

Condensed Interim Consolidated Financial Statements

BRITISH COLUMBIA FERRY SERVICES INC.

Six months ended September 30, 2019 and 2018
(Unaudited)

BRITISH COLUMBIA FERRY SERVICES INC.

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

	September 30, 2019	March 31, 2019
Assets		
Current assets		
Cash and cash equivalents	134,897	59,888
Restricted short-term investments (note 6(b))	31,341	31,651
Other short-term investments	76,617	74,648
Trade and other receivables	29,415	23,246
Prepaid expenses	14,027	8,306
Inventories	31,258	30,870
Derivative assets (note 9(a))	1,317	8,145
	318,872	236,754
Non-current assets		
Loan receivable	24,515	24,515
Property, plant and equipment (note 3)	1,785,321	1,820,232
Intangible assets (note 4)	101,152	101,029
Derivative assets (note 9(a))	5	-
	1,910,993	1,945,776
Total assets	2,229,865	2,182,530
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	45,414	80,173
Interest payable on long-term debt (note 5)	18,456	18,429
Contract liabilities	21,872	28,709
Current portion of long-term debt (notes 5,6)	74,104	57,183
Current portion of accrued employee future benefits (note 14)	2,000	2,000
Current portion of lease liabilities (note 5)	2,297	2,184
Provisions	66,145	62,778
Derivative liabilities (note 9(a))	433	-
	230,721	251,456
Non-current liabilities		
Accrued employee future benefits (note 14)	20,681	20,583
Long-term debt (notes 5,6)	1,188,748	1,222,860
Lease liabilities (note 5)	39,983	39,797
Other liabilities (note 7)	11,493	9,516
Derivative liabilities (note 9(a))	977	-
	1,261,882	1,292,756
Total liabilities	1,492,603	1,544,212
Equity		
Share capital	75,478	75,478
Contributed surplus	25,000	25,000
Retained earnings	632,177	525,006
Total equity before reserves	732,655	625,484
Reserves (note 10(a))	4,607	12,834
Total equity including reserves	737,262	638,318
Total liabilities and equity	2,229,865	2,182,530
Commitments (note 3)		

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Profit or Loss and Other Comprehensive Income (unaudited)
(Expressed in thousands of Canadian dollars)

	Three months ended September 30		Six months ended September 30	
	2019	2018	2019	2018
Revenue				
Vehicle and passenger fares	216,516	213,187	378,992	371,614
Net retail (note 11)	23,869	23,061	40,666	38,620
Fuel surcharges (rebates) (note 16)	2,981	(67)	3,820	(4,585)
Other income	3,532	3,433	6,569	6,240
Revenue from customers	246,898	239,614	430,047	411,889
Ferry service fees	74,579	68,581	129,988	118,380
Federal-Provincial Subsidy Agreement	7,835	7,626	15,670	15,252
Total revenue	329,312	315,821	575,705	545,521
Expenses (note 12, 14)				
Operations	152,231	142,664	292,919	278,535
Maintenance	13,440	15,713	39,752	37,934
Administration	9,271	9,955	17,967	19,694
Depreciation and amortization	45,740	42,921	90,462	84,946
Total operating expenses	220,682	211,253	441,100	421,109
Operating profit	108,630	104,568	134,605	124,412
Net finance and other expenses (note 13)				
Finance expenses	15,330	15,268	30,321	30,240
Finance income	(1,508)	(1,610)	(2,681)	(2,867)
Net finance expense	13,822	13,658	27,640	27,373
(Gain) loss on disposal and revaluation of property, plant and equipment and intangible assets	(194)	54	(206)	143
Net finance and other expenses	13,628	13,712	27,434	27,516
NET EARNINGS	95,002	90,856	107,171	96,896
Other comprehensive (loss) income (note 10(b))				
Items that are or may be reclassified subsequently to net earnings	(3,832)	1,445	(3,890)	9,324
Items not to be reclassified to net earnings	(126)	-	(126)	-
Total other comprehensive (loss) income	(3,958)	1,445	(4,016)	9,324
Total comprehensive income	91,044	92,301	103,155	106,220

BRITISH COLUMBIA FERRY SERVICES INC.

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

	Six months ended September 30	
	2019	2018
Cash flows from operating activities		
Net earnings	107,171	96,896
Items not affecting cash		
Net finance expense	27,640	27,373
Depreciation and amortization	90,462	84,946
Other non-cash changes to property, plant and equipment	(1,152)	(24)
Changes in:		
Accrued employee future benefits	(28)	(507)
Derivative assets and liabilities recognized in net earnings	8	71
Provisions	3,367	2,343
Accrued financing costs	(434)	(276)
Total non-cash items	119,863	113,926
Movements in operating working capital		
Trade and other receivables	(6,169)	(16,757)
Prepaid expenses	(5,721)	(4,247)
Inventories	(388)	(544)
Accounts payable and accrued liabilities	(34,759)	(1,856)
Contract liabilities	(6,837)	(1,593)
Change in non-cash working capital	(53,874)	(24,997)
Change attributable to capital asset acquisitions	23,550	18,456
Change in non-cash operating working capital	(30,324)	(6,541)
Cash generated from operating activities	196,710	204,281
Interest received	3,276	3,149
Interest paid	(32,211)	(32,891)
Net cash generated by operating activities	167,775	174,539

BRITISH COLUMBIA FERRY SERVICES INC.

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

	Six months ended September 30	
	2019	2018
Cash flows from financing activities		
Repayment of long-term debt	(17,641)	(17,641)
Repayment of lease liabilities	(1,093)	(1,064)
Net cash used in financing activities	(18,734)	(18,705)
Cash flows from investing activities		
Proceeds from disposal of property, plant and equipment	295	41
Purchase of property, plant and equipment and intangible assets	(72,668)	(139,309)
Changes in debt service reserve	310	310
Net (purchase of) proceeds from short-term investments	(1,969)	1,626
Net cash used in investing activities	(74,032)	(137,332)
Net increase in cash and cash equivalents	75,009	18,502
Cash and cash equivalents, beginning of period	59,888	69,913
Cash and cash equivalents, end of period	134,897	88,415

BRITISH COLUMBIA FERRY SERVICES INC.

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

	Share capital	Contributed surplus	Retained earnings	Total equity before reserves	Reserves (note 10(a))	Total equity including reserves
Balance as at April 1, 2018	75,478	25,000	478,855	579,333	8,974	588,307
Net earnings	-	-	96,896	96,896	-	96,896
Other comprehensive income	-	-	-	-	9,324	9,324
Realized hedge gains recognized in fuel swaps	-	-	-	-	(7,517)	(7,517)
Hedge losses on interest rate forward contract reclassified to net earnings	-	-	-	-	124	124
Balance as at September 30, 2018	75,478	25,000	575,751	676,229	10,905	687,134
Balance as at April 1, 2019	75,478	25,000	525,006	625,484	12,834	638,318
Net earnings	-	-	107,171	107,171	-	107,171
Other comprehensive loss	-	-	-	-	(4,016)	(4,016)
Realized hedge gains recognized in fuel swaps	-	-	-	-	(4,335)	(4,335)
Hedge losses on interest rate forward contract reclassified to net earnings	-	-	-	-	124	124
Balance as at September 30, 2019	75,478	25,000	632,177	732,655	4,607	737,262

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2019 and 2018
(Tabular amounts expressed in thousands of Canadian dollars)

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

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

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

1. Accounting policies:

(a) Reporting entity:

British Columbia Ferry Services Inc. is a company domiciled in Canada. The address of the Company’s registered office is Suite 500, 1321 Blanshard Street, Victoria, BC Canada, V8W 0B7. These condensed interim consolidated financial statements, as at and for the six months ended September 30, 2019 and 2018, comprise the Company and its subsidiaries (together referred to as the “Group”).

(b) Basis of preparation:

These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) and its interpretations and comply with International Accounting Standard (“IAS”) 34 *Interim Financial Reporting*. These condensed interim consolidated financial statements do not include all disclosures normally provided in annual financial statements and should be read in conjunction with the Company’s last annual consolidated financial statements as at and for the year ended March 31, 2019, as they follow the same accounting policies. For changes in accounting policies effective April 1, 2019, refer to note 2.

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

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

These condensed interim consolidated financial statements were approved by the Board of Directors on November 22, 2019.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2019 and 2018
(Tabular amounts expressed in thousands of Canadian dollars)

2. Adoption of new and amended standards:

Changes in accounting policies:

Amendments to IAS 19 *Employee Benefits*:

On February 7, 2018, the IASB published Amendments to IAS 19 *Employee Benefits*. The amendments to IAS 19 require entities to use the updated actuarial assumptions to determine current service cost and net interest for the remainder of the annual reporting period after a plan amendment, curtailment or settlement. The amendments also clarify how the requirements for accounting for a plan amendment, curtailment or settlement affect the asset ceiling requirements. The Group adopted IAS 19 effective April 1, 2019, and the requirements of these amendments will be applied to all plan amendments, curtailments or settlements occurring after this date. There was no adjustment to the condensed interim consolidated financial statements as a result of this adoption.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2019 and 2018
(Tabular amounts expressed in thousands of Canadian dollars)

3. Property, plant and equipment:

	Vessels	Berths, buildings and equipment	Right-of-use assets - berths, building & equipment	Right-of-use assets - land	Land	Construction in progress	Total
Cost:							
Balance as at March 31, 2019	1,627,311	655,543	173,548	40,868	24,714	196,359	2,718,343
Additions	(648) ¹	-	1,136	256	-	46,517	47,261
Disposals	(26,960)	(2,862)	-	-	-	-	(29,822)
Transfers from construction in progress	152,480	12,510	-	-	-	(164,990)	-
Balance as at September 30, 2019	1,752,183	665,191	174,684	41,124	24,714	77,886	2,735,782
Accumulated depreciation:							
Balance as at March 31, 2019	624,593	205,671	67,241	606	-	-	898,111
Depreciation	60,905	17,285	3,482	411	-	-	82,083
Disposals	(26,880)	(2,853)	-	-	-	-	(29,733)
Balance as at September 30, 2019	658,618	220,103	70,723	1,017	-	-	950,461
Net carrying value:							
As at March 31, 2019	1,002,718	449,872	106,307	40,262	24,714	196,359	1,820,232
As at September 30, 2019	1,093,565	445,088	103,961	40,107	24,714	77,886	1,785,321

¹ Reclassifications from Other liabilities (note 7)

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2019 and 2018
(Tabular amounts expressed in thousands of Canadian dollars)

3. Property, plant and equipment (continued):

During the six months ended September 30, 2019, financing costs capitalized during construction amounted to \$1.8 million (September 30, 2018: \$2.9 million) with an average capitalization rate of 4.99% (September 30, 2018: 5.01%).

Contractual commitments as at September 30, 2019, for assets to be constructed totalled \$38.7 million (March 31, 2019: \$47.5 million). The majority of these contractual commitments relate to the construction of two Island class vessels.

The Government of Canada, through the New Building Canada Fund, agreed to provide funding of up to \$43.4 million to help offset the costs of the newly established route connecting Port Hardy and Bella Coola and the replacement of two minor vessels. During the six months ended September 30, 2019, the Group recorded \$2.2 million as a reduction of the cost of property, plant and equipment as a result of funding provided. Funding of \$29.5 million was recorded as a reduction of the cost of the property, plant and equipment in fiscal years 2019 and 2018.

FortisBC Energy Inc. has committed to provide the Group with funding as part of the Natural Gas for Transportation ("NGT") incentive funding. The contributions are dependent upon the purchase of liquified natural gas ("LNG"). During the six months ended September 30, 2019, \$0.6 million (September 30, 2018: \$nil) was recognized as a reduction of the cost of property, plant and equipment.

During the six months ended September 30, 2019, the Group received \$0.5 million (September 30, 2018: \$0.5 million) of rental income earned from buildings held for leasing purposes. These buildings have a cost and accumulated depreciation of \$11.9 million and \$3.8 million, respectively, as at September 30, 2019.

The *Howe Sound Queen* (decommissioned during the three months ended June 30, 2019) was sold in August 2019. The *Queen of Burnaby* (decommissioned during the year ended March 31, 2018) is classified as held for sale and has no carrying value.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2019 and 2018
(Tabular amounts expressed in thousands of Canadian dollars)

4. Intangible assets:

	Acquired software, licenses and rights	Internally developed software and website	Assets under development	Total
Cost:				
Balance as at March 31, 2019	130,335	18,887	22,297	171,519
Additions	-	-	8,502	8,502
Disposals	(169)	-	-	(169)
Transfers from assets under development	3,627	1	(3,628)	-
Balance as at September 30, 2019	133,793	18,888	27,171	179,852
Accumulated amortization:				
Balance as at March 31, 2019	58,879	11,611	-	70,490
Amortization	7,740	639	-	8,379
Disposals	(169)	-	-	(169)
Balance as at September 30, 2019	66,450	12,250	-	78,700
Net carrying value:				
As at March 31, 2019	71,456	7,276	22,297	101,029
As at September 30, 2019	67,343	6,638	27,171	101,152

Capitalized financing costs during construction for intangible assets with an average capitalization rate of 4.99% for the six months ended September 30, 2019 totalled \$0.5 million (September 30, 2018: \$0.4 million).

During the six months ended September 30, 2019, intangible assets totalling \$4.8 million (September 30, 2018: \$3.7 million) were acquired and \$3.7 million (September 30, 2018: \$4.6 million) were internally developed.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2019 and 2018

(Tabular amounts expressed in thousands of Canadian dollars)

5. Liabilities arising from financing activities:

Continuity of liabilities arising from financing activities:

	Long-term debt	Lease liabilities	Interest payable on long-term debt
Balance as at March 31, 2019	1,280,043	41,981	18,429
Additions	-	1,392	30,983
Payments	(17,641)	(1,093)	(30,956)
Amortization of debt issue costs	450	-	-
Balance as at September 30, 2019	1,262,852	42,280	18,456
Current	74,104	2,297	18,456
Non-current	1,188,748	39,983	-
Balance as at September 30, 2019	1,262,852	42,280	18,456

During the six months ended September 30, 2019, the Group recorded \$1.0 million (September 30, 2018: \$0.9 million) of interest expense related to lease liabilities.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2019 and 2018
(Tabular amounts expressed in thousands of Canadian dollars)

6. Loans:

Long-term debt:	As at	
	September 30, 2019	March 31, 2019
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (effective interest rate of 6.41%)	250,000	250,000
5.02% Senior Secured Bonds, Series 07-1, due March 2037 (effective interest rate of 5.06%)	250,000	250,000
5.58% Senior Secured Bonds, Series 08-1, due January 2038 (effective interest rate of 5.62%)	200,000	200,000
4.70% Senior Secured Bonds, Series 13-1, due October 2043 (effective interest rate of 4.75%)	200,000	200,000
4.29% Senior Secured Bonds, Series 14-1, due April 2044 (effective interest rate of 4.45%)	200,000	200,000
12 Year Loan, maturing March 2020		
Tranche A (effective interest rate of 5.17%)	3,750	7,500
Tranche B (floating interest rate of 2.28% at September 30, 2019)	22,500	22,500
12 Year Loan, maturing June 2020		
Tranche A (effective interest rate of 5.18%)	5,625	9,375
Tranche B (floating interest rate of 2.27% at September 30, 2019)	22,500	22,500
2.95% Loan, maturing January 2021 (effective interest rate of 3.08%)	13,500	18,000
2.09% Loan, maturing October 2028 (effective interest rate of 2.70%)	34,569	36,437
2.09% Loan, maturing January 2029 (effective interest rate of 2.68%)	35,824	37,710
2.09% Loan, maturing January 2029 (effective interest rate of 2.70%)	35,824	37,710
	1,274,092	1,291,732
Less: Unamortized deferred financing costs and bond discounts	(11,240)	(11,689)
Balance as at September 30, 2019	1,262,852	1,280,043
Current	74,104	57,183
Non-current	1,188,748	1,222,860
Balance as at September 30, 2019	1,262,852	1,280,043

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2019 and 2018
(Tabular amounts expressed in thousands of Canadian dollars)

6. Loans (continued):

(a) Credit facility:

The Group has a credit facility with a syndicate of Canadian banks, secured by pledged bonds. This revolving facility, in the amount of \$155.0 million, was renewed on March 6, 2019 to extend the maturity date to April 20, 2024. There were no draws on this credit facility as at September 30, 2019 and as at March 31, 2019. There was no interest expensed during the six months ended September 30, 2019 and September 30, 2018. Letters of credit outstanding against this facility as at September 30, 2019 totalled \$0.2 million (March 31, 2019: \$0.1 million).

(b) Debt service reserves:

Long-term debt agreements require the Group to maintain debt service reserves equal to a minimum of six months of interest payments, to be increased under certain conditions. As at September 30, 2019, debt service reserves of \$31.3 million (March 31, 2019: \$31.6 million) were held in short-term investments and have been classified as restricted short-term investments on the statements of financial position.

(c) Debt service coverage:

Debt service coverage (earnings before interest, taxes, depreciation, amortization, and rent) is required to be at least 1.25 times the debt service cost under the credit facility agreement. As at September 30, 2019, the debt service coverage ratio was 3.01.

In addition, there are other covenants contained in the Master Trust Indenture ("MTI") (May 2004) available at www.SEDAR.com. The Group was in compliance with all of its covenants at September 30, 2019 and at March 31, 2019.

7. Other liabilities:

FortisBC Energy Inc. has committed to provide the Group with funding as part of the NGT incentive funding. The funding is dependent upon the purchase of LNG and the incremental costs of building/converting vessels to be capable of using LNG for propulsion.

As of March 31, 2018, the Group had received all of the eligible contributions related to the Salish Class vessels. During the six months ended September 30, 2019, the Group recorded \$2.6 million of the total contribution of up to \$10.0 million to be applied towards the mid-life upgrade, including conversion to LNG, of the two Spirit class vessels. As at September 30, 2019, the Group has received a total of \$13.0 million in contributions related to the Spirit Class and Salish Class vessels.

During the six months ended September 30, 2019, the Group recognized \$0.6 million (March 31, 2019: \$0.9 million) as an offset to the capital costs of the vessels.

	Salish Class	Spirit Class	Total
Balance as at March 31, 2019	5,489	4,027	9,516
Additions	-	2,625	2,625
Reclassifications to property, plant and equipment (note 3)	(249)	(399)	(648)
Balance as at September 30, 2019	5,240	6,253	11,493

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2019 and 2018
(Tabular amounts expressed in thousands of Canadian dollars)

8. Financial instruments:

The carrying values of the Group's financial instruments approximate fair value as at September 30, 2019 and March 31, 2019 for all financial instruments except for long-term debt.

	As at September 30, 2019		As at March 31, 2019	
	Carrying Value	Approximate Fair Value	Carrying Value	Approximate Fair Value
Long-term debt, including current portion ¹	1,262,852	1,678,049	1,280,043	1,623,838

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

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

The following items shown in the consolidated statements of financial position as at September 30, 2019 and March 31, 2019 are carried at fair value on a recurring basis using Level 1 or 2 inputs. There were no financial assets and liabilities at September 30, 2019, or at March 31, 2019, valued using Level 3 inputs.

	As at September 30, 2019		As at March 31, 2019	
	Level 1	Level 2	Level 1	Level 2
Asset (liability):				
Cash ¹	130,177	-	49,486	-
Cash equivalents ¹	4,720	-	472	-
Derivative assets ²	-	1,322	-	8,145
Derivative liabilities ²	-	(1,410)	-	-
	134,897	(88)	49,958	8,145

¹ Classified in Level 1 as the measurement inputs are derived from observable, unadjusted quoted prices in active markets for identical assets.

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

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment. Where market prices are not available, fair values are estimated using discounted cash flow analysis. No amounts have been reclassified into or out of fair value classifications in the six months ended September 30, 2019 or September 30, 2018.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2019 and 2018
(Tabular amounts expressed in thousands of Canadian dollars)

8. Financial instruments (continued):

During the six months ended September 30, 2019 and September 30, 2018, gains or losses related to Level 2 derivatives have been recorded in OCI.

There were no Level 3 instruments outstanding during the period.

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

9. Financial risk management:

Credit risk:

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

Based on the historical default experience, the Group has established a lifetime ECL allowance of 1% of the trade receivables. Amounts due from the Government of Canada and the Province are considered low credit risk and are excluded. As at March 31, 2019, the provision for impairment was \$0.1 million. During the six months ended September 30, 2019, the Group recorded an additional provision of \$0.1 million for a total of \$0.2 million.

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

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

Fuel price risk:

The Group is exposed to risks associated with changes in the market price of marine diesel fuel and LNG fuel. In order to reduce price volatility and add a fixed component to the inherent floating nature of fuel prices, the Group may manage its exposure by entering into hedging instruments with certain financial intermediaries. Fuel price hedging instruments are used to reduce fuel price risk and to minimize fuel surcharges, not for generating trading profits. Gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs. The Group's Financial Risk Management Policy limits hedging, to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period; 90% of anticipated monthly fuel consumption for the 12 month period thereafter; 85% of anticipated monthly fuel consumption for the period thereafter to the end of 36 month period; and to 70% of anticipated monthly fuel consumption for the period between 36 months and the end of the fifth performance term. Performance term five will commence April 1, 2020 and end on March 31, 2024.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2019 and 2018
(Tabular amounts expressed in thousands of Canadian dollars)

9. Financial risk management (continued):

Fuel price risk (continued):

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

The Group hedges using CAD denominated ultra-low sulfur diesel ("ULSD") to reduce its exposure to changes in ULSD and foreign exchange risk components associated with forecast diesel fuel purchases. During the six months ended September 30, 2019, the Group entered into ULSD fuel swap contracts with a notional value of \$77.4 million CAD. The notional value of all fuel swap contracts outstanding as at September 30, 2019 was \$98.0 million CAD (March 31, 2019: \$50.6 million). Hedge accounting was applied to these contracts. No LNG swap contracts were entered into during the six months ended September 30, 2019 and no LNG swap contracts were outstanding as at September 30, 2019.

During the six months ended September 30, 2019, open fuel swap contracts had unrealized hedging losses of \$3.9 million recognized in OCI (September 30, 2018: unrealized gains of \$9.3 million). In addition, for closed fuel swap contracts net realized hedging gains of \$4.3 million were reclassified from reserves and included in the Group's fuel expense during the six months ended September 30, 2019 (September 30, 2018: net realized hedging gains of \$7.5 million). There was no hedge ineffectiveness during the six months ended September 30, 2019 or in the comparative period in 2018.

Cash flow hedges:

	Fiscal 2020	Fiscal 2021	Fiscal 2022	Total
Fuel contracts (litres in thousands)	33,328	62,995	58,030	154,353
Contract price range (\$/litre)	\$0.5475 - \$0.6385	\$0.6280 - \$0.6520	\$0.6270 - \$0.6499	

(a) As at September 30, 2019, the Group's current derivative assets of \$1,316,928 included fuel swap contracts of \$1,311,551 and foreign exchange forward contracts of \$5,377 (foreign exchange forward contracts notional value: \$364,119). The Group's current derivative liabilities of \$432,910 as at September 30, 2019, included fuel swap contracts of \$425,781 and foreign exchange forward contracts of \$7,129 (foreign exchange forward contracts notional value: \$616,163).

Fuel swap contracts as at September 30, 2019 were as follows:

	Notional value of the hedging instrument	Carrying value of the hedging instrument	Cash flow hedge reserve	Fair value changes used for calculating hedge ineffectiveness	
				Hedging instruments	Hedged items
Derivative assets:					
Current	25,275	1,312	1,312	1,312	1,313
Non-current	1,672	5	5	5	5
Derivative liabilities:					
Current	17,982	426	426	426	427
Non-current	53,046	977	977	977	984

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2019 and 2018
(Tabular amounts expressed in thousands of Canadian dollars)

9. Financial risk management (continued):

Fuel price risk (continued):

(b) Cash flow hedge reserve (note 10(a)):

	Three months ended September 30		Six months ended September 30	
	2019	2018	2019	2018
Items recognized in cash flow hedge reserve:				
Unrealized (losses) gains in fuel swap contracts	(3,832)	1,445	(3,890)	9,324
Items reclassified from cash flow hedge reserve:				
Hedge losses on interest rate forward contract reclassified to net earnings	63	62	124	124
Realized hedge gains recognized in fuel swaps	(1,378)	(4,196)	(4,335)	(7,517)
Net change in cash flow hedge reserve	(5,147)	(2,689)	(8,101)	1,931

10. Reserves and other comprehensive (loss) income:

(a) Continuity of reserves:

	Land revaluation reserves	Employee future benefit revaluation reserves	Fuel swaps reserves	Interest rate forward contracts reserves	Total
Balance as at March 31, 2019	16,879	(5,969)	8,138	(6,214)	12,834
Actuarial losses on post-employment benefit obligations	-	(126)	-	-	(126)
Derivatives designated as cash flow hedges (note 9(b)):					
Increase in unrealized loss	-	-	(3,890)	-	(3,890)
Reclassification of realized gains	-	-	(4,335)	-	(4,335)
Amortization of loss	-	-	-	124	124
Balance as at September 30, 2019	16,879	(6,095)	(87)	(6,090)	4,607

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2019 and 2018
(Tabular amounts expressed in thousands of Canadian dollars)

10. Reserves and other comprehensive (loss) income (continued):

(b) Other comprehensive (loss) income:

	Three months ended September 30		Six months ended September 30	
	2019	2018	2019	2018
Items that are or may be reclassified subsequently to net earnings:				
Hedge (losses) gains on fuel swaps (note 9(b))	(3,832)	1,445	(3,890)	9,324
Items that will not be reclassified to net earnings:				
Actuarial losses on post-employment benefit obligations (note 14)	(126)	-	(126)	-
Total other comprehensive (loss) income	(3,958)	1,445	(4,016)	9,324

11. Net retail:

	Three months ended September 30		Six months ended September 30	
	2019	2018	2019	2018
Retail revenue	37,597	36,431	64,622	61,544
Cost of goods sold	(13,728)	(13,370)	(23,956)	(22,924)
Net retail	23,869	23,061	40,666	38,620

12. Operating expenses:

	Three months ended September 30		Six months ended September 30	
	2019	2018	2019	2018
Salaries, wages and benefits	106,966	100,019	214,300	199,499
Fuel	32,808	32,019	59,781	60,956
Materials, supplies and contracted services	19,651	19,527	44,995	42,719
Other operating expenses	15,517	16,767	31,562	32,989
Depreciation and amortization	45,740	42,921	90,462	84,946
Total operating expenses	220,682	211,253	441,100	421,109

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2019 and 2018
(Tabular amounts expressed in thousands of Canadian dollars)

13. Net finance expense:

	Three months ended September 30		Six months ended September 30	
	2019	2018	2019	2018
Finance expenses:				
Long-term debt	15,527	15,819	30,983	31,564
Lease liabilities	477	471	984	948
Amortization of deferred financing costs and bond discounts	286	305	574	613
Other finance charges	47	48	110	399
Interest capitalized in the cost of qualifying assets	(1,007)	(1,375)	(2,330)	(3,284)
Total finance expenses	15,330	15,268	30,321	30,240
Finance income	(1,508)	(1,610)	(2,681)	(2,867)
Net finance expense	13,822	13,658	27,640	27,373

14. Accrued employee future benefits:

During the six months ended September 30, 2019, the Group recognized total defined benefit costs of \$1.1 million (September 30, 2018: \$1.3 million).

During the three months ended September 30, 2019, the Group recognized a loss of \$0.1 million (September 30, 2018: \$nil) in other comprehensive income reflecting an actuarial valuation as at March 31, 2019, for the residual liability for Worker's Compensation Claims arising from the Workers' Compensation Board deposit coverage system.

15. Related party transactions:

In accordance with the Act, the Group is responsible for paying any expenses that are incurred by the Authority, without charge. During the six months ended September 30, 2019, the Group paid \$134,479 (September 30, 2018: \$79,772) of such expenses.

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

16. Economic effect of rate regulation:

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

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

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2019 and 2018
(Tabular amounts expressed in thousands of Canadian dollars)

16. Economic effect of rate regulation (continued):

As a result, the Group is not permitted to recognize its regulatory assets and regulatory liabilities in its consolidated statements of financial position.

Regulatory assets generally represent incurred costs that have been deferred for purposes of rate regulation because they are probable of future recovery in tariffs or fuel surcharges. Regulatory liabilities represent obligations to customers which will be settled through future tariff reductions or fuel rebates. Management continually assesses whether the Group's regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes. Management believes that the regulatory assets at September 30, 2019, are probable of future recovery in tariff or fuel surcharges.

The Act contains provisions which ensure that if tariffs charged by the Group exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. At September 30, 2019 and March 31, 2019, tariffs charged to customers were below established price caps.

If the Group was permitted under IFRS to recognize the effects of rate regulation, the regulatory liabilities at September 30, 2019 would have been \$1.6 million (March 31, 2019: regulatory assets of \$4.5 million).

If the Group was permitted under IFRS to recognize the effects of rate regulations and to record regulatory assets and regulatory liabilities, net earnings for the three months ended September 30, 2019 would have been \$4.2 million lower (September 30, 2018: \$1.5 million lower) and during the six months ended September 30, 2019 would have been \$6.0 million lower (September 30, 2018: \$3.5 million higher) as detailed below:

	Three months ended September 30		Six months ended September 30	
	2019	2018	2019	2018
Effect of rate regulation on net earnings				
Regulatory accounts:				
Deferred fuel costs:				
Fuel costs under set price	(1,261)	(1,603)	(2,198)	(1,116)
(Surcharges) rebates	(2,981)	67	(3,820)	4,585
Total (decrease) increase in net earnings	(4,242)	(1,536)	(6,018)	3,469

17. Subsequent event:

- (a) On October 15, 2019, the Group issued \$250.0 million of senior secured bonds and established a debt service reserve for these bonds in the amount of \$3.5 million. The Series 19-1 bonds bear interest at 2.794% per annum, payable semi-annually and will mature October 15, 2049.

The net proceeds from the sale of the bonds will be used, together with additional cash on hand, to provide funding for capital expenditures and general corporate purposes and to fund the series' debt service reserve account.

- (b) On October 25, 2019, contracts with a shipbuilding vendor became effective for the construction of four new Island Class vessels, expected to enter service during fiscal 2023. The total costs expected to be capitalized related to this project, including capital financing costs are approximately \$200 million.