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

For the three and six months ended
September 30, 2018

Dated November 20, 2018

Table of Contents

Management's Discussion & Analysis
of Financial Condition and Financial Performance
For the three and six months ended September 30, 2018
Dated November 20, 2018

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 and six months ended September 30, 2018 that has been prepared with information available as of November 20, 2018. This discussion and analysis should be read in conjunction with our unaudited condensed interim financial statements and related notes for the six month periods ended September 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 & Analysis for fiscal 2018. 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") 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 September 30, 2018 (the second quarter of fiscal 2019), we provided transportation service with 35 vessels operating on 24 routes (25 routes as of mid-September) out of 47 terminals spread over 1,600 kilometres 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.

Our Major Routes, which are our four busiest routes, consist of three regulated routes connecting Metro Vancouver with Vancouver Island and one regulated route connecting Horseshoe Bay and Langdale. In mid-September, we began service on a new Northern Route directly connecting Port Hardy and Bella Coola, bringing the total number of Northern Routes in operation to three. 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 September 30, 2018, we provided an average of 517 sailings per day for our customers. We delivered over 47,000 sailings, 470 more than in the same period in the prior year. We carried 7.8 million passengers and 2.9 million vehicles, an increase of 0.3% and 1.1%, respectively, compared to the same quarter in the prior year. Year-to-date, we have carried 13.5 million passengers and 5.2 million vehicles, an increase of 1.1% and 1.8%, respectively, compared to the same period in the prior year. The passenger traffic levels experienced 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 second quarter of fiscal 2019 include the following:

Vessels

- On August 17, 2018, we issued two Requests for Pre-Qualification ("RFPQ") with a closing date of September 7, 2018. The RFPQs are for the procurement of five new vessels to replace aged fleet assets with the procurement process open to local, national and international shipyards. The first RFPQ is for the construction of four 81-metre Island Class ferries, each with a capacity of up to 450 passengers and approximately 47 vehicles. The expected delivery date of the first two vessels is in 2020, with the following two ships expected to be delivered in 2021. The second RFPQ is for the construction of one 107-metre Salish Class vessel with a capacity of 600 passengers and approximately 138 vehicles and an expected delivery date in 2021. The Island Class vessels will have hybrid diesel-electric propulsion and will be built to be capable of conversion to all-electric propulsion as the technology permits and the necessary infrastructure is put in place to support it. The Salish Class vessel will be dual-fuel capable, running primarily on liquefied natural gas ("LNG") using marine diesel as backup. The five new vessels will allow for the retirement of the *Bowen Queen*, *Mayne Queen* and *Powell River Queen* and for the redeployment of certain other vessels around the fleet. We submitted our application to the British Columbia Ferries Commissioner (the "Commissioner") for approval of this major capital expenditure on November 5, 2018. Requests for proposals will be issued and, subject to a favourable decision by the Commissioner, we expect to award contracts in the spring of 2019.

- On September 16, 2018, we commenced the direct seasonal service between Port Hardy and Bella Coola using the *Northern Adventure* and running through to October 11, 2018. The entry into service of the *Northern Sea Wolf*, the vessel acquired for this service, has been delayed until the spring of 2019. The 75-metre used vessel is 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 October 5, 2018, we issued a Request for Expression of Interest ("RFEOI") for the procurement of five new major vessels to replace aged fleet assets with the procurement process open to local, national and international shipyards. These new major vessels will reflect capacity and levels of service consistent with the current Coastal and Spirit Class vessels in size, capabilities and passenger amenities. These vessels are anticipated to begin service in 2023 on our Major Routes between Metro Vancouver and Vancouver Island. The five new vessels will allow for the retirement of the *Queen of Alberni*, *Queen of New Westminster, Queen of Cowichan* and *Queen of Coquitlam* and will introduce an additional vessel to the fleet to accommodate future traffic, and to build resiliency in the fleet. We expect to complete the procurement process and award contracts by the end of 2019.

General

- On September 28, 2018, we filed our Performance Term Five ("PT5") Submission with the Commissioner as required by the *Coastal Ferry Act*. The purpose of this submission is to provide information to assist the Commissioner in establishing price caps for PT5 (April 1, 2020 – March 31, 2024) for all regulated routes as specified in the Coastal Ferry Services Contract ("CFSC") between BC Ferries and the Province. The submission is comprised of five reports:
    - Performance Term Four (April 1, 2016 to March 31, 2020) Report;
    - Fuel Management Plan Outcomes in Performance Term Four;
    - Capital Plan (fiscal years 2019 through 2030);
    - Strategies for Enhancing Efficiency in Performance Term Five and Beyond; and
    - Traffic Demand Forecast (fiscal years 2019 through 2024).

  These reports are available on the Commissioner's website at www.bcferrycommission.ca. The Commissioner will make his preliminary determination on the PT5 price caps by March 31, 2019 and his final determination by September 30, 2019.

FINANCIAL AND OPERATIONAL OVERVIEW

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

($millions)	Three months ended September 30			Six months ended September 30		
	2018	**2017**	**Variance**	**2018**	**2017**	**Variance**
Total revenue	315.8	309.9	5.9	545.5	536.1	9.4
Operations	142.6	134.4	(8.2)	278.5	259.6	(18.9)
Maintenance	15.7	13.6	(2.1)	37.9	34.5	(3.4)
Administration	9.9	9.2	(0.7)	19.7	19.2	(0.5)
Depreciation and amortization	43.0	40.1	(2.9)	85.0	78.7	(6.3)
Operating expenses	211.2	197.3	(13.9)	421.1	392.0	(29.1)
Operating profit	104.6	112.6	(8.0)	124.4	144.1	(19.7)
Net finance and other	13.7	14.2	0.5	27.5	28.4	0.9
Net earnings	90.9	98.4	(7.5)	96.9	115.7	(18.8)
Other comprehensive income	1.4	4.6	(3.2)	9.3	(1.1)	10.4
Total comprehensive income	92.3	103.0	(10.7)	106.2	114.6	(8.4)

Our net earnings in the three months ended September 30, 2018 were $7.5 million lower ($18.8 million year-to-date) than the same period in the prior year.

In the three months ended September 30, 2018, revenues increased by 1.9% (1.8% year-to-date) compared to the same period in the prior year, primarily as a result of the increased traffic volumes partially offset by a decrease in the average 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 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 we will contribute $39 million ($16.7 million in fiscal 2019) in foregone revenue and the Province will contribute $59 million ($26.5 million in fiscal 2019). In the three months ended September 30, 2018, $9.1 million ($15.9 million year-to-date) 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.)

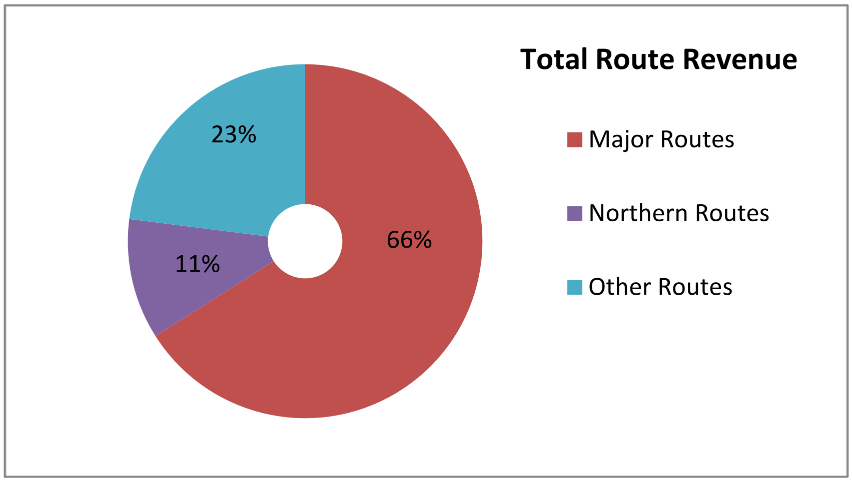
In the three months ended September 30, 2018, operating expenses increased by $13.9 million or 7.0% ($29.1 million or 7.4% year-to-date) compared to the same period in the prior year. The year-to-date expense increase included $6.3 million in depreciation, $5.9 million in wage rates and benefit costs, $3.7 million in fuel prices, $3.7 million in one-time project-related costs and $3.4 million in maintenance costs. The remainder of the increase was primarily in labour, fuel consumption, and training-related costs to improve our customer experience and to accommodate the higher traffic volumes. We provided 640 additional round trips throughout the system and adjusted the schedules for the routes operating out of Horseshoe Bay terminal. We also re-introduced the upgraded *Spirit of British Columbia* into service and implemented our new reservation system. (See "Expenses" for more detail.)

In the three months ended September 30, 2018, other comprehensive income was $3.2 million lower than in the same period in the prior year. The $1.4 million of other comprehensive income in the three months ended September 30, 2018 reflects the change in the fair value of our fuel swap contracts. The $4.6 million of other comprehensive income in the three months ended September 30, 2017 reflects a $6.5 million change in the fair value of our fuel swap contracts partially offset by a $1.9 million loss on the actuarial valuation of our employee benefit plans.

Year-to-date, other comprehensive income was $10.4 million higher than in the same period in the prior year. The $9.3 million of other comprehensive income in the six months ended September 30, 2018 reflects the change in the fair value of our fuel swap contracts. The $1.1 million loss in the six months ended September 30, 2017 reflects a $1.9 million loss on the actuarial valuation of our employee benefit plans partially offset by a $0.8 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 Vancouver Island and one regulated route connecting Horseshoe Bay and Langdale. Our Northern Routes consist of three regulated routes, including the new route connecting Port Hardy and Bella Coola, 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 six months ended September 30, 2018, the greatest portion of our revenues (66%) was earned on our Major Routes. Revenue from the Northern Routes contributed 11% and revenue from Other Routes contributed 23%.

Select operational statistics and total revenues for the three and six month periods ended September 30, 2018 compared to the same periods in the prior year are shown in the tables below.

	Three months ended September 30		Six months ended September 30	
Operational Statistics	**2018**	**2017**	**2018**	**2017**
Vehicle traffic	2,897,321	2,866,107	5,199,018	5,108,606
Passenger traffic	7,834,538	7,809,766	13,539,854	13,398,760
On-time performance	83.6%	84.3%	85.1%	85.3%
Number of round trips	21,675	21,387	41,562	40,922
Capacity provided (AEQs)	4,400,431	4,318,588	8,274,277	8,140,805
AEQs carried	3,254,960	3,219,644	5,878,156	5,772,281
Capacity utilization	74.0%	74.6%	71.0%	70.9%

In the three months ended September 30, 2018, vehicle traffic increased 1.1% (1.8% year-to-date) and passenger traffic increased 0.3% (1.1% year-to-date) compared to the same period in the prior year. We believe fare reductions and our vehicle fare pricing promotion had a positive impact on both passenger and vehicle traffic, partially offset by unfavorable weather in September and unanticipated service disruptions.

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. 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 demands. In the three months ended September 30, 2018, on-time performance decreased by 0.7% (0.2% year-to-date) compared to the same period in the prior year.

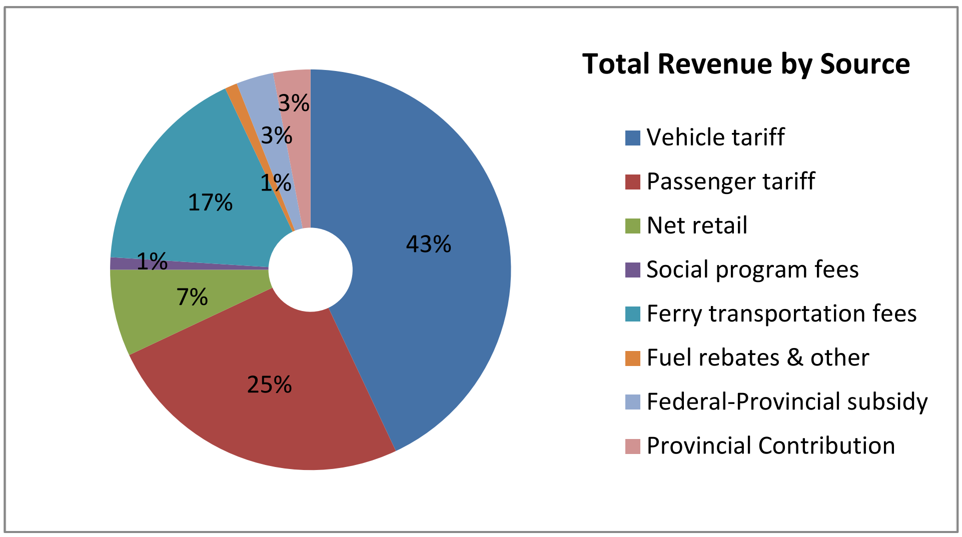
An automobile equivalent ("AEQ") is a standard unit of measure for an approximation of one car length. AEQs are calculated by using a conversion factor for each vehicle type. For example, a passenger vehicle would be one AEQ while a bus would be three AEQs. The change in AEQs from one period to the next 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.

Vehicle capacity provided, measured in AEQs, is the available vehicle deck space on a vessel multiplied by the number of sailings. The 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 round trips stipulated by the CFSC. In the three months ended September 30, 2018, we provided 288 (640 year-to-date) additional round trips compared to the same period in the prior year, resulting in an increase in capacity provided.

These statistics, shown in the table above, 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 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 decreased from 74.6% to 74.0% for the three months ended September 30, 2018 compared to the same period in the prior year, as a result of an increase in capacity provided from additional round trips, partially offset by a higher number of AEQs carried due to higher vehicle traffic levels.

Revenue ($ millions)	**Three months ended September 30**			**Six months ended September 30**		
	2018	**2017**	**Increase (Decrease)**	**2018**	**2017**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	131.0	135.7	(4.7)	233.3	238.3	(5.0)
Passenger tariff	82.1	89.6	(7.5)	138.3	150.1	(11.8)
Fuel (rebates) surcharges	(0.1)	(6.7)	6.6	(4.6)	(11.6)	7.0
Net retail	22.4	21.1	1.3	37.4	35.4	2.0
Social program fees	3.5	4.0	(0.5)	8.0	8.9	(0.9)
Other revenue	3.3	3.3	-	6.1	6.1	-
Total Direct Route Revenue	242.2	247.0	(4.8)	418.5	427.2	(8.7)
Indirect Route Revenue						
Ferry transportation fees	55.9	54.6	1.3	94.4	92.6	1.8
Federal-Provincial subsidy	7.7	7.4	0.3	15.3	14.9	0.4
Provincial contribution	9.1	-	9.1	15.9	-	15.9
Total Route Revenue	314.9	309.0	5.9	544.1	534.7	9.4
Other general revenue	0.9	0.9	-	1.4	1.4	-
Total Revenue	315.8	309.9	5.9	545.5	536.1	9.4



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 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 September 30, 2018, $9.1 million ($15.9 million year-to-date) of the $26.5 million was recorded as revenue. In the three months ended September 30, 2018, the number of BC seniors travelling with the discount increased 18.0% (19.8% year-to-date) 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 on 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 operational statistics and revenue for the three and six months ended September 30, 2018 and 2017 for the Major, Northern and Other Routes are discussed separately below.

Major Routes

Our Major Routes are our four busiest routes, carrying approximately 60% of our vehicle traffic and 65% of our passenger traffic and generating approximately 83% of our total customer revenue during the three and six month periods ended September 30, 2018 and 2017.

	Three months ended September 30		Six months ended September 30	
Operational Statistics	**2018**	**2017**	**2018**	**2017**
Vehicle traffic	1,748,243	1,751,156	3,098,991	3,081,349
Passenger traffic	5,139,097	5,176,188	8,781,813	8,780,326
On-time performance	76.9%	80.2%	79.9%	79.2%
Number of round trips	3,972.0	3,952.5	7,373.0	7,259.0
Capacity provided (AEQs)	2,474,224	2,463,024	4,592,308	4,533,396
AEQs carried	2,023,728	2,025,315	3,625,361	3,599,073
Capacity utilization	81.8%	82.2%	78.9%	79.4%

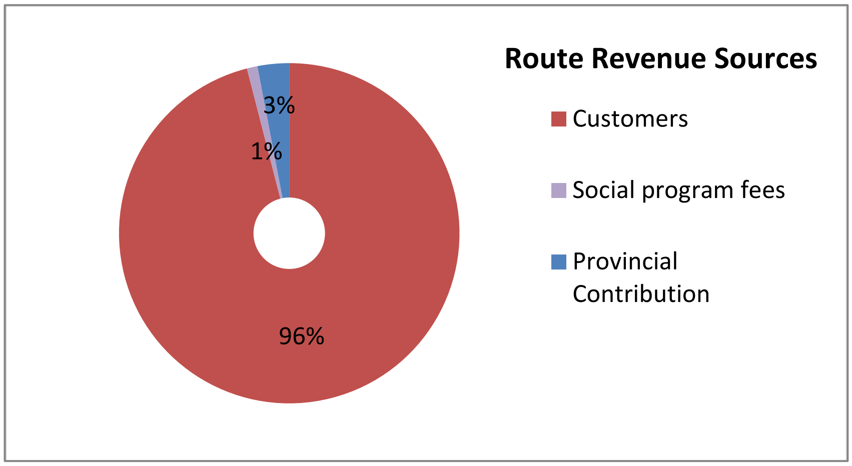
In the three months ended September 30, 2018, vehicle traffic decreased 0.2% and passenger traffic decreased 0.7% compared to the same period in the prior year. Year-to-date, vehicle traffic increased 0.6% and passenger traffic was on par with the same period in the prior year. We believe traffic was negatively impacted in the three months ended September 30, 2018 mainly due to unfavorable weather in September and unanticipated service disruptions.

In the three months ended September 30, 2018, on-time performance decreased from 80.2% to 76.9%, with all of the Major Routes decreasing with the exception of the route connecting Tsawwassen and Swartz Bay, which improved 6.3% compared to the same period in the prior year when there were more delays due to mechanical issues. Year-to-date, on-time performance on the Major Routes improved slightly from 79.2% to 79.9% compared to the same period in the prior year.

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. These initiatives were successful in the three months ended June 30, 2018. However, in the three months ended September 30, 2018, with heavier seasonal traffic, we found the timing of the scheduled sailings were too close together. Once one sailing was delayed, delays continued for the remainder of the day causing a decline in on-time performance. We expect to make further adjustments in the timing of scheduled service in our ongoing efforts to improve our service delivery and on-time performance.

Capacity utilization on these routes during the three months ended September 30, 2018 declined 0.4% (0.5% year-to-date) compared to the same period in the prior year, mainly as a result of an increase in capacity provided from additional round trips, partially offset by a higher number of AEQs carried due to higher traffic levels.

Major Routes cont'd



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

Revenue ($ thousands)	**Three months ended September 30**			**Six months ended September 30**		
	2018	**2017**	**Increase (Decrease)**	**2018**	**2017**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	110,026	111,774	(1,748)	197,883	198,455	(572)
Passenger tariff	66,879	70,782	(3,903)	113,789	119,992	(6,203)
Fuel rebates	(2)	(5,370)	5,368	(3,759)	(9,352)	5,593
Net retail	19,190	18,102	1,088	32,668	30,951	1,717
Social program fees	1,912	2,041	(129)	4,275	4,542	(267)
Parking	2,099	1,931	168	3,836	3,563	273
Other revenue	1,065	1,228	(163)	1,969	2,249	(280)
Total Direct Route Revenue	201,169	200,488	681	350,661	350,400	261
Indirect Route Revenue						
Provincial contribution	5,097	-	5,097	9,157	-	9,157
Total Route Revenue	206,266	200,488	5,778	359,818	350,400	9,418

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 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 September 30, 2018, average tariff (tariff revenue divided by traffic volume) per vehicle decreased $0.89 or 1.4% ($0.55 or 0.9% year-to-date) compared to the same period in the prior year, mainly due to the 15% reduction on our Major Route connecting Horseshoe Bay and Langdale. Passenger tariff revenue in the three months ended September 30, 2017 included $1.9 million ($3.4 million year-to-date) in revenue for BC seniors. In the three months ended September 30, 2018, average tariff per passenger decreased $0.66 or 4.8% ($0.71 or 5.2% year-to-date) compared to the same period in the prior year, primarily as a result of the increase in the BC seniors' discount, changes in the passenger mix and the 15% fare reduction on our Major Route connecting Horseshoe Bay and Langdale. The decrease in average tariff resulted in a total tariff revenue decrease of $5.7 million ($6.8 million year-to-date) 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 on June 27, 2018 (fiscal 2019), due to the rise in fuel prices.

Major Routes cont'd

All vessels that provide service on our Major Routes have a gift shop and options for food service. In the three months ended September 30, 2018, net retail sales increased 6.0% (5.5% year-to-date) compared to the same period in the prior year, primarily as a result of higher average sales per passenger. Food sales remain strong, providing approximately 72% of total retail revenue. Sales of quality apparel continue to grow and comprise over 10% of total retail revenue. Cost of goods sold is approximately 40% of total sales. The new coffee bar and the gift shop expansion on the *Spirit of British Columbia* contributed to the increase in net retail sales.

Social program fees are reimbursements from the Province of discounts provided on fares for students travelling to and from school, persons with disabilities and persons travelling under the Ministry of Health Travel Assistance Program ("MTAP"). Social program fees for the three months ended September 30, 2018 decreased 6.3% (5.9% year-to-date) 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 8.7% in the three months ended September 30, 2018 (7.7% year-to-date) compared to the same period in the prior year, as a result of both an increase in parking rates and higher usage.

Other revenue decreased 13.3% in the three months ended September 30, 2018 (12.4% year-to-date) compared to the prior year, mainly as a result of a decrease in commissions received on the sale of books and magazines.

The provincial contribution of $5.1 million in the three months ended September 30, 2018 ($9.2 million year-to-date) consisted of $2.3 million ($4.3 million year-to-date) towards the increased BC seniors' discount and $2.8 million ($4.9 million year-to-date) 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

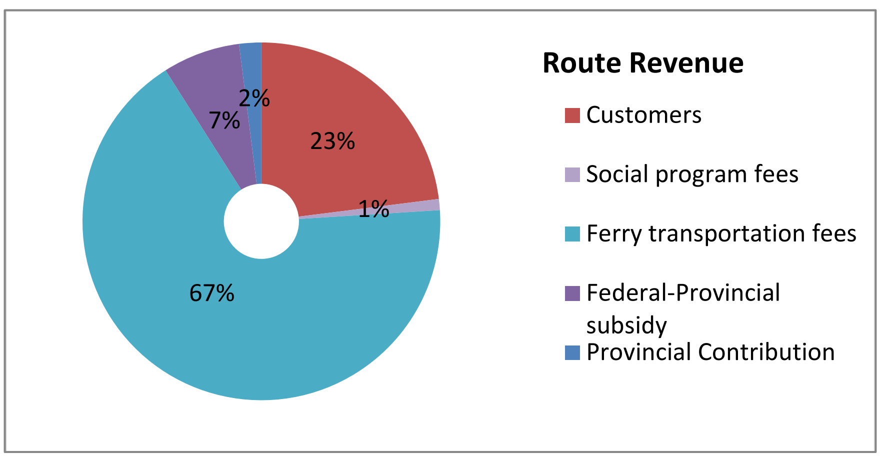
Until mid-September, our Northern Routes consisted of two regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island. In September, we commenced a new seasonal direct ferry service connecting Port Hardy and Bella Coola.

Operational Statistics	Three months ended September 30		Six months ended September 30	
	2018	2017	2018	2017
Vehicle traffic	15,392	15,036	23,240	22,610
Passenger traffic	45,516	45,853	65,788	66,226
On-time performance	86.4%	91.3%	84.6%	89.2%
Number of round trips	106.5	101.0	165.5	159.5
Capacity provided (AEQs)	24,374	23,542	36,200	35,329
AEQs carried	18,346	17,923	28,084	27,408
Capacity utilization	75.3%	76.1%	77.6%	77.6%

In the three months ended September 30, 2018, vehicle traffic increased 2.4% (2.8% year-to-date) primarily as a result of the impact of fare reductions. Passenger traffic decreased 0.7% in the three and six months ended compared to the same periods in the prior year.

On-time performance in the three months ended September 30, 2018 decreased 4.9% (4.6% year-to-date) over the same period in the prior year, primarily due to the increased vehicle traffic demands and delays due to weather.

Capacity utilization on these routes during the three months ended September 30, 2018 was 0.8% lower than the same period in the prior year, primarily as a result of increased capacity provided, partially offset by a higher number of AEQs carried. Year-to-date, capacity utilization was on par with the prior year.



In the six months ended September 30, 2018, revenue from our Northern Routes consisted of 23% from customers and 77% from the Province (2% Provincial contribution, 1% social program fees, 67% ferry transportation fees, and 7% from payments under the Federal-Provincial subsidy agreement).

Northern Routes cont'd

Revenue ($ thousands)	Three months ended September 30			Six months ended September 30		
	2018	**2017**	**Increase (Decrease)**	**2018**	**2017**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	3,922	4,692	(770)	5,814	6,865	(1,051)
Passenger tariff	3,895	4,856	(961)	5,267	6,491	(1,224)
Fuel rebates	(41)	(210)	169	(104)	(290)	186
Net retail	965	987	(22)	1,233	1,232	1
Social program fees	302	357	(55)	586	652	(66)
Stateroom rental	710	682	28	1,156	1,097	59
Hostling & other	12	63	(51)	76	141	(65)
Total Direct Route Revenue	9,765	11,427	(1,662)	14,028	16,188	(2,160)
Indirect Route Revenue						
Ferry transportation fees	26,681	25,613	1,068	39,640	38,439	1,201
Federal-Provincial subsidy	1,956	1,911	45	3,913	3,821	92
Provincial contribution	809	-	809	1,107	-	1,107
Total Route Revenue	39,211	38,951	260	58,688	58,448	240

In the three months ended September 30, 2018, average tariff (tariff revenue divided by traffic volume) per vehicle decreased 18.3% (17.6% year-to-date) and average tariff per passenger decreased 18.3% (19.2% year-to-date) 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 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 during the three months ended September 30, 2018 resulted in a total tariff revenue decrease of $1.7 million ($2.3 million year-to-date) 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 on June 27, 2018 (fiscal 2019), due to the rise in fuel prices.

Reimbursements from the Province for social program fees for the three months ended September 30, 2018 decreased 15.4% (10.1% year-to-date) compared to the same period in the prior year, primarily as a result of the 15% fare reduction.

Stateroom rental revenue increased due to higher utilization.

Ferry transportation fees received from the Province increased $1.1 million in the three months ended September 30, 2018 ($1.2 million year-to-date) compared to the same period in the prior year, mainly as a result of additional funding from the Province for the provision of additional services.

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

The provincial contribution of $0.8 million in the three months ended September 30, 2018 ($1.1 million year-to-date) consisted of a contribution towards the 15% fare reductions.

Other Routes

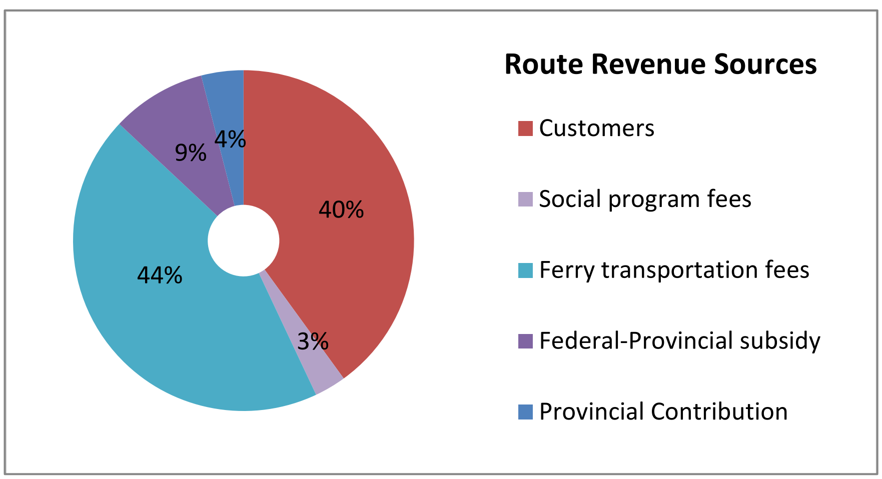
Our Other Routes primarily serve the northern and southern Gulf Islands and the northern Sunshine Coast. One of the 18 regulated routes and all eight of the unregulated routes are operated under contract by alternative service providers. We receive fees from the Province for the provision of contracted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

Operational Statistics	Three months ended September 30		Six months ended September 30	
	2018	2017	2018	2017
Vehicle traffic	1,133,686	1,099,915	2,076,787	2,004,647
Passenger traffic	2,649,925	2,587,725	4,692,253	4,552,208
On-time performance	84.9%	85.0%	86.1%	86.4%
Number of round trips	17,596.5	17,333.5	34,023.5	33,503.5
Capacity provided (AEQs)	1,901,833	1,832,022	3,645,769	3,572,080
AEQs carried	1,212,886	1,176,406	2,224,711	2,145,800
Capacity utilization	63.8%	64.2%	61.0%	60.1%

In the three months ended September 30, 2018, vehicle traffic increased 3.1% (3.6% year-to-date) and passenger traffic increased 2.4% (3.1% year-to-date) compared to the same period in the prior year. We believe fare reductions and the BC seniors' passenger discount increase had a positive impact on both vehicle and passenger traffic.

On-time performance in the three and six months ended September 30, 2018 was on par with the same periods in the prior year.

Capacity utilization on these routes during the three months ended September 30, 2018 was 0.4% lower compared to the same period in the prior year, primarily due by an increase in capacity provided, mainly due an increase in the number of round trips, and partially offset by a higher number of AEQs carried. Year-to-date, capacity utilization was 0.9% 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 six months ended September 30, 2018, revenue from our Other Routes consisted of 40% from customers and 60% from the Province (4% Provincial contribution, 3% social program fees, 44% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

Other Routes cont'd

Revenue ($ thousands)	Three months ended September 30			Six months ended September 30		
	2018	**2017**	**Increase (Decrease)**	**2018**	**2017**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	17,102	19,231	(2,129)	29,617	33,022	(3,405)
Passenger tariff	11,363	13,971	(2,608)	19,244	23,601	(4,357)
Fuel rebates	(25)	(1,166)	1,141	(722)	(1,972)	1,250
Social program fees	1,343	1,664	(321)	3,167	3,744	(577)
Net retail	1,498	1,301	197	2,325	2,107	218
Parking & other	98	113	(15)	198	216	(18)
Total Direct Route Revenue	31,379	35,114	(3,735)	53,829	60,718	(6,889)
Indirect Route Revenue						
Ferry transportation fees	29,221	28,920	301	54,797	54,117	680
Federal-Provincial subsidy	5,670	5,535	135	11,339	11,070	269
Provincial contribution	3,218	-	3,218	5,652	-	5,652
Total Route Revenue	69,488	69,569	(81)	125,617	125,905	(288)

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 September 30, 2018, average tariff per vehicle (tariff revenue divided by traffic volume) decreased 13.7% (13.4% year-to-date), reflecting the fare reduction and partially offset by an increase in the proportion of traffic on routes with higher versus lower tariffs. In the three months ended September 30, 2018, average tariff per passenger decreased 20.6% (20.9% year-to-date), mainly reflecting the fare reduction of 15% and increased BC seniors' passenger discount implemented at April 1, 2018 on our Other Routes. Passenger tariff revenue in the three months ended September 30, 2018, included $0.8 million ($1.6 million year-to-date) in revenue for BC seniors. The decrease in average tariff, partially offset by the increase in traffic levels resulted in a total tariff revenue decrease of $4.7 million ($7.8 million year-to-date) 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 on June 27, 2018 (fiscal 2019), due to the rise in fuel prices.

Social program fees for the three months ended September 30, 2018 decreased 19.3% (15.4% year-to-date) compared to the same period in the prior year, mainly as a result of the 15% fare reduction and a decrease in the usage of the MTAP program.

Net retail services revenue increased in the three and six months ended September 30, 2018 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 increased by the change in the annual CPI (Vancouver).

The provincial contribution of $3.2 million in the three months ended September 30, 2018 ($5.6 million year-to-date) consisted of $0.8 million ($1.4 million year-to-date) towards the increased BC seniors' discount and $2.4 million ($4.2 million year-to-date) for fare reductions.

Expenses

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

Operating expenses ($ millions)	Three months ended September 30			Six months ended September 30		
	2018	**2017**	**Increase**	**2018**	**2017**	**Increase**
Operations	142.6	134.4	8.2	278.5	259.6	18.9
Maintenance	15.7	13.6	2.1	37.9	34.5	3.4
Administration	9.9	9.2	0.7	19.7	19.2	0.5
Total operations, maintenance & administration	168.2	157.2	11.0	336.1	313.3	22.8
Depreciation and amortization	43.0	40.1	2.9	85.0	78.7	6.3
Total operating expenses	211.2	197.3	13.9	421.1	392.0	29.1

To improve our customer experience and to accommodate higher traffic volumes, we provided 288 (640 year-to-date) additional round trips throughout the system 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 and implemented our new reservation system. Together, these actions resulted in an increase in labour, fuel consumption, and training-related costs partially offset by the lower cost reflecting the *Spirit of British Columbia*'s consumption of LNG rather than marine diesel. The increase in operating expense also included the impact of higher marine diesel 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 September 30, 2018, operations expenses increased $8.2 million compared to the same period in the prior year due to:

- $5.0 million increase in wages and benefits costs, mainly due to staffing for the additional round trips provided throughout the system 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;
- $1.1 million increase in fuel expense, reflecting a 0.8% or $0.2 million increase in fuel consumption primarily as a result of additional round trips provided and a 2.9% or $0.9 million increase due to higher marine diesel prices, somewhat offset by lower LNG prices;
- $1.0 million increase in contracted services, which includes feasibility costs related to projects currently in the planning stage; and
- $1.1 million increase in other costs including training related costs, software licences, network costs and materials and supplies.

Year-to-date, operations expenses increased $18.9 million compared to the same period in the prior year due to:

- $12.0 million increase in wages and benefits costs, mainly due to staffing for the additional round trips provided throughout the system 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;
- $4.8 million increase in fuel expense, reflecting a 2.0% or $1.1 million increase in fuel consumption primarily as a result of additional round trips provided and a 6.5% or $3.7 million increase due to higher marine diesel prices, somewhat offset by lower LNG prices;
- $2.9 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;
- $0.8 million increase in other costs including training related costs, software licences, network costs and materials and supplies; partially offset by:
- $1.6 million decrease primarily due to an emergency drydocking in the prior year of the *Spirit of Vancouver Island.*

The $2.1 million ($3.4 million year-to-date) increase in maintenance costs compared to the prior year is primarily as a result of the cyclical nature of vessel refit activity and unplanned repairs on the *Coastal Inspiration* and Salish Class vessels.

The $0.7 million ($0.5 million year-to-date) increase in administration costs compared to the prior year is primarily as a result of contracted services for information technology including equipment maintenance.

Depreciation and amortization increased $2.9 million ($6.3 million year-to-date), reflecting new capital assets that have entered service. (See "Investing in our Capital Assets" below for details of capital asset expenditures.)

Net finance and other expenses ($ millions)	**Three months ended September 30**			**Six months ended September 30**		
	2018	**2017**	**Increase (Decrease)**	**2018**	**2017**	**Increase (Decrease)**
Finance expense	15.3	15.4	(0.1)	30.3	30.6	(0.3)
Less: finance income	(1.6)	(1.3)	(0.3)	(2.9)	(2.4)	(0.5)
Net finance expense	13.7	14.1	(0.4)	27.4	28.2	(0.8)
Loss on disposal and revaluation of property, plant and equipment, intangible assets and inventory	0.0	0.1	(0.1)	0.1	0.2	(0.1)
Total net finance and other expenses	13.7	14.2	(0.5)	27.5	28.4	(0.9)

In the three months ended September 30, 2018, net finance and other expenses decreased $0.5 million ($0.9 million year-to-date) compared to the same period in the prior year mainly due to:

- $0.3 million ($0.5 million year-to-date) increase in interest income on investments; and
- $0.2 million ($0.4 million year-to-date) decrease in interest on KfW IPEX-Bank GmbH ("KfW") loans, reflecting $11.0 million ($17.6 million year-to-date) in principal repayments.

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 September 30, 2018, our unrestricted cash and cash equivalents and other short-term investments totalled $88 million and $113 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 the 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 currently under construction and a major upgrade of our Langdale terminal. In total, up to $60.5 million in funding under the New Building Canada Fund has been approved of which, $12.0 million was received by September 30, 2018.

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 September 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 September 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 also ensure that our leverage ratio (total borrowings as a percentage of total borrowings plus shareholders equity) does not exceed 85%. At September 30, 2018, we achieved a debt service coverage ratio of 2.67 and a leverage ratio of 69.0%.

Sources & Uses of Cash

Sources and uses of cash and cash equivalents for the six month periods ended September 30, 2018 and 2017 are summarized in the table below:

($ millions)	Six months ended September 30 2018	2017	Increase (Decrease)
Cash and cash equivalents, beginning of period	69.9	72.0	(2.1)
Cash from operating activities:			
Net earnings	96.9	115.7	(18.8)
Items not affecting cash	113.9	108.4	5.5
Changes in non-cash operating working capital	(6.6)	(7.9)	1.3
Net interest paid	(29.7)	(30.6)	0.9
Cash generated by operating activities	174.5	185.6	(11.1)
Cash (used in) generated by financing activities	(18.7)	25.4	(44.1)
Cash used in investing activities	(137.3)	(185.8)	48.5
Net increase in cash and cash equivalents	18.5	25.2	(6.7)
Cash and cash equivalents, end of period	88.4	97.2	(8.8)

For the six months ended September 30, 2018, cash generated by operating activities decreased $11.1 million compared to the prior year, primarily due to a decrease in net earnings, changes in working capital (receivables, prepaids, payables and deferred revenue) and offset by items not affecting cash. Net earnings reflect the impact of higher operating expenses partially offset by increased traffic levels, higher revenues and lower finance expenses.

Cash used in financing activities in the six months ended September 30, 2018 was $18.7 million. This amount consisted of $17.6 million repayment of KfW loans and $1.1 million in repayment of finance lease obligations.

Cash generated by financing activities in the six months ended September 30, 2017 was $25.4 million. This amount consisted of an additional $45.3 million loan from KfW partially offset by $18.4 million in repayment of KfW loans and finance lease obligations and $1.5 million in deferred financing costs.

Cash used in investing activities in the six months ended September 30, 2018 decreased by $48.5 million compared to the prior year, mainly due to an $11.0 million decrease in cash used for capital expenditures, a $37.0 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

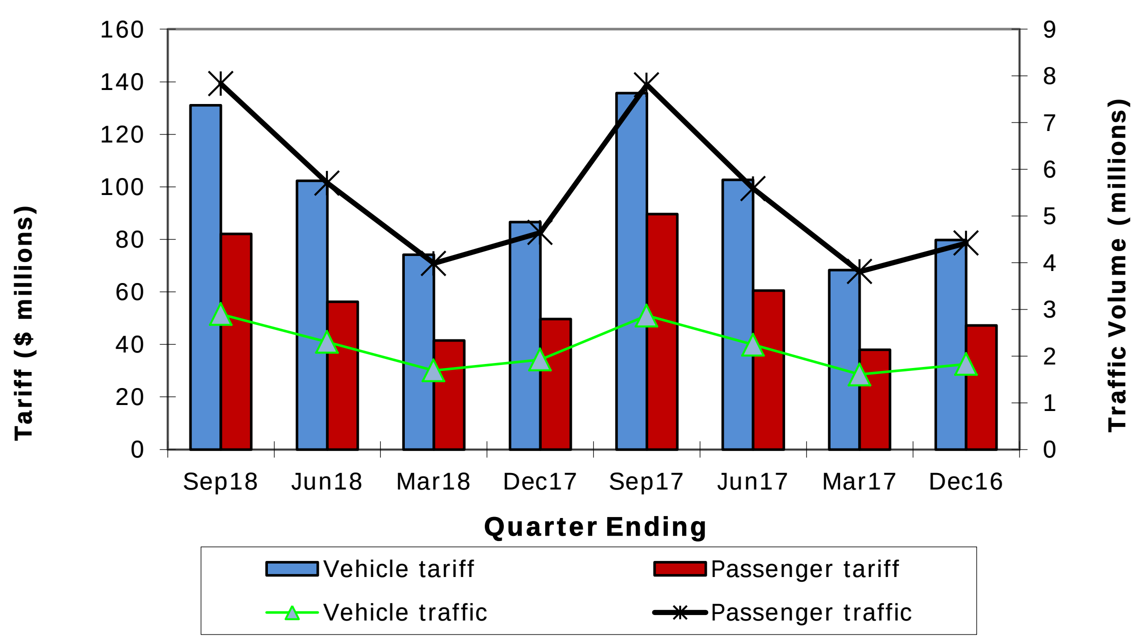
The table below compares earnings and comprehensive income by quarter for the most recent eight quarters:

($ millions)	Sep 18	Jun 18	Mar 18	Dec 17	Sep 17	Jun 17	Mar 17	Dec 16
	Quarter Ended (unaudited)							
Total revenue *	315.8	229.7	168.7	195.7	309.9	226.2	157.9	184.0
Operating profit (loss)	104.6	19.8	(27.8)	-	112.6	31.5	(25.8)	9.8
Net earnings (loss)	90.9	6.0	(41.0)	(14.8)	98.4	17.3	(40.8)	(4.0)

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

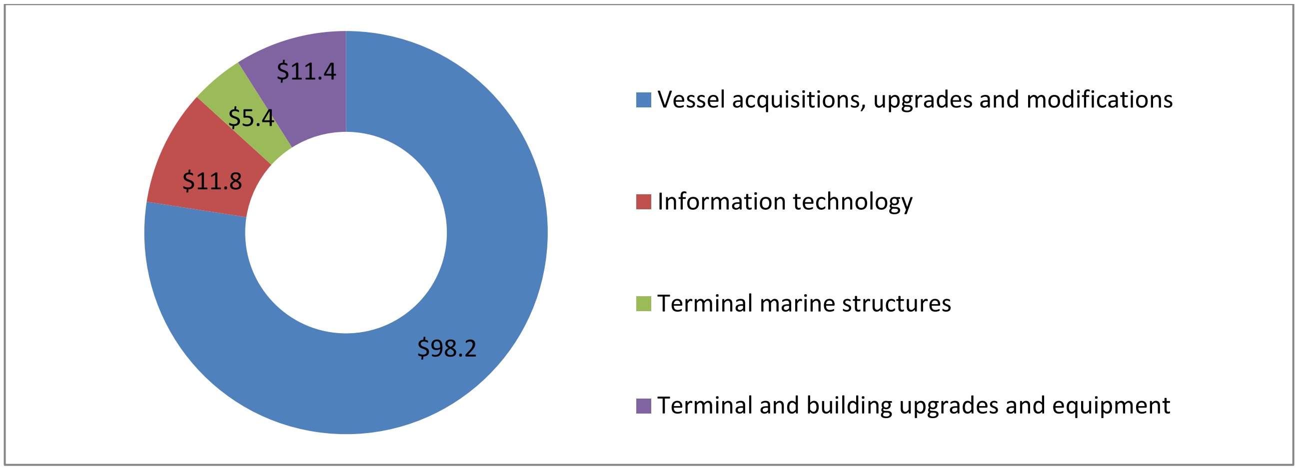
Quarterly results are affected by the seasonality of leisure travel patterns. The second quarter, covering the summer period, experiences the highest traffic levels and the highest net earnings. The third and fourth quarters reflect a seasonal reduction in traffic. We utilize these periods to perform 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:



INVESTING IN OUR CAPITAL ASSETS

Capital Expenditures
Capital expenditures, net of funding, in the six months ended September 30, 2018 totalled $126.8 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 funding, in the three and six month periods ended September 30, 2018, included the following:

($ millions)	**September 30, 2018**	
	3 months	**6 months**
Spirit Class mid-life upgrades	15.3	39.7
Northern Sea Wolf and terminal modifications	11.8	24.7
Major overhauls and inspections	3.4	17.7
New Island Class vessels	8.7	15.3
Customer experience program	2.9	6.3
Hardware upgrades	1.8	3.5
Fleet maintenance facility	2.9	3.9
Tsawwassen-shoreline stabilization	1.6	2.8
Departure Bay-holding compound	-	1.6
Various other projects	5.6	11.3
	54.0	126.8

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. On October 15, 2018, the *Spirit of Vancouver Island* arrived in Gdansk, Poland for its mid-life upgrade. 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, sulphur and nitrogen dioxide emissions from our vessels. FortisBC has committed to provide us with up to $10 million in incentive funding to help offset incremental capital costs associated with the conversion of the Spirit Class vessels to use LNG. The contribution ($4.4 million has been received by September 30, 2018) is dependent upon the purchase of at least 10 million gigajoules of LNG over a 10-year period and will be applied to the capital costs as LNG is consumed by the vessel beginning October 1, 2018. We included $30 million in the original project budget to cover import duty for when the Spirit Class vessels re-enter Canada. On October 31, 2018, we received a ruling from the Canada Border Services Agency confirming that entry would be duty free.

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 $3.3 million in the six months ended September 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 necessary to bring it up to our and Transport Canada's standards of safety and reliability and will enter service in the spring of 2019. The *Northern Sea Wolf*, built in 2000, will accommodate approximately 35 vehicles and 150 passenger and crew.

Major overhauls and inspections

In the three months ended September 30, 2018, we had capital expenditures of $3.4 million ($17.7 million year-to-date) in respect of major overhauls and inspections of components of hull, propulsion and generators for seven vessels that were completed or underway.

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 $7.2 million in the six months ended September 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 450 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 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.

Fleet Maintenance Facility

At Richmond, a project to redevelop and modernize our ship repair and maintenance facility is underway, with phased implementation strategies and construction activities, and is expected to complete in fiscal 2023.

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.

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.

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 $342 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 August 17, 2018, we issued two RFPQ with a closing date of September 7, 2018. The RFPQs are for the procurement of five new vessels to replace aged fleet assets with the procurement process open to local, national and international shipyards. The first RFPQ is for the construction of four 81-metre Island Class ferries, each with a capacity of up to 450 passengers and approximately 47 vehicles. The expected delivery date of the first two vessels is in 2020, with the following two ships expected to be delivered in 2021. The second RFPQ is for the construction of one 107-metre Salish Class vessel with a capacity of 600 passengers and approximately 138 vehicles and an expected delivery date in 2021. The Island Class vessels will have hybrid diesel-electric propulsion and will be built to be capable of conversion to all-electric propulsion as the technology permits and the necessary infrastructure is put in place to support it. The Salish Class vessel will be dual-fuel capable, running primarily on LNG using marine diesel as backup. The five new vessels will allow for the retirement of the *Bowen Queen*, *Mayne Queen* and *Powell River Queen* and for the redeployment of certain other vessels around the fleet. Replacing one older vessel with two new smaller vessels on the Nanaimo Harbour – Gabriola Island route and the Campbell River – Quadra Island route will result in significant increases in capacity and frequency of service and build resiliency in the fleet. We submitted our application to the Commissioner for approval of this major capital expenditure on November 5, 2018. Request for proposals will be issued and, subject to a favourable decision by the Commissioner, we expect to award contracts in the spring of 2019.

On October 5, 2018, we issued a RFEOI for the procurement of five new major vessels to replace aged fleet assets with the procurement process open to local, national and international shipyards. These new major vessels will reflect capacity and levels of service consistent with the current Coastal and Spirit Class vessels in size, capabilities and passenger amenities. These vessels are anticipated to begin service in 2023 on our Major Routes between Metro Vancouver and Vancouver Island. The five new vessels will allow for the retirement of the *Queen of Alberni*, *Queen of New Westminster, Queen of Cowichan* and *Queen of Coquitlam* and will introduce an additional vessel to the fleet to accommodate future traffic, and to build resiliency in the fleet. We expect to make our application to the Commissioner for approval of this major capital expenditure. We expect to complete the procurement process and award contracts by the end of 2019.

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 updates our existing website with an enhanced ecommerce platform. This new platform will allow us to offer customers additional fare choices, including the opportunity to purchase fares at a discount in advance on less popular sailings. We expect it will enhance the customer experience and 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, other service plan changes, and higher costs related to the deployment of major initiatives, partially offset by lower vessel maintenance costs and savings from operating vessels on LNG. We continue to manage our costs prudently without compromising safe operations.

We expect positive net earnings in fiscal 2019, reflecting strong and stable traffic together with our continued focus on managing costs and capacity utilization.

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 six months ended September 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 six months ended September 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, 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, 2018 audited consolidated financial statements and our September 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 and six months ended September 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 Commissioner to ensure, among other things, that our tariffs are fair and reasonable. Under the terms of the Act, the tariffs we charge our customers over a performance term are subject to price caps set by the Commissioner. 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 September 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 and six month periods ended September 30, 2018 and 2017 would be as follows:

($ millions)		Three months ended September 30		Six months ended September 30	
		2018	**2017**	**2018**	**2017**
Net earnings		90.9	98.4	96.9	115.7
Changes in net earnings:					
Regulatory asset or liability	**Statement line item**				
Deferred fuel costs (a)					
Fuel costs under set price	Operations expense	(1.6)	(3.7)	(1.1)	(6.3)
Fuel rebates	Fuel rebates	0.1	6.7	4.6	11.6
Payments from the Province	Ferry service fees	-	0.2	-	0.3
(Decrease) increase in total net earnings		(1.5)	3.2	3.5	5.6
Adjusted net earnings		89.4	101.6	100.4	121.3

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 on 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, and asset renewal programs for vessels and terminals; our customer experience program, Fare Flexibility and Digital Experience Initiative, and pricing promotions; the *Northern Sea Wolf* and the seasonal direct ferry service between Port Hardy and Bella Coola, the minor class vessel replacements, the major class vessel replacements, the Island Class vessels, and Spirit Class mid-life upgrades; the agreements with FortisBC Energy Inc. regarding incentive funding, and the New Building Canada Fund; 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.