increase, effectively resulting in no net increase to our customers at the beginning of PT4. Fuel rebates increased from 1.0% to 2.9% on our Major and regulated Other Routes and a fuel rebate of 1.9% was implemented on the Northern Routes.

- On April 25, 2016, the Province confirmed the Government of Canada's expansion of the criteria eligibility for projects to be funded under the New Building Canada Fund. This will provide an opportunity for us to apply for funding for our ferries and related infrastructure.

- On May 17, 2016, we finalized the sale of the 52-year old *Tenaka* to Lady Rose Marine Services of Port Alberni, BC.

- On June 2, 2016, the *Salish Eagle* and the *Salish Raven,* the second and third of our three new Salish (intermediate) Class vessels, were launched and christened at Remontowa Shipbuilding S.A. in Gdansk, Poland. The *Salish Orca* was previously launched and christened on November 24, 2015. The contracts with Remontowa Shipbuilding S.A, with a total value of $165 million, form the majority of the total project budget of $206 million. The original project budget of $252 million has been reduced by $46 million reflecting the elimination of tariffs to import the vessels into Canada. These vessels will be dual-fuel capable, designed to run primarily on liquefied natural gas ("LNG") with marine diesel as a backup. The *Salish Orca* is scheduled for delivery in the third quarter of fiscal 2017, and the *Salish Eagle* and *Salish Raven* are scheduled for delivery in the fourth quarter of fiscal 2017.

Economic Regulatory Environment – PT4

In September 2015, the Commissioner issued Order 15-03 and Order 15-03A. These orders included the following:

- Establishment of the final price cap increase of 1.9% for each of the four years of PT4;
- Incorporation of an efficiency target ($27.6 million over the four years of PT4);
- Requirement for a fuel management plan to be submitted prior to the start of PT4 setting out our strategies for fuel procurement, minimizing fuel consumption and the transition to alternate fuels during PT4;
- Authorization to continue to use fuel cost deferral accounts in PT4;
- Establishment of the set price per litre at 91.5 cents for marine diesel (reduced from 99.0 cents per litre in fiscal 2015);
- Establishment of the set price per litre at 46.4 cents for LNG in the first year of PT4; and
- Incorporation of an inflation factor of 2% per year on the price per litre of both marine diesel and LNG for the balance of PT4. (The set price per litre is a required input into the calculation of fuel surcharges or rebates.)

In addition, the Commissioner reset the price caps to an index level of 100 as of April 1, 2016 based on the weighted average tariffs that existed as at March 31, 2016. The price cap compliance calculation for PT4 was adjusted from the compliance calculation for performance term three ("PT3") by:

- Combining reservation fee revenue with vehicle revenue at the beginning of PT4. The new advance purchase model outlined in the Fare Flexibility and Digital Experience Initiative approved by Order 15-01 will effectively eliminate separate reservation fees and, instead, reservations will be included in variable priced fare products.
- Addressing the impact of the elimination of the funding for BC seniors' discounts in PT4 by recalibrating the seniors' base price level.
- Setting the opening PT4 Price Compliance Index equal to the price cap underage at the end of PT3.

Effective April 1, 2016, the CFSC was amended for PT4 to, among other things, establish ferry transportation fees for the four-year term.

Effective April 1, 2014, we implemented the Province's decision to amend its program to reduce the passenger fare discount for BC seniors travelling Mondays through Thursdays from 100% to 50% on the Major and regulated Other Routes. The CFSC was amended to establish the maximum annual amount payable by the Province in respect of senior discounts. The amounts reflected an estimate of what the Province would have paid if there had been no change in the level of senior discounts. To the extent these funds were not required for the reimbursement of discounts provided to BC seniors under the amended policy, the excess was directed to the ferry transportation fees and allocated to the regulated Northern and Other Routes. Effective April 1, 2016, the CFSC was amended to direct the maximum annual amount payable by the Province in respect of senior discounts entirely to ferry transportation fees.

It was also established that, for price cap calculations, the consolidated route group effective April 1, 2013 will be in effect until March 31, 2020. In the absence of any further amendments, on April 1, 2020, the route group structure in the CFSC will revert back to the structure that was in place at March 31, 2013. The structure at that time was comprised of three individual route groups, being the Major Routes, Northern Routes and Minor Routes.

The Effect of Rate Regulation

We are regulated by the Commissioner to ensure, among other things, that our tariffs are fair and reasonable. Under the terms of the Coastal Ferry Act (the "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 adopted IFRS with a transition date of April 1, 2011. At that time, IFRS did not provide any guidance with respect to accounting for rate-regulated activities.

In January 2014, the International Accounting Standards Board ("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. We believe the obligations represented by the regulatory liabilities at June 30, 2016 will be settled in the future. These regulatory liabilities are considered supplemental disclosures and are detailed in note 15 to our June 30, 2016 unaudited consolidated financial statements.

If IFRS permitted us to report regulatory assets and liabilities in our financial statements, the effect on our net earnings for the three month periods ended June 30, 2016 and 2015 would be as follows:

($ millions)		**Three months ended June 30**	
		2016	**2015**
Net earnings		27.0	18.8
Changes in net earnings:			
Regulatory asset or liability	**Statement line item**		
Deferred fuel costs (a)			
Fuel costs under set price	Operations expense	(3.1)	(1.9)
Fuel rebates	Fuel rebates	4.7	1.6
Payments from the Province	Ferry service fees	-	(0.3)
		1.6	(0.6)
Tariffs in excess of price cap (b)			
Obligation settled during the period	Vehicle and passenger fares	-	(0.9)
Increase (decrease) in total net earnings		1.6	(1.5)
Adjusted net earnings		28.6	17.3

(a) 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. Also, 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.

(b) Tariffs in excess of price cap: The Act contains provisions which ensure that, if the average of tariffs we charge exceeds established price cap, the excess amounts collected will be returned to customers through future tariffs. Average tariffs charged did not exceed price caps at June 30, 2016.

FINANCIAL AND OPERATIONAL OVERVIEW

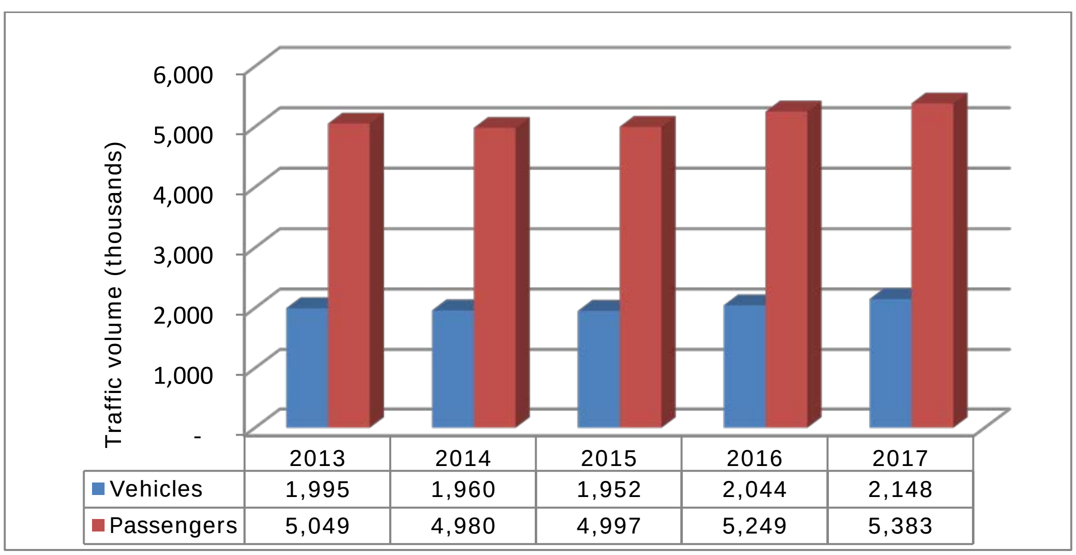
This section provides an overview of our financial and operational performance for the three month periods ended June 30, 2016 and 2015.

	Three months ended June 30			
			Variance	
($ millions)	**2016**	**2015**	**$**	**%**
Total revenue	219.2	209.0	10.2	4.9%
Operating expenses	178.6	175.9	(2.7)	(1.5%)
Operating profit	40.6	33.1	7.5	22.7%
Net finance and other	13.6	14.3	0.7	4.9%
Net earnings	27.0	18.8	8.2	43.6%
Other comprehensive income	10.3	3.5	6.8	194.3%
Total comprehensive income	37.3	22.3	15.0	67.3%

Our net earnings in the three months ended June 30, 2016 were $8.2 million higher, and total comprehensive income was $15.0 million higher, than in the three months ended June 30, 2015. The increase in net earnings during the first quarter of fiscal 2017 reflect the effects of higher traffic levels, higher retail sales, higher ferry transportation fees and lower financing costs, partially offset by lower social program fees and operating cost increases. The April 1, 2016 tariff increases have a net zero impact to our customers, as they were offset by an equal increase in fuel rebates. The increase in other comprehensive income from $3.5 million in the first quarter of fiscal 2016 to $10.3 million in the first quarter of fiscal 2017 reflects the change in the fair value of our fuel swap contracts.

In the first quarter of fiscal 2017, vehicle traffic increased 5.1% and passenger traffic increased 2.5% compared to the same quarter in the prior year. Vehicle and passenger traffic on our Major, Northern and regulated Other Routes increased. Overall, commercial traffic increased by 10.7% in the quarter, while drop-trailer traffic, a component of commercial traffic, increased by 7.2% in the same period.

The following graph illustrates our vehicle and passenger traffic levels for the first quarter of fiscal 2013 through fiscal 2017:



Safety and Environment
We are dedicated to the safety and well-being of customers and employees at our terminals and on board our vessels, which includes dealing with medical incidents such as passenger illnesses and injuries. We have more than 800 employees who, in addition to their normal duties, are trained as Occupational First Aid Attendants. In addition, we respond to requests from BC Ambulance Service that range from assembling a crew to make unscheduled sailings for medical patients to holding a vessel in dock or turning one around for medical emergencies.

We received the Certificate of Recognition ("COR") from WorkSafeBC in fiscal 2014. A COR recognizes companies that go beyond the legal requirements of the *Workers' Compensation Act* and the Occupational Health & Safety Regulations by taking a best practices approach to implementing health, safety and return to work programs. In fiscal 2015, the COR audit resulted in a combined score of 94.1%. In fiscal 2016, the COR audit resulted in a 96% score in Health and Safety and 92% score in Injury Management, for a combined score of 95.7%. In the three months ended June 30, 2016, WorkSafeBC provided us with a $566,000 rebate on our 2015 assessed premiums as a result of the audit. In fiscal 2014 and 2015, WorkSafeBC provided us with a rebate on each of our 2013 and 2014 assessed premiums of approximately $600,000.

We are also dedicated to safeguarding the environment. We have training programs in place that include training our staff in environmental awareness and first response to an oil spill and we conduct regularly scheduled oil spill drills on our vessels and at our terminals. We monitor all environment spills and in the three months ended June 30, 2016, we experienced three minor environmental incidents. Our aging vessels can experience mechanical issues from time to time that may result in small oil leaks. Two of our aged vessels, the 51-year old *Queen of Burnaby* and the 52-year old *Queen of Nanaimo*, will be replaced by the *Salish Orca* and the *Salish Eagle* respectively.

We were recently recognized at the annual Green Marine conference as a top performer. The company was recognized for achieving eight levels of improvement in performance indicators over last year's evaluation. We joined Green Marine in late 2014 and were certified by an independent verifier in May 2015. Green Marine is a globally recognized, voluntary, industry sustainability initiative for ship operators, ports, terminals and shipyards.

Training
Each year we invest heavily in operational and safety training.

In the first quarter of fiscal 2017, over 12,000 days of operational and Standardized Education and Assessment ("SEA") training were provided to employees. In preparation for the busy summer season, training programs for seasonal employees focused on first aid and safety, including passenger safety and emergency evacuation systems as well as job specific requirements.

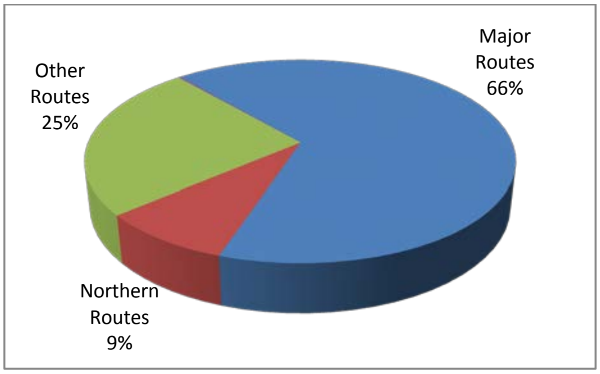
By the end of June 30, 2016, through our Bridge Team Simulation training program, we had delivered Bridge Operations Skills and Systems Level 2 to 57% and Level 3 to 17% of deck officers in the fleet to continue to strengthen their knowledge, situational awareness and decision making skills.

Our SEA program is continuing to develop and a pilot project continues for a career navigator system which will assist in planning and tracking employee career progression and succession and support employee engagement and retention.

We continue to prepare a collaborative training plan for familiarization with the new equipment on the Salish Class vessels, including LNG Safety Awareness training. This LNG training material will also be utilized for the employees on the Spirit Class vessels as the mid-life upgrades on the Spirit Class vessels include conversion to dual-fuel capability.

Revenue

The following discussions of revenue are based on IFRS results, with reference to the impacts of rate regulation.



In the three months ended June 30, 2016, the greatest portion of our revenues (66%) was earned on our Major Routes. Revenue from the Northern Routes contributed 9% and revenue from Other Routes contributed 25%.

Select operational statistics and total revenues for the three months ended June 30, 2016 compared to the same period in the prior year are shown in the tables below.

	Three months ended June 30	
Operational Statistics	**2016**	**2015**
Vehicle traffic	2,148,116	2,044,346
Passenger traffic	5,383,124	5,249,478
On-time performance	88.0%	89.5%
Number of round trips	19,224	18,618
Capacity provided (AEQs)	4,344,308	4,197,417
AEQs carried	2,455,327	2,330,718
Capacity utilization	56.5%	55.5%

In the three months ended June 30, 2016, vehicle traffic increased 5.1% and passenger traffic increased 2.5% compared to the same quarter in the prior year. Overall, traffic during the first quarter of fiscal 2017 was favourably impacted by an increase in domestic tourism, lower fuel prices and other economic activity in British Columbia which made travel by vehicle more attractive. The percentage increase in passenger traffic was lower than the percentage increase in vehicle traffic mainly due to incremental passenger traffic in the same period of the prior year resulting from the Easter holiday and the 2015 FIFA Women's World Cup.

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 unusually high traffic demand. Meeting customer service expectations in a safe and reliable manner is an important factor in our focus on on-time performance. On-time performance on the Major and Northern Routes was marginally better, however on the Other Routes there was a pronounced drop as discussed below.

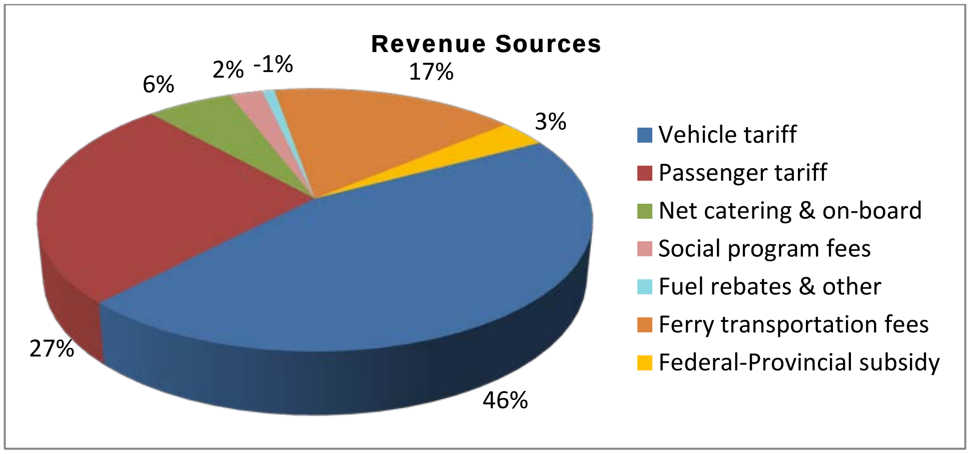
Minimum crewing levels are set by Transport Canada and these levels determine our maximum allowable passenger capacity for each sailing. Passengers are counted as they arrive for a sailing, both as a walk-on and by vehicle, to ensure we do not exceed the maximum allowable passenger capacity.

Vehicle capacity provided, measured in automobile equivalents ("AEQs"), is the available vehicle deck space on a vessel multiplied by the number of round trips. Round trips normally stay fairly stable as the CFSC stipulates, among other things, the minimum number of round trips to be provided for each regulated ferry service route. 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, 2016, we provided 606 additional round trips, resulting in an increase in capacity provided compared to the same quarter in the prior year.

An AEQ is a 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 vehicles types (the relative number of buses, commercial vehicles, and passenger vehicles), and actual size of vehicles carried.

Capacity utilization 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 to 56.5% from 55.5% for the three months ended June 30, 2016, 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)**	
	2016	**2015**	**$**	**%**
Direct Route Revenue				
Vehicle tariff	100.3	91.6	8.7	9.5%
Passenger tariff	58.1	55.8	2.3	4.1%
Fuel rebates	(4.7)	(1.6)	(3.1)	(193.8%)
Net retail	13.1	12.2	0.9	7.4%
Social program fees	5.0	7.0	(2.0)	(28.6%)
Other revenue	2.3	2.1	0.2	9.5%
Total Direct Route Revenue	174.1	167.1	7.0	4.2%
Indirect Route Revenue				
Ferry transportation fees	37.2	34.3	2.9	8.5%
Federal-Provincial subsidy	7.3	7.2	0.1	1.4%
Total Route Revenue	218.6	208.6	10.0	4.8%
Other general revenue	0.6	0.4	0.2	50.0%
Total Revenue	219.2	209.0	10.2	4.9%



Vehicle tariffs (which include reservation fee revenue) and passenger tariffs account for the majority of our revenues. Our year-over-year tariff revenues may be impacted by such things as changes in overall traffic levels, tariffs and the proportion of total traffic on routes with higher versus lower tariffs. Retail service is our second highest source of direct revenue and provides a gross margin of approximately 60%. Catering, retail and other on-board services are impacted by traffic, price, service quality and product offerings.

On April 1, 2016, we implemented tariff increases in accordance with the Commissioner's Order 15-03 dated September 16, 2015. Tariff increases were 1.9% on average. These increases are directly associated with increased operating costs, capital replacement and labour.

Surcharges and/or rebates are implemented as a direct result of rising and declining fuel prices. On April 1, 2016, due to lower fuel prices, coupled with the fact that we have, through our fuel hedging program, locked in pricing for a significant portion of our forecast fuel consumption to the end of fiscal 2018, we implemented a fuel rebate increase of 1.9% across the system. Fuel rebates increased from 1.0% to 2.9% on our Major and regulated Other Routes and a fuel rebate of 1.9% was implemented on the Northern Routes. Prior to April 1, 2016, no rebates or surcharges were in place on our Northern Routes. For the purpose of rate regulation, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" for more detail.)

In the three months ended June 30, 2015, social program fees included $2.4 million in senior discounts. In the three months ended June 30, 2016, social program fees decreased $2.0 million and ferry transportation fees increased $2.9 million, mainly as a result of the funding for seniors' discounts being included in ferry transportation fees as of April 1, 2016, as discussed above.

From time–to-time, we utilize promotional fares designed to stimulate growth in traffic, to direct traffic towards our less busy sailings and/or to ensure we are in compliance with approved price cap orders. The utilization of promotional fare incentives is one factor that may cause the average vehicle and passenger tariff rate to be under or over the allowed price cap in any one period. Under the Act, we cannot be over price cap for more than four consecutive quarters.

Year-to-year changes in operational statistics and revenue for the three months ended June 30, 2016 and 2015 for the Major, Northern and Other Routes are discussed separately below.

Major Routes

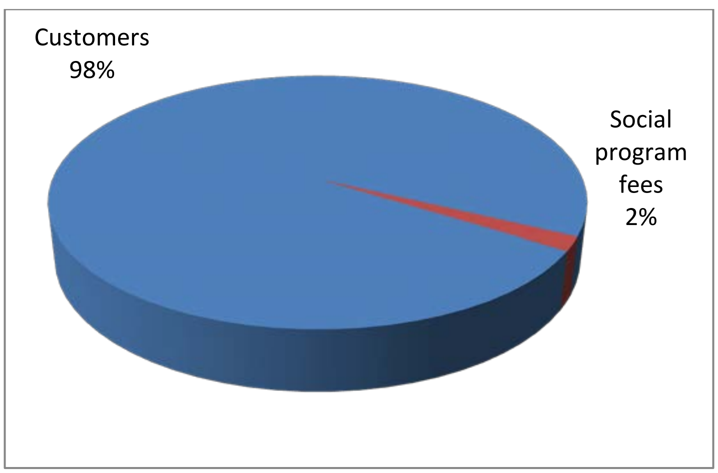
Our Major Routes consist of three regulated routes connecting Metro Vancouver with mid and southern Vancouver Island and our regulated route connecting Horseshoe Bay and Langdale. These are our four busiest routes, carrying approximately 60% of our vehicle traffic and 64% of our passenger traffic during the three month periods ended June 30, 2016 and 2015.

Operational Statistics	Three months ended June 30 2016	Three months ended June 30 2015
Vehicle traffic	1,282,364	1,226,265
Passenger traffic	3,471,058	3,398,980
On-time performance	73.4%	73.1%
Number of round trips	3,184	3,134
Capacity provided (AEQs)	2,297,406	2,254,370
AEQs carried	1,527,843	1,451,881
Capacity utilization	66.5%	64.4%

In the three months ended June 30, 2016, vehicle traffic increased 4.6% and passenger traffic increased 2.1% compared to the same period in the prior year. Overall, commercial traffic increased 12.4% in the quarter, while drop-trailer traffic, a component of total commercial traffic, increased 7.2% in the same period. Traffic during the first quarter of fiscal 2017 was favourably impacted by lower fuel prices, the lower Canadian dollar and a general increase in tourism and other economic activity in British Columbia.

On-time performance during the first quarter of fiscal 2017 was marginally improved compared to the same period in the prior period. Notably, the on-time performance on the route connecting Horseshoe Bay and Langdale improved to 63.0% from 56.7% compared to the same period in the prior year as a result of additional trips to reduce the amount of overloads. This was partially offset by a reduction of on-time performance from 91.0% to 84.1% due to heavy traffic demand on the route connecting Duke Point to Tsawwassen.

Utilization on these routes during the three months ended June 30, 2016 was higher compared to the same period in the prior year mainly 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.



In the three months ended June 30, 2016, revenue from our Major Routes consisted of 98% from customers and 2% from the Province.

Major Routes cont'd

Revenue ($ thousands)	Three months ended June 30			
	2016	**2015**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	85,133	77,543	7,590	9.8%
Passenger tariff	47,327	45,568	1,759	3.9%
Fuel rebates	(3,854)	(1,354)	(2,500)	(184.6%)
Net retail	11,788	11,063	725	6.6%
Social program fees	2,551	3,892	(1,341)	(34.5%)
Parking	1,267	1,225	42	3.4%
Other revenue	984	790	194	24.6%
Total Direct Route Revenue	145,196	138,727	6,469	4.7%
Indirect Route Revenue				
Ferry transportation fees	-	236	(236)	(100.0%)
Total Route Revenue	145,196	138,963	6,233	4.5%

Average tariff ($)	Three months ended June 30		
	2016	**2015**	**Increase**
Vehicle tariff ($000's)	85,133	77,543	
Vehicle traffic	1,282,364	1,226,265	
Average tariff per vehicle	66.39	63.24	3.15
Passenger tariff ($000's)	47,327	45,568	
Passenger traffic	3,471,058	3,398,980	
Average tariff per passenger	13.63	13.41	0.22

In the three months ended June 30, 2016, average tariff revenue per vehicle increased $3.15 or 5.0% compared to the same period in the prior year. Average tariff revenue per passenger during the same period increased $0.22 or 1.6%. The increase in average tariff revenues reflects the price cap increase authorized by the Commissioner. The average tariff per vehicle also reflects an increase in revenue from reservation fees due to higher traffic and higher usage. The increase in both traffic levels and in average fares during the first quarter of fiscal 2016 resulted in a tariff revenue increase of $9.3 million compared to the same period in the prior year.

On April 1, 2016, due to lower fuel prices, coupled with the fact that we have, through our fuel hedging program, locked in pricing for a significant portion of our forecast fuel consumption to the end of fiscal 2018, we implemented a fuel rebate increase from 1% to 2.9% on our Major Routes. Fuel rebates of 1.0% were in place on our Major Routes in the first quarter of fiscal 2016. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

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, 2016, net retail sales increased 6.6% 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 75% of the total retail revenue. Sales of quality apparel continue to grow and now comprise over 10% 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 BC seniors, students travelling to and from school, persons with disabilities and persons travelling under the Ministry of Health Travel Assistance Program ("MTAP"). In the three months ended June 30, 2015, social program fees included $1.5 million in seniors' discounts. In the three months ended June 30, 2016, social program fees decreased $1.3 million, mainly as a result of the funding for seniors' discounts being included in ferry transportation fees as of April 1, 2016 (and allocated to the Northern and regulated Other Routes), partially offset by more students travelling and an increase in the number of people using the MTAP program.

Revenue from parking increased as a result of higher traffic levels and proportionately higher usage.

In fiscal 2016, ferry transportation fees on the Major Routes represented funds received from the Province related to the import duty remission on one of our foreign-built vessels. As discussed above, effective April 1, 2016, the CFSC was amended and all ferry transportation fees are now allocated to the Northern and regulated Other Routes.

Northern Routes

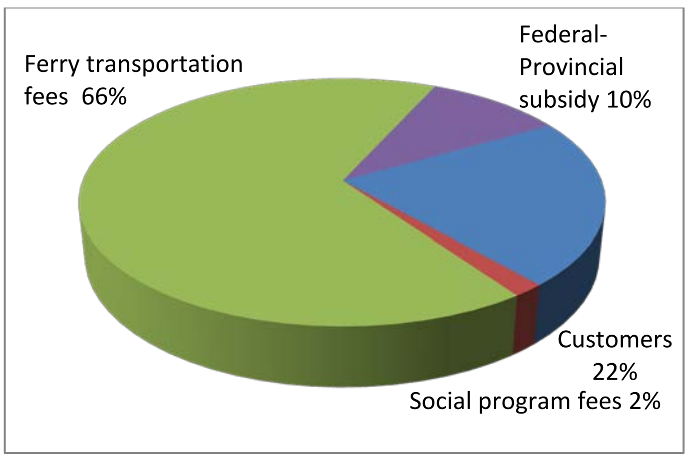
Our Northern Routes consist of two regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island.

Operational Statistics	Three months ended June 30 2016	2015
Vehicle traffic	7,102	6,358
Passenger traffic	18,995	17,589
On-time performance	90.3%	89.8%
Number of round trips	54	49
Capacity provided (AEQs)	13,032	12,107
AEQs carried	8,799	7,960
Capacity utilization	67.5%	65.7%

In the three months ended June 30, 2016, vehicle traffic increased 11.7% and passenger traffic increased 8.0% compared to the same period in the prior year. Traffic during the first quarter of fiscal 2017 was favourably impacted by lower fuel prices, the lower Canadian dollar and a general increase in tourism and other economic activity in British Columbia.

On-time performance in the three months ended June 30, 2016 improved by 0.5% from 89.8% to 90.3% over the same period in the prior year.

Capacity utilization on these routes during the three months ended June 30, 2016 was 1.8% higher than the same period in the prior year as a result of a higher number of AEQs carried offset by increased capacity provided due to an increase in the number of round trips.



In the three months ended June 30, 2016, revenue from our Northern Routes consisted of 22% from customers and 78% from the Province (2% social program fees, 66% ferry transportation fees, and 10% from payments under the Federal-Provincial subsidy agreement).

Northern Routes cont'd

Revenue ($ thousands)	**Three months ended June 30**			
	2016	**2015**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	2,001	1,863	138	7.4%
Passenger tariff	1,550	1,414	136	9.6%
Fuel (rebates) surcharges	(75)	-	(75)	-
Net retail	217	156	61	39.1%
Social program fees	317	328	(11)	(3.4%)
Stateroom rental	374	334	40	12.0%
Hostling & other	63	65	(2)	(3.1%)
Total Direct Route Revenue	4,447	4,160	287	6.9%
Indirect Route Revenue				
Ferry transportation fees	12,535	11,372	1,163	10.2%
Federal-Provincial subsidy	1,870	1,843	27	1.5%
Total Route Revenue	18,852	17,375	1,477	8.5%

Average tariff ($)	**Three months ended June 30**		
	2016	**2015**	**(Decrease) Increase**
Vehicle tariff ($000's)	2,001	1,863	
Vehicle traffic	7,102	6,358	
Average tariff per vehicle	281.75	293.02	(11.27)
Passenger tariff ($000's)	1,550	1,414	
Passenger traffic	18,995	17,589	
Average tariff per passenger	81.60	80.39	1.21

In the three months ended June 30, 2016, average tariff revenue per vehicle decreased $11.27 or 3.8% compared to the same period in the prior year. Average tariff revenue per passenger during the same period increased $1.21 or 1.5%. Average tariff revenues reflect a change in the proportion of traffic on routes with lower versus higher tariffs and the price cap increase authorized by the Commissioner. The increase in traffic levels and changes in average fares, during the first quarter of fiscal 2016 resulted in a total tariff revenue increase of $0.3 million compared to the same period in the prior year.

On April 1, 2016, due to lower fuel prices, coupled with the fact that we have, through our fuel hedging program, locked in pricing for a significant portion of our forecast fuel consumption to the end of fiscal 2018, we implemented a fuel rebate of 1.9% on our Northern Routes. There were no fuel surcharges or rebates in place on our Northern Routes in the first quarter of fiscal 2016.

Reimbursements from the Province for social program fees decreased mainly as a result of the funding for seniors' discounts being included in ferry transportation fees as of April 1, 2016, and partially offset by an increase in the fees received from the MTAP program.

Revenue from net retail services increased $61,000 or 39.1% in the quarter compared to the same period in the prior year mainly as a result of higher passenger levels.

Stateroom rental revenue increased $40,000 or 12.0% due to higher passenger levels and increased utilization.

Ferry transportation fees received from the Province increased $1.2 million in the quarter compared to the same period in the prior year as a result of the following:

- $1.3 million increase as a result of additional funding from the Province and the differences in the monthly schedule of round trips (fiscal 2017 ferry transportation fees which include BC seniors discounts, are expected to be $4.6 million higher than the prior fiscal year); and
- $0.1 million decrease in fees related to a lower fuel price. For regulatory purposes, the amounts received from or paid to the Province relating to the price of fuel are applied to our deferred fuel cost accounts (see “The Effect of Rate Regulation” above for more detail).

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

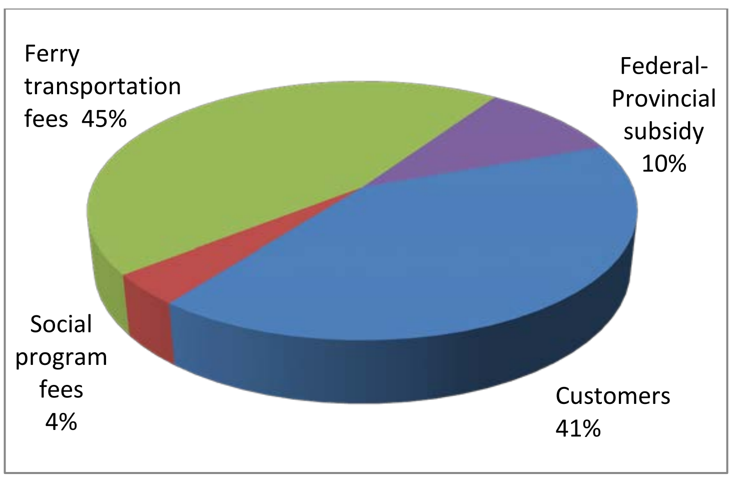
Other Routes

Our Other Routes consist of 18 regulated routes and 8 small unregulated routes primarily serving the northern and southern Gulf Islands and the northern Sunshine Coast. One of the regulated routes and all 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 in the table below. Operational statistics for the unregulated routes are not incorporated in the following analysis.

	Three months ended June 30	
Operational Statistics	**2016**	**2015**
Vehicle traffic	858,650	811,723
Passenger traffic	1,893,071	1,832,909
On-time performance	90.5%	92.5%
Number of round trips	15,986	15,435
Capacity provided (AEQs)	2,033,870	1,930,940
AEQs carried	918,685	870,877
Capacity utilization	45.2%	45.1%

In the three months ended June 30, 2016, vehicle traffic increased 5.8% and passenger traffic increased 3.3% compared to the same period in the prior year. Traffic during the first quarter of fiscal 2017 was favourably impacted by lower fuel prices, the lower Canadian dollar and a general increase in tourism and other economic activity in British Columbia.

Capacity utilization on these routes during the three months ended June 30, 2016 was marginally higher compared to the same period in the prior year, with a higher number of AEQs carried offset by increased capacity provided due to additional round trips.



In the three months ended June 30, 2016, revenue from our Other Routes consisted of 41% from customers and 59% from the Province (4% social program fees, 45% ferry transportation fees, and 10% from payments under the Federal-Provincial subsidy agreement).

Other Routes cont'd

Revenue ($ thousands)	**Three months ended June 30**			
	2016	**2015**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	13,099	12,239	860	7.0%
Passenger tariff	9,254	8,786	468	5.3%
Fuel (rebates) surcharges	(770)	(273)	(497)	182.1%
Social program fees	2,122	2,730	(608)	(22.3%)
Net retail	742	700	42	6.0%
Parking & other	68	68	-	-
Total Direct Route Revenue	24,515	24,250	265	1.1%
Indirect Route Revenue				
Ferry transportation fees	24,631	22,700	1,931	8.5%
Federal-Provincial subsidy	5,419	5,340	79	1.5%
Total Route Revenue	54,565	52,290	2,275	4.4%

Average tariff ($)	**Three months ended June 30**		
	2016	**2015**	**Increase**
Vehicle tariff ($000's)	13,099	12,239	
Vehicle traffic	858,650	811,723	
Average tariff per vehicle	15.26	15.08	0.18
Passenger tariff ($000's)	9,254	8,786	
Passenger traffic	1,893,071	1,832,909	
Average tariff per passenger	4.89	4.79	0.10

In the three months ended June 30, 2016, average tariff revenue per vehicle increased $0.18 or 1.2% compared to the same period in the prior year. Average tariff revenue per passenger during the same period increased $0.10 or 2.1%. The increase in average tariff revenues reflects the price cap increase authorized by the Commissioner and a change in the proportion of traffic on routes with higher versus lower tariffs. The increase in both traffic levels and average fares, during the first quarter of fiscal 2016 resulted in a total tariff revenue increase of $1.3 million compared to the same period in the prior year.

On April 1, 2016, due to lower fuel prices, coupled with the fact that we have, through our fuel hedging program, locked in pricing for a significant portion of our forecast fuel consumption to the end of fiscal 2018, we implemented a fuel rebate increase from 1% to 2.9%. Fuel rebates of 1.0% were in place in the first quarter of fiscal 2016. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

In the three months ended June 30, 2015, social program fees included $0.8 million in seniors' discounts. In the three months ended June 30, 2016, social program fees decreased $0.6 million, mainly as a result of funding for seniors' discounts being included in ferry transportation fees as of April 1, 2016 and partially offset by more students travelling and an increase in the number of people using the MTAP program.

Revenue from net retail services increased by $42,000 or 6.0% compared to the same period in the prior year as a result of both higher passenger traffic and higher average sales per passenger. Cost of goods sold is approximately 40% of total retail revenues.

Ferry transportation fees received from the Province increased $1.9 million in the quarter compared to the same period in the prior year, primarily as a result of additional funding in PT4 from the Province (fiscal 2017 ferry transportation fees, which include funding for seniors' discounts, are expected to be $4.4 million higher than the prior fiscal year).

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

Expenses
Expenses for the three months ended June 30, 2016 and 2015 are summarized in the table below:

Operating expenses ($ millions)	**Three months ended June 30**			
			Increase (Decrease)	
	2016	**2015**	**$**	**%**
Operations	112.7	112.2	0.5	0.4%
Maintenance	21.1	20.6	0.5	2.4%
Administration	8.0	8.0	0.0	-
Total operations, maintenance & administration	141.8	140.8	1.0	0.7%
Depreciation and amortization	36.8	35.1	1.7	4.8%
Total operating expenses	178.6	175.9	2.7	1.5%

We continue to take proactive measures to contain, reduce and optimize expenses while operating a sustainable, safe and reliable service.

In the three months ended June 30, 2016, operations expenses increased $0.5 million compared to the same period in the prior year mainly due to:

- $2.4 million increase in wages and benefits costs, mainly due to a bargaining unit wage rate increase of 1.5% effective April 1, 2016 in accordance with the Collective Agreement, an increase in overtime and an increase in hours spent in training activities; and
- $0.7 million increase in insurance claims, credit card fees, promotional costs and travel expenses;

partially offset by:

- $2.6 million decrease in fuel expense reflecting a $3.4 million or 12.7% decrease in fuel prices, partially offset by a $0.8 million or 3.0% increase in fuel consumption primarily from additional round trips provided. While IFRS does not permit accounting for rate-regulated entities, we are, in fact, rate-regulated. For purposes of rate regulation, $3.1 million over our actual fuel expense in the three months ended June 30, 2016 is recorded in deferred fuel cost accounts which is expected to be settled through fuel rebates. (See "The Effect of Rate Regulation" above for more detail.)

Maintenance costs were $0.5 million higher in the three months ended June 30, 2016 compared to the same period in the prior year as a result of variations in vessel refit scheduling and increased terminal maintenance.

Administration costs were consistent to the same period in the prior year.

Depreciation and amortization increased $1.7 million compared to the same period in the prior year reflecting higher depreciation resulting from the new capital assets that have entered service. (See "Investing in our Capital Assets" below for details of significant capital asset expenditures.)

Net finance and other expenses	**Three months ended June 30**			
($ millions)			**Increase (Decrease)**	
	2016	**2015**	**$**	**%**
Finance expense				
Bond interest	14.4	14.3	0.1	0.7%
KfW bank group (KfW) loans	1.3	1.5	(0.2)	(13.3%)
Interest on finance lease	0.5	0.5	-	-
Short-term debt	0.1	0.1	-	-
Capitalized interest	(1.9)	(1.2)	(0.7)	58.3%
Total finance expense	14.4	15.2	(0.8)	(5.3%)
Less: finance income	(1.0)	(0.9)	(0.1)	11.1%
Net finance expense	13.4	14.3	(0.9)	(6.3%)
Loss on disposal and revaluation of property, plant and equipment, intangible assets and inventory	0.2	-	0.2	-
Total net finance and other expenses	13.6	14.3	(0.7)	(4.9%)

In the three months ended June 30, 2016, net finance and other expenses decreased $0.7 million compared to the same periods in the prior year mainly due to:

- $0.7 million increase in capitalized interest in the quarter; and
- $0.2 million decrease in interest on KfW loans, reflecting $3.8 million in principal repayments;

partially offset by:

- $0.2 million increase loss on disposal and revaluation of property, plant and equipment, intangible assets and inventory.

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.

On November 12, 2015, we executed an export loan agreement with KfW IPEX-Bank GmbH, a German export credit bank. This loan agreement is secured under the Master Trust Indenture (May 2004) and allows for three loans of up to $45 million each. These amortizing loans will be repaid over a 12-year term and bear an annual interest rate of 2.09%. The net proceeds will be used to partially finance the purchase of our three new Salish Class vessels and will coincide with the conditional acceptance of each of the vessels from the shipyard. No amounts have been drawn under the loan agreement.

In the near term, we expect that our cash requirements will be met through operating cash flows, the three new KfW loans, and by accessing our credit facility from time to time. At June 30, 2016, our unrestricted cash and cash equivalents and other short-term investments totalled $136 million.

Our $155 million credit facility was renewed on March 15, 2016 to extend the maturity date of the facility from April 2020 to April 2021. The facility is available to fund capital expenditures and for other general corporate purposes. At June 30, 2016, 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. Our credit ratings at June 30, 2016 were “A” (DBRS) with a stable trend and “AA-” (Standard & Poor’s) with a stable outlook.

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. At June 30, 2016 we achieved a leverage ratio of 76.7% and a debt service ratio of 3.22.

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

Sources and uses of cash and cash equivalents for the three months ended June 30, 2016 and 2015 are summarized in the table below:

	Three months ended June 30		
($ millions)	**2016**	**2015**	**Increase (Decrease)**
Cash and cash equivalents, beginning of period	79.1	65.6	13.5
Cash from operating activities:			
Net earnings	27.0	18.8	8.2
Items not affecting cash	51.7	51.9	(0.2)
Changes in non-cash operating working capital	(20.0)	(16.0)	(4.0)
Net interest paid	(17.6)	(18.1)	0.5
Cash generated by operating activities	41.1	36.6	4.5
Cash used in financing activities	(4.1)	(4.0)	(0.1)
Cash used in investing activities	(38.0)	(28.2)	(9.8)
Net (decrease) increase in cash and cash equivalents	(1.0)	4.4	(5.4)
Cash and cash equivalents, end of period	78.1	70.0	8.1

For the three months ended June 30, 2016, cash generated by operating activities increased by $4.5 million compared to the same period in the prior year, primarily due to an increase in net earnings reflecting the impact of increased traffic levels, higher revenues and lower financing costs, partially offset by higher operating expenses.

Cash used in financing activities in the three months ended June 30, 2016 was $4.1 million. This amount consisted of $3.7 million in repayment of KfW loans and $0.4 million repayment of finance lease obligations.

Cash used in financing activities in the three months ended June 30, 2015 was $4.0 million. This amount consisted of $3.7 million in repayment of KfW loans and $0.3 million repayment of finance lease obligations.

Cash used in investing activities in the three months ended June 30, 2016 increased by $9.8 million compared to the same period in the prior year, due to a $9.5 million increase in cash used for capital expenditures and $0.3 million provided by short-term investments. (See “Investing in Our Capital Assets” below for detail of significant capital expenditures.)

SUMMARY OF QUARTERLY RESULTS

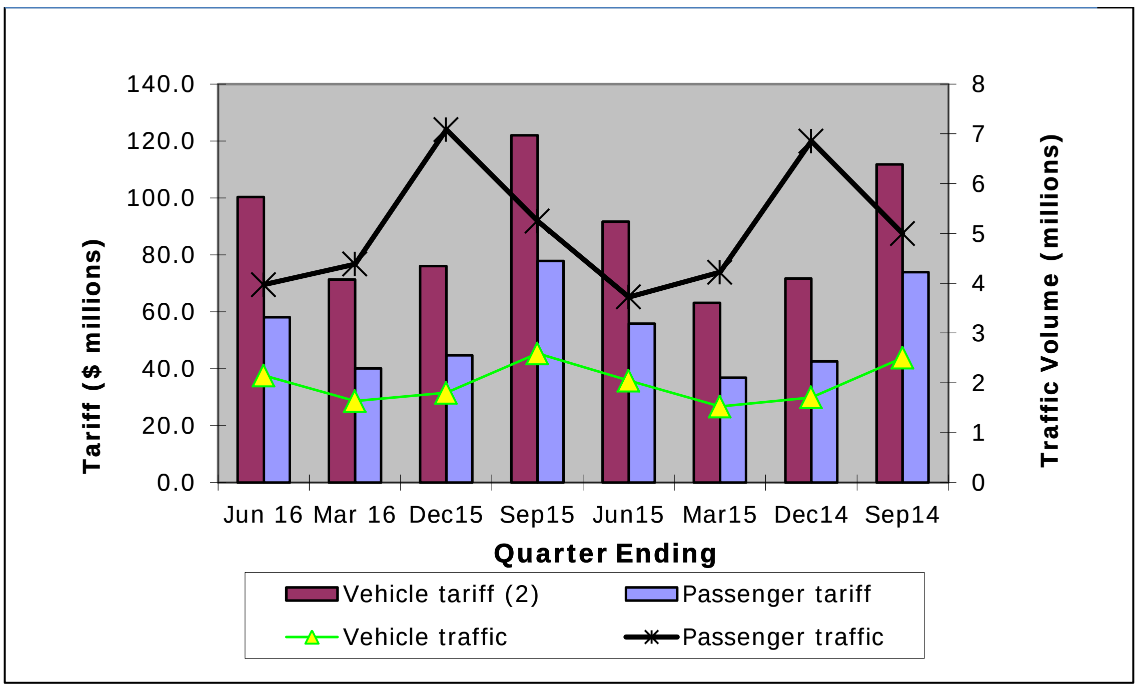
The table below compares earnings and comprehensive income by quarter for the most recent eight quarters:

($ millions)	Quarter Ended (unaudited)							
	Jun 16	**Mar 16**	**Dec 15**	**Sep 15**	**Jun 15**	**Mar 15**	**Dec 14**	**Sep 14**
Total revenue (1)	219.2	166.3	178.7	280.6	209.0	55.3	175.2	273.1
Operating profit (loss)	40.6	(16.2)	10.2	98.5	33.1	(11.8)	8.2	91.6
Net earnings (loss)	27.0	(30.0)	(3.7)	84.5	18.8	(35.1)	(6.1)	76.4
Other comprehensive income (loss)	10.3	(12.0)	(11.7)	(3.6)	3.5	2.7	(7.4)	(2.9)
Total comprehensive income (loss)	37.3	(42.0)	(15.4)	80.9	22.3	(32.4)	(13.5)	73.5

(1) Total revenue is net of cost of retail goods sold.

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:



(2) Effective April 1, 2016, vehicle tariff includes reservation fees. For comparative purposes, all quarters reflect this change.

Capital Expenditures
Capital expenditures in the three months ended June 30, 2016 totalled $45.9 million.

	($ millions)
Vessel upgrades and modifications	30.8
Information technology	7.9
Terminal marine structures	5.4
Terminal and building upgrades and equipment	1.8
Total capital expenditures	45.9

Vessels
Capital expenditures for new vessels, as well as vessel upgrades and modifications in the three months ended June 30, 2016, included the following:

	($ millions)
Spirit Class mid-life upgrades	13.1
Major overhauls and inspections	7.4
New Salish Class vessels	4.8
Queen of Surrey ¾-life upgrade	2.1
Queen of Cumberland mid-life upgrade	1.5
Navigational equipment upgrades	0.6
Other projects	1.3
	30.8

On March 24, 2016, we announced the award of a contract totalling $140 million to Remontowa Ship Repair Yard S.A. to conduct the mid-life upgrades, including conversion to dual-fuel, of our two largest vessels, the *Spirit of Vancouver Island* and the *Spirit of British Columbia*. In the first quarter of fiscal 2017, expenditures of $13.1 million mainly consisted of the second milestone payment in accordance with the contract payment schedule for each vessel. The mid-life upgrade of the *Spirit of British Columbia* is expected to be completed during the spring of 2018 and the mid-life upgrade of the *Spirit of Vancouver Island* is expected to be completed the following year. We expect the conversion of these vessels to result in substantial savings, as LNG costs considerably less than marine diesel. It also has significant environmental benefits such as reducing CO_2 emissions by approximately 12,000 tonnes annually, which is the equivalent of taking approximately 2,500 vehicles off the road per year.

The $7.4 million in major overhauls and inspections of components of hull, propulsion and generators completed in the quarter ended June 30, 2016 or currently underway include:
- $1.6 million for the *Northern Expedition*;
- $1.5 million for the *Kahloke*;
- $1.4 million for the *Queen of Surrey*;
- $1.0 million for the *Coastal Celebration;* and
- $1.9 million for the *Spirit of Vancouver Island, Spirit of British Columbia, Queen of Cumberland* and the *Queen of Cowichan.*

In July 2014, we entered into contracts with Remontowa Shipbuilding S.A. of Gdansk, Poland to build three new Salish (intermediate) Class vessels. The contracts, with a total value of $165 million, form the majority of the total project budget of $206 million. The original project budget of $252 million has been reduced by $46 million reflecting the elimination of tariffs to import the vessels into Canada. On June 2, 2016, the *Salish Eagle* and the *Salish Raven,* and on November 24, 2015, the *Salish Orca,* were launched and christened at Remontowa Shipbuilding S.A. The new vessels will be dual-fuel capable, designed to run primarily on LNG with marine diesel fuel as a backup. The *Salish Orca* is scheduled for delivery in the third quarter of fiscal 2017, and the *Salish Eagle* and *Salish Raven* are scheduled for delivery in the fourth quarter of fiscal 2017. The *Salish Orca* and the *Salish Eagle* will replace the 51-year old *Queen of Burnaby* on the Comox – Powell River route and the 52-year old *Queen of Nanaimo* on the Tsawwassen – Southern Gulf Islands route, respectively. The *Salish Raven* is expected to service the Southern Gulf Islands.

A $6 million project for a three-quarter life upgrade of the *Queen of Surrey* includes upgrades to the electrical system, the fire protection system, the elevator and the propulsion, improvements to the pet area and replacement of the emergency generator. This project is now complete.

An $18 million major upgrade and refit to the *Queen of Cumberland* included steelwork, upgrades to the propulsion system, passenger accommodation improvements, bridge standardization and safety improvements. The *Queen of Cumberland* returned to service in April 2016.

Fiscal 2017 is the first year of a three-year program to upgrade vessels with new navigational equipment. This year, we expect to spend $4 million on upgrading the radar equipment, voyage data recorders and gyro compasses on several vessels to take us towards bridge standardization and further improve navigational safety.

Other projects include life-saving equipment for the *Northern Adventure,* upgrades to the elevator, lighting and the electrical equipment and standardization of the bridge for the *Queen of Alberni,* and upgrades to the mechanical and electrical equipment and standardization of the bridge for the *Queen of Cowichan*.

Information Technology

Capital expenditures for information technology in the three months ended June 30, 2016 included the following:

	($ millions)
Customer service program	4.2
Payroll system replacement	1.4
Hardware upgrades	1.0
Payment card process enhancement	0.4
Fare flexibility and digital experience initiative	0.3
Other projects	0.6
	7.9

Our customer service program will replace our aged point–of-sale, website, e-commerce platform and reservations systems and allow us to respond in a more timely fashion to changing business needs and to support marketing, travel services and pricing initiatives. The main elements of this multi-year program will be implemented in stages, which began with the installation of the customer relationship management application in 2015. Other elements including software to allow online bookings, the second phase of the customer relationship management system, and the architecture to facilitate integration between the systems are expected to complete in the fall of 2016. We believe this program will significantly improve our transaction processing and enhance our ability to efficiently respond to the changing needs of our customers.

Our payroll system replacement initiative will replace our legacy payroll and labour distribution systems and provide processing efficiencies and flexibility. It is expected to be complete in the fall of 2016.

Hardware upgrades include the replacement of aged computers, printers, servers, routers, closed-circuit cameras and electronic signage.

Our payment card process enhancement project includes designing and implementing an integrated solution for data processing streams of each application that accepts payments. The first phase was completed in the fall of 2015 and the second phase of our customer payment solution is scheduled to complete in the fall of 2017.

Our fare flexibility and digital experience initiative will introduce a new system to manage fares and provide customers with a modernized e-commerce platform with greater online functionality and booking options.

Other projects include software to automate the management of our server environments, software tools to provide application performance monitoring, software to improve our telecommunication systems, upgrading our safety management system and upgrading our catering and retail inventory management system.

Terminal Marine Structures
Capital expenditures for terminal marine structures in the three months ended June 30, 2016 included the following:

Terminal	**Description**	
		($ millions)
Tsawwassen	Berth rebuild	4.0
Langdale	Replace dolphin and gangways	0.8
Various	Other projects	0.6
		5.4

At Tsawwassen terminal, a $14 million project to replace a tower, abutment, ramp, dolphins, and wingwalls is now complete.

At Langdale terminal, a $13 million project to replace four dolphins, the baffle wall and catwalk with a floating pontoon is underway. This project is expected to be completed by the end of the first quarter in fiscal 2018.

Other projects currently in progress include upgrades at Nanaimo Harbour, Village Bay, Blubber Bay, and Long Harbour terminals.

Terminal and Building Upgrades and Equipment
Capital expenditures for terminal and building upgrades and equipment in the three months ended June 30, 2016 included the following:

	($ millions)
Waiting shelter and upgrade water supply at Whaletown terminal	0.4
Vehicles and other equipment	0.5
Signage standardization	0.2
Other terminal projects	0.7
	1.8

A $1 million dollar project at Whaletown is underway to replace the waiting shelter and to upgrade the water supply. This project is expected to complete in the second quarter of fiscal 2017.

Vehicles and other equipment include a generator, welding trucks, tow tractors and a forklift at our maintenance facility.

Several signage standardization projects are in progress, including way-finding signage at Duke Point, Departure Bay and various minor terminals.

Other projects include upgrades at Langdale and Hornby terminals and at our Richmond maintenance facility.

OUTLOOK

We anticipate that moderate growth in the Canadian economy together with a low Canadian dollar and low fuel prices will support strong vehicle and passenger levels. We are continuing our cost containment program, while maintaining safe, reliable service. We will continue to invest in our vessel, marine, terminal and information system infrastructure, as well as our training, safety and maintenance programs.

We continue to explore strategies to create an affordable and sustainable ferry system beyond fiscal 2017 by optimizing our service routes, standardizing our vessels, optimizing our fuel consumption, and reducing our environmental impact. We have also started testing variable pricing concepts as we prepare for a new revenue management system and a new reservation and point-of-sale system. We continue to look at ways to diversify our revenue sources, increase operational efficiencies, and leverage opportunities for federal infrastructure funding and provincial incentive funding to renew our fleet and terminals.

Traffic

Overall, vehicle traffic increased 5.1% while passenger traffic increased 2.5% in the three months ended June 30, 2016 compared to the same quarter in the prior year. Traffic levels in the quarter are discussed above in “Financial and Operational Overview”.

We believe the US economy and the outlook for the travel and tourism industry will remain strong. With the lower value of the Canadian dollar relative to the US dollar, and the lower cost of fuel, we believe that passenger and vehicle traffic will also remain strong in the near term, sustaining the improved discretionary traffic levels we are experiencing.

Financial performance

We expect positive net earnings in fiscal 2017, reflecting continued increases in discretionary traffic due to the low Canadian dollar and the lower cost of fuel, offset somewhat by a slight decrease in traffic primarily due to the timing of Easter and an increase in total expenses.

We expect an increase in total revenue in fiscal 2017, reflecting higher traffic levels, higher net retail revenues, and higher ferry transportation fees, partially offset by the net cost of pricing promotions. The April 1, 2016 tariff increases have a net zero impact as they were offset by an equal increase in fuel rebates.

We expect an increase in total expenses in fiscal 2017, reflecting higher wage and benefit costs resulting from the implementation of the new Collective Agreement and introduction of new assets, higher fuel costs primarily resulting from additional round trips provided, partially offset by lower vessel maintenance costs and cost savings from the introduction of our new cable ferry and other operational related efficiencies. We continue to manage our costs prudently without compromising safe operations.

We will be offering future pricing promotions. We expect they will help shift traffic to sailings that typically run with low capacity utilization and generate incremental traffic.

Asset renewal program
From time-to-time, our aging fleet can experience mechanical issues that may have environmental and customer service impacts. We have a 12-year capital plan, covering fiscal 2015 through fiscal 2026, to invest $3 billion to replace 14 aged vessels, execute vessel upgrades and modifications, make significant improvements at our terminals, and renew our information technology infrastructure.

Salish Class

In July 2014, we entered into contracts with Remontowa Shipbuilding S.A. in Gdansk, Poland to build three new intermediate class vessels. Each vessel will have the capacity to carry 145 vehicles and be designed to operate as dual-fuel capable, so they can run predominantly on LNG with marine diesel fuel as a backup. These vessels will set a new standard of efficiency with standardized bridges, engine rooms and life-saving equipment moving us to a higher safety standard and improving interoperability. The Remontowa contracts, with a total value of $165 million, form the majority of the total project budget of $206 million. The original project budget of $252 million has been reduced by $46 million reflecting the elimination of tariffs to import the vessels into Canada. These contracts are design-build, fixed price contracts that provide us with substantial guarantees related to delivery dates, performance criteria, cost certainty and quality of construction.

The *Salish Orca* is scheduled for delivery in the third quarter of fiscal 2017, and the *Salish Eagle* and *Salish Raven* are scheduled for delivery in the fourth quarter of fiscal 2017. FortisBC has committed to provide us with $6 million in incentive funding for the new vessels to help offset incremental capital costs associated with the use of LNG. The use of LNG will result in the reduction of an estimated 9,000 tonnes of carbon dioxide equivalent per year.

Spirit Class Mid-life Upgrades

On March 24, 2016, we announced the award of a contract totalling $140 million to Remontowa Ship Repair Yard S.A. of Gdansk, Poland to conduct the mid-life upgrades, including conversion to dual-fuel, of our two largest vessels, the *Spirit of Vancouver Island* and the *Spirit of British Columbia*. The upgrade of the *Spirit of British Columbia* is expected to be completed during the spring of 2018 and the upgrade of the *Spirit of Vancouver Island* is expected to be completed the following year. The conversion of these vessels is expected to result in substantial savings, as LNG costs considerably less than marine diesel. It also has significant environmental impacts such as reducing CO_2 emissions by approximately 12,000 tonnes annually, which is the equivalent of taking approximately 2,500 vehicles off the road per year. FortisBC has committed to provide us with up to $10 million in incentive funding to help offset incremental capital costs associated with the use of LNG.

Automated Customer Experience Program

Our customer service program will replace our aged point-of-sale and reservations systems and allow us to respond in a more timely fashion to changing business needs and to support marketing, travel services and flexible pricing initiatives. Elements including software to allow online bookings, the second phase of the customer relationship management system and the architecture to facilitate integration between the systems are expected to complete in the fall of 2016.

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 61 through 64 of our fiscal 2016 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2016. Our 2016 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

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 65 through 71 of our fiscal 2016 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2016. Our 2016 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 profitability levels, 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, profitable future. We do not believe that material uncertainties exist in regards 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, 2016 and June 30, 2016 consolidated financial statements. Certain of these policies involve critical accounting estimates because they require us to make particularly subjective or complex judgments 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 72 and 73 of our fiscal 2016 Management's Discussion & Analysis. The following describes the changes to critical accounting policies we have used in the preparation of our consolidated financial statements for the three months ended June 30, 2016, or expect to use in the future. Our 2016 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

Adoption of New Accounting Standards

The following is a discussion of changes in accounting standards that we adopted effective April 1, 2016:

Amendments to IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*, explicitly state that revenue-based methods of depreciation cannot be used for property, plant and equipment. The application of these amendments did not have any impact on our interim consolidated financial statements.

The IASB has published a *Disclosure Initiative (Amendments to IAS 1)* with narrow-scope amendments clarifying IAS 1 to address perceived impediments to preparers exercising their judgement in preparing their financial reports. The application of this standard did not have any impact on our interim consolidated financial statements. Any immaterial disclosures are expected to be removed from our annual consolidated financial statements.

The IASB published amendments to IAS 7 *Statement of Cash Flows*. These amendments require a disclosure of changes in liabilities arising from financing activities, including changes arising from cash flows and non-cash changes. The mandatory effective date is April 1, 2017. We early adopted, as permitted. The application of these amendments did not have any impact on our interim consolidated financial statements, other than additional disclosure as presented in note 4 to our June 30, 2016 unaudited financial statements.

Future Accounting Changes

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

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. IFRS 15 will be effective for us April 1, 2018. Earlier application is permitted. We are in the process of assessing the financial reporting impact of the adoption of this standard.

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). Mandatory adoption of IFRS 9 (2014) for us will be April 1, 2018. We are in the process of assessing the financial reporting impact of the adoption of this standard.

IFRS 16 *Leases* introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all assets 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. This standard will be effective for us April 1, 2019. Early adoption is permitted if IFRS 15 *Revenue from Contracts with Customers* has also been applied. We are in the process of assessing the financial reporting impact of the adoption of this standard.

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, fuel prices, and fiscal 2017 net earnings; our short-term and long-range business plans, and asset renewal programs for vessels and terminals; our customer service program, pricing promotions, and payroll system replacement initiative; our Salish Class vessels, the loan agreement with KFW IPEX-Bank GmbH, the agreements with FortisBC Energy Inc. regarding incentive funding, the New Building Canada Fund, LNG plans, Spirit Class mid-life upgrades, and safety, environmental, and training projects; our expectations regarding food sales, and sales of quality apparel; and total revenue and expense projections, and how our cash requirements will be met in the near term. In some cases, forward looking statements can be identified by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue" or the negative of these terms or other comparable terminology. A number of factors could cause actual events or results to differ materially from the results discussed in the forward looking statements. In evaluating these statements, prospective investors should specifically consider various factors including, but not limited to, the risks and uncertainties associated with: vendor non-performance; capital market access; interest rate, foreign currency, fuel price, and traffic volume fluctuations; the implementation of major capital projects; security, safety, and environmental incidents; confidential or sensitive information breaches; changes in laws; vessel repair facility limitations; economic regulatory environment changes; tax changes; and 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.