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

For the three and nine months and ended December 31, 2019

Dated February 21, 2020

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The following is our discussion and analysis of the financial condition and financial performance of British Columbia Ferry Services Inc. ("BC Ferries" or the "Company") for the three and nine months ended December 31, 2019 that has been prepared with information available as of February 21, 2020. This discussion and analysis should be read in conjunction with our unaudited condensed interim consolidated financial statements and related notes for the nine months ended December 31, 2019 and 2018, and our audited consolidated financial statements and related notes for the years ended March 31, 2019 ("fiscal 2019") and March 31, 2018 ("fiscal 2018"), together with our Management's Discussion and Analysis for fiscal 2019. These documents are available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html and on SEDAR at www.sedar.com.

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

BUSINESS OVERVIEW

British Columbia Ferry Services Inc. is an independent company, providing passenger and vehicle ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world. We provide frequent year-round transportation service, with 35 vessels operating on 25 routes out of 47 terminals spread over 1,600 kilometres of coastline. We also manage ferry transportation services on other remote routes through contracts with independent operators.

Our service is an integral part of British Columbia's coastal transportation system and has been designated by the Province of British Columbia (the "Province") as an essential service for purposes of the provincial Labour Relations Code. This designation means our services are considered necessary for the protection of the health, safety and welfare of the residents of British Columbia.

Our principal business of ferry transportation requires positive net earnings and ongoing access to capital in order to fund operations, satisfy outstanding long-term debt obligations and fulfill future capital asset obligations.

During the three months ended December 31, 2019 (the third quarter of fiscal 2020), we provided over 44,000 sailings, carrying 4.8 million passengers and 2.0 million vehicles. We experienced a 0.7% increase in passenger traffic and a 1.6% increase in vehicle traffic compared to the same quarter in the prior year. Year-to-date, we have carried 18.3 million passengers and 7.3 million vehicles, an increase of 0.2% and 1.3%, respectively, compared to the same period in the prior year. For a discussion of our traffic levels, see "Financial and Operational Overview" below.

Our Major Routes, which are our four busiest routes, consist of three regulated routes connecting Metro Vancouver with mid and southern Vancouver Island and one regulated route connecting Horseshoe Bay and Langdale. Our Northern Routes currently consist of three regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island. Our Other Routes consist of 18 regulated routes and 8 unregulated routes primarily serving the northern and southern Gulf Islands and the northern Sunshine Coast.

Significant events during or subsequent to the third quarter of fiscal 2020 include the following:

Vessels

- On October 25, 2019, contracts became effective with Damen Shipyard Group of the Netherlands for the construction of four new Island Class vessels expected to enter service during fiscal 2023. These four vessels are in addition to the two Island Class vessels constructed by Damen Shipyard Group which arrived in Canada on January 18, 2020 and are expected to enter service in fiscal 2021. The Island Class vessels will be outfitted with hybrid diesel-electric propulsion and will each have a capacity of up to 450 passengers and approximately 47 vehicles. The total project budget for the four additional vessels, including financing and project management costs, is approximately $200 million.

- On December 20, 2019, a contract became effective with Remontowa Shipbuilding S.A. of Gdansk, Poland to build a new Salish Class vessel. The new vessel will be identical to our three existing Salish Class vessels which are dual-fuel capable, designed to run primarily on LNG with marine diesel fuel as a backup. This fourth Salish Class vessel will replace the 55-year old *Mayne Queen* and is expected to enter service in fiscal 2023.

Regulatory

- On October 18, 2019, the British Columbia Ferries Commissioner (the "Commissioner") issued Order 19-02B, approving a supplementary application to amend the previously approved major capital expenditure amount for the construction and introduction of one new Salish Class vessel and four new Island Class vessels. The initial Order 19-02 granted on January 7, 2019, and Order 19-02B are available on the Commissioner's website at www.bcferrycommission.com.

- On December 24, 2019, the Commissioner issued Order 16-02B, approving a supplemental application to amend the previously approved amount for our Fare Flexibility and Digital Experience Initiative. The initial Order 16-02 granted on September 21, 2016 is available on the Commissioner's website at www.bcferrycommission.com.

General

- On October 15, 2019, we completed a private placement of $250 million of 30-year senior secured bonds. These bonds bear interest at a rate of 2.794% per annum, payable semi-annually. The net proceeds of this new issue will be used, together with additional cash on hand, to provide for capital expenditures, general corporate purposes and to fund the bond series reserve account. These bonds were rated "A (high)" by DBRS and "AA-" by Standard & Poor's ("S&P").

- On December 16, 2019, we announced that as of December 17, 2019, fuel surcharges would be eliminated from our routes as a result of declining fuel prices. Surcharges of 1.5% on average, on all routes with the exception of the Northern Routes, had been in place since June 1, 2019.

FINANCIAL AND OPERATIONAL OVERVIEW

This section provides an overview of our financial and operational performance for the three and nine month periods ended December 31, 2019 and 2018.

($ millions)	Three months ended December 31			Nine months ended December 31		
	2019	**2018**	**Variance**	**2019**	**2018**	**Variance**
Total revenue	210.9	207.7	3.2	786.7	753.2	33.5
Operating expenses	205.7	198.3	7.4	646.8	619.4	27.4
Operating profit	5.2	9.4	(4.2)	139.9	133.8	6.1
Net finance and other	13.5	13.1	0.4	41.0	40.6	0.4
Net (loss) earnings	(8.3)	(3.7)	(4.6)	98.9	93.2	5.7
Other comprehensive income (loss)	4.6	(10.9)	15.5	0.6	(1.6)	2.2
Total comprehensive (loss) income	(3.7)	(14.6)	10.9	99.5	91.6	7.9

Quarterly results are affected by the seasonality of leisure travel patterns. Our third quarter results reflect a seasonal reduction in traffic. We utilize this period to perform upgrades and major maintenance and refit programs, as well as to undertake mandatory inspections on the majority of our vessels.

Our net loss in the three months ended December 31, 2019 was $4.6 million larger than in the three months ended December 31, 2018. However, year-to-date, our net earnings were $5.7 million higher than the same period in the prior year.

In the three months ended December 31, 2019, revenues increased by $3.2 million or 1.5% compared to the same period in the prior year, primarily as a result of increased traffic, retail revenue and provincial contribution to fare initiatives. Year-to-date revenues increased $33.5 million or 4.4% compared to the same period in the prior year, primarily as a result of increased vehicle traffic, average vehicle tariff yield, ferry transportation fees, provincial contribution to fare initiatives, net retail sales and the expanded service of the Central Coast seasonal route. On April 1, 2019, fares on all routes were held at the fiscal 2019 level.

In addition, a fuel surcharge was in place from June 1, 2019 through December 16, 2019 due to fuel price market conditions. On December 17, 2019, fuel surcharges were eliminated from our routes as a result of declining fuel prices.

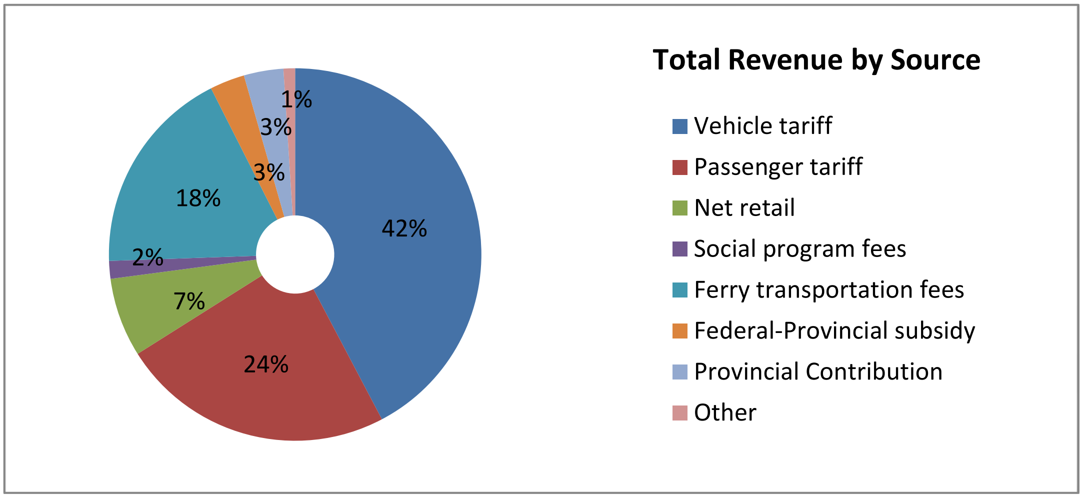
In the three months ended December 31, 2019, operating expenses increased by $7.4 million or 3.7% ($27.4 million or 4.4% year-to-date) compared to the same period of the prior year. We provided 582.5 (1,676.5 year-to-date) additional round trips compared to the same period in the prior year to satisfy increased service levels agreed to with the Province, accommodate higher traffic volumes, and improve our customer experience. We introduced the *Northern Sea Wolf* and re-introduced the upgraded *Spirit of Vancouver Island* into service. These actions resulted in an increase in labour costs and a decrease in marine diesel fuel consumption with the upgraded Spirit Class vessels primarily operating on lower-cost LNG. The increase in operating expenses also included the impact of wage rate increases in accordance with the Collective Agreement with the BC Ferry & Marine Workers' Union (the "Union"), higher benefit costs (Employer Health Tax, Workers Compensation and pension), and higher depreciation. (See "Expenses" for more detail.)

During the three months ended December 31, 2019, total comprehensive income increased $10.9 million ($7.9 million year-to-date) compared to the same period in the prior year, comprised of an increase in other comprehensive income of $15.5 million ($2.2 million year-to-date) and an increase in net loss of $4.6 million ($5.7 million increase in earnings year-to-date).

In the three months ended December 31, 2019, the increase in other comprehensive income of $15.5 million reflects the change in fair value of our open fuel swap contracts. Year-to-date, the increase in other comprehensive income of $2.2 million reflects a $2.3 million increase in the change in fair value of our open fuel swap contracts and $0.1 million loss on the actuarial valuation of our employee benefit plan.

Revenue and Operational Statistics - Overall

The following discussions of revenue are based on IFRS results, with reference to the impacts of rate regulation (See "Accounting Practices - The Effect of Rate Regulation"). Our Major Routes, which are our four busiest routes, consist of three regulated routes connecting Metro Vancouver with mid and southern Vancouver Island and one regulated route connecting Horseshoe Bay and Langdale. Our Northern Routes consist of three regulated routes, including the new route connecting Port Hardy and Bella Coola which commenced in fiscal 2019, 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.



The Provincial Contribution is provided by the Province to partially fund the initiative for fare freezes, fare reductions and increasing the BC Seniors' discount from 50% to 100%. Fuel rebates and surcharges are not included in the above total revenue by source.

Select operational statistics and total revenues for the three and nine months ended December 31, 2019 and 2018 are shown in the tables below.

	Three months ended December 31		Nine months ended December 31	
Operational Statistics	**2019**	**2018**	**2019**	**2018**
Vehicle traffic	2,006,216	1,973,694	7,266,267	7,172,712
Passenger traffic	4,758,567	4,727,250	18,305,644	18,267,104
On-time performance	91.3%	90.8%	87.7%	86.9%
Number of round trips	20,094.0	19,511.5	62,750.0	61,073.5
Capacity provided (AEQs)	3,734,777	3,637,950	12,115,784	11,912,227
AEQs carried	2,278,262	2,243,156	8,220,072	8,121,312
Capacity utilization	61.0%	61.7%	67.8%	68.2%

During the three months ended December 31, 2019, vehicle traffic increased 1.6% (1.3% year-to-date) and passenger traffic increased 0.7% (0.2% year-to-date) compared to the same period in the prior year. We believe that vehicle and passenger traffic, during the three months ended December 31, 2019, were positively impacted by fewer sailing disruptions as a result of fewer storm events compared to the same period in the prior year. Year-to-date, we believe that passenger and vehicle traffic were positively impacted by holding fares at fiscal 2019 levels, two more days of Easter holidays falling in fiscal 2020 and fewer storm events; partially offset by a decrease in the number of tour buses using our ferry services compared to the same period in the prior year.

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 departure 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 arrival time. In each case, on-time performance can be impacted by delays due to weather, vessel substitution, mechanical issues, terminal dock maintenance or closures and periods of high traffic demand.

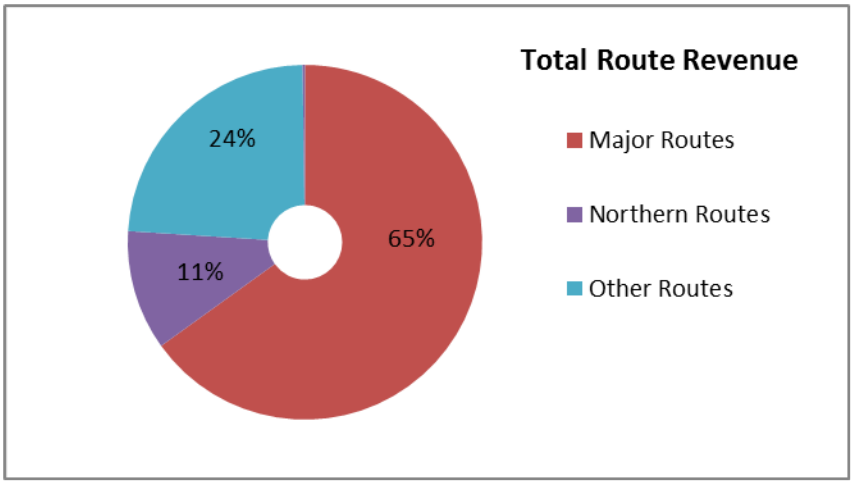
Meeting customer service expectations in a safe and reliable manner is the principal factor guiding our focus on on-time performance. Our initiatives to improve on-time performance include adjusting and/or expanding sailing schedules, adjusting crewing schedules and refining vehicle loading processes during peak periods. In the three months ended December 31, 2019, overall on-time performance improved 0.5% (0.8% year-to-date) compared to the same period in the prior year.

An automobile equivalent ("AEQ") is our standard unit of measure for an approximation of one car length. AEQs are calculated by using a conversion factor for each vehicle type. For example, a passenger vehicle would be one AEQ while a bus would be three AEQs. The change in AEQs from one period to the next may not be proportionate to the change in vehicle traffic, due to variations in the mix of vehicle types (the relative number of buses, commercial vehicles and passenger vehicles) and actual size of vehicles carried.

Vehicle capacity provided, measured in AEQs, is the available vehicle deck space on a vessel multiplied by the number of trips. The Coastal Ferry Services Contract ("CFSC") stipulates, among other things, the minimum number of round trips to be provided for each regulated ferry service route in exchange for the payment of ferry transportation fees by the Province. The year–over-year change in the number of round trips provided can be impacted by cancellations and in response to changes in demand or the number of trips stipulated by the CFSC. In the three months ended December 31, 2019, we provided 582.5 (1,676.5 year-to-date) additional round trips compared to the same period in the prior year, resulting in an increase in capacity provided.

Capacity utilization in a period is calculated by dividing the AEQs carried during the period by the AEQ capacity provided by our vessels in the same period. 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 61.7% to 61.0% for the three months ended December 31, 2019 (from 68.2% year-to-date to 67.8%), 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 traffic levels.

Revenue ($ millions)	**Three months ended December 31**			**Nine months ended December 31**		
	2019	**2018**	**Increase (Decrease)**	**2019**	**2018**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	88.5	87.9	0.6	328.9	321.2	7.7
Passenger tariff	46.2	46.2	-	184.8	184.5	0.3
Net retail	14.1	13.4	0.7	53.4	50.8	2.6
Social program fees	3.9	3.9	-	12.0	11.9	0.1
Other revenue	3.0	2.9	0.1	9.6	9.0	0.6
Fuel surcharge (rebate)	1.6	-	1.6	5.4	(4.6)	10.0
Total Direct Route Revenue	157.3	154.3	3.0	594.1	572.8	21.3
Indirect Route Revenue						
Ferry transportation fees	38.5	40.0	(1.5)	140.7	134.4	6.3
Federal-Provincial subsidy	7.8	7.6	0.2	23.5	22.9	0.6
Provincial contribution: Tariffs	4.6	3.4	1.2	18.2	13.6	4.6
Provincial contribution: Seniors	2.5	2.3	0.2	8.5	8.0	0.5
Total Route Revenue	210.7	207.6	3.1	785.0	751.7	33.3
Other general revenue	0.3	0.1	0.2	1.7	1.5	0.2
Total Revenue	211.0	207.7	3.3	786.7	753.2	33.5



In the nine months ended December 31, 2019, the greatest portion of our revenues (65%) was earned on our Major Routes. Revenue from the Northern Routes contributed 11% and revenue from Other Routes contributed 24%.

Vehicle tariffs (which include reservation fee revenue) and passenger tariffs account for the majority of our revenues. Our year-over-year tariff revenues are impacted by factors such as changes in overall traffic levels, traffic types and average tariff yields.

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, 2019, fares on all routes for fiscal 2020 were held at fiscal 2019 levels. For fiscal 2019, 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 for fiscal 2019 on the three Major Routes connecting Metro Vancouver with mid and southern Vancouver Island. In addition, the BC seniors' passenger discount for fiscal 2019 increased from 50% to 100% for travel Monday to Thursday on the Major Routes and Other Routes. The total value of these initiatives over two years is estimated to be approximately $98 million, of which BC Ferries will contribute $39 million in foregone revenue. The Province partially funded the fare reductions and the increase to the BC seniors' discount with a contribution of $26.5 million in fiscal 2019 and will contribute $32.5 million in fiscal 2020. In the three months ended December 31, 2019, Provincial Contributions of $7.1 million ($26.7 million year-to-date) of the $32.5 million was recognized as revenue compared to $5.7 million ($21.6 million year-to-date) in the same period in the prior year. In the three months ended December 31, 2019, the number of BC seniors travelling with the discount increased 4.2% (6.0% year-to-date) compared to same period in the prior year.

From time to time, we implement fuel surcharges as a result of rising fuel prices or rebates as a result of falling fuel prices. In fiscal 2019, fuel rebates of 1.9% on the Northern Routes and 2.9% on our Major and regulated Other Routes were in place until they were discontinued effective June 27, 2018. In fiscal 2020, fuel surcharges of 1.5% on average on all routes with the exception of the Northern Routes were in place from June 1, 2019 until they were discontinued effective December 16, 2019. 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).

Effective April 1, 2019, we reached an agreement with the Province to amend service levels to include over 2,700 additional trips for which the Province will contribute an incremental aggregate amount not to exceed $5.8 million per year. In fiscal 2020, the first phase of this will be implemented with over 1,700 additional trips to be provided and the Province is expected to pay an additional $3.8 million in ferry transportation fees. In the three months ended December 31, 2019, $1.0 million ($2.6 million year-to-date) was recognized as revenue for 445 (964 year-to-date) additional trips.

Changes in revenue and operational statistics for the three and nine months ended December 31, 2018 and 2019 for the Major Routes, Northern Routes and Other Routes are discussed separately below.

Revenue and Operational Statistics - Major Routes

Our Major Routes consist of our four busiest routes, carrying approximately 60% of our total vehicle traffic and 65% of our total passenger traffic, generating approximately 85% of our direct route revenue.

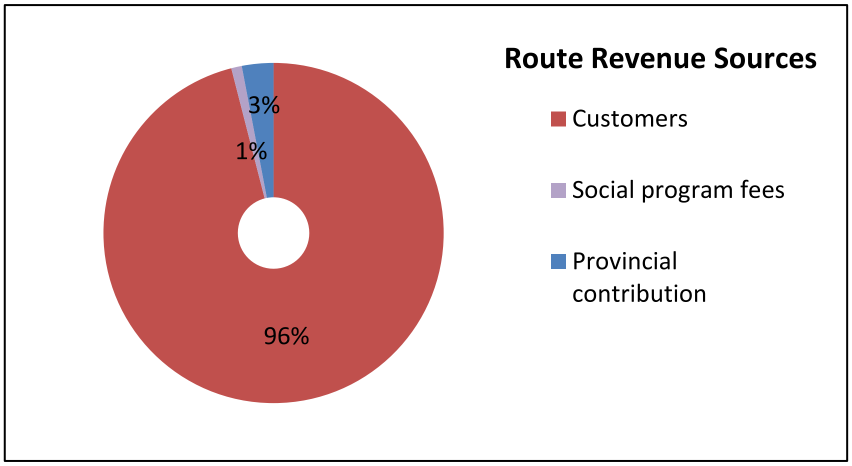
	Three months ended December 31		Nine months ended December 31	
Operational Statistics	**2019**	**2018**	**2019**	**2018**
Vehicle traffic	1,153,989	1,143,324	4,253,532	4,242,315
Passenger traffic	3,006,277	3,012,425	11,702,673	11,794,238
On-time performance	90.4%	87.8%	84.4%	82.2%
Number of round trips	3,079.5	3,040.5	10,509.5	10,413.5
Capacity provided (AEQs)	1,947,176	1,893,360	6,573,486	6,485,668
AEQs carried	1,365,458	1,350,806	4,986,547	4,976,166
Capacity utilization	70.1%	71.3%	75.9%	76.7%

Over the three months ended December 31, 2019, vehicle traffic increased 0.9% (0.3% year-to-date) compared to the same period in the prior year. Vehicle traffic increased primarily as a result of the positive impact of fewer sailing disruptions due to fewer storm events compared to the same period in the prior year, partially offset by the impact of a decrease in the number of tour buses using our service compared to the same period in the prior year. Passenger and vehicle traffic was negatively impacted by a 9.4% (13.9% year-to-date) decrease in the number of tour buses using our ferry services on these routes compared to the same period in the prior year. Over the three months ended December 31, 2019, passenger traffic decreased 0.2% (0.8% year-to-date) compared to the same period in the prior year primarily as a result of the negative impact of the decrease in the number of tour buses, somewhat offset by the positive impact of fewer sailing disruptions and holding fares at fiscal 2019 levels. Year-to-date, we believe the decrease in passenger traffic was also somewhat offset by two more days of Easter holidays falling in the first quarter of fiscal 2020.

In the three months ended December 31, 2019, overall on-time performance on the Major Routes increased 2.6% (2.2% year-to-date) compared to the same period in the prior year. Our initiatives to improve on-time performance include adjusting and/or expanding sailing schedules, adjusting crewing schedules, changing operational procedures and refining vehicle loading processes during peak periods.

Capacity utilization decreased from 71.3% to 70.1% for the three months ended December 31, 2019 (from 76.7% year-to-date to 75.9%) 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 an increased number of AEQs carried.

Major Routes (continued)



In the nine months ended December 31, 2019, revenue from our Major Routes consisted of 96% from customers and the remaining 4% from the Province.

Revenue ($ thousands)	Three months ended December 31			Nine months ended December 31		
	2019	**2018**	**Increase (Decrease)**	**2019**	**2018**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	76,263	75,789	474	278,569	273,672	4,897
Passenger tariff	38,923	39,034	(111)	151,660	152,823	(1,163)
Net retail	12,518	12,192	326	46,430	44,860	1,570
Social program fees	2,023	2,021	2	6,314	6,296	18
Parking	1,834	1,622	212	5,891	5,458	433
Other revenue	966	1,086	(120)	3,141	3,055	86
Fuel surcharge (rebate)	1,376	1	1,375	4,649	(3,758)	8,407
Total Direct Route Revenue	133,903	131,745	2,158	496,654	482,406	14,248
Indirect Route Revenue						
Provincial contribution: Tariffs	2,394	1,818	576	8,876	6,691	2,185
Provincial contribution: Seniors	1,820	1,670	150	6,345	5,954	391
Total Route Revenue	138,117	135,233	2,884	511,875	495,051	16,824

In the three months ended December 31, 2019, average tariff revenue per vehicle (tariff revenue divided by traffic volume) decreased by $0.20 or 0.3% compared to the same period in the prior year, mainly as a result of a change in the mix of traffic. Year-to-date, average tariff revenue per vehicle increased $0.98 or 1.5% compared to the same period in the prior year, mainly as a result of increased reservations and less traffic on promotional sailings partially offset by a change in the mix of traffic. In the three months ended December 31, 2019, average tariff revenue per passenger remained at $12.95 ($12.96 year-to-date) compared to the same period in the prior year. The change in average tariff revenue, the increase in vehicle traffic levels and the decrease in passenger traffic levels resulted in a total tariff revenue increase of $0.4 million ($3.7 million year-to-date) compared to the same period in the prior year.

All vessels that provide service on our Major Routes have a gift shop and options for food service. In the three months ended December 31, 2019, net retail sales increased 2.7% (3.5% year-to-date) compared to the same period in the prior year as a result of higher average sales per passenger. Food sales remain strong, providing approximately 72% of total retail revenue. Retail sales are presented net of cost of goods, sold which is approximately 40% of gross 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 and nine months ended December 31, 2019 increased compared to the same periods in the prior year, mainly due to an increase in the usage of the MTAP program, slightly offset by a reduction in the number of students travelling under the program.

Revenue from parking increased 13.1% (7.9% year-to-date) in the three months ended December 31, 2019 compared to the same period in the prior year, as a result of higher usage.

Fuel surcharges and rebates are implemented or removed due to changes in fuel market conditions. On June 1, 2019, a fuel surcharge of 1.5% on our Major Routes was in place until it was discontinued, effective December 16, 2019. A fuel rebate of 2.9% on our Major Routes was in place during the first quarter of fiscal 2019 until it was discontinued, effective June 27, 2018.

The provincial contribution increased by $0.7 million ($2.6 million year-to-date) compared to the same period in the prior year. The provincial contribution of $4.2 million ($15.2 million year-to-date) in the three months ended December 31, 2019 consisted of $1.8 million ($6.3 million year-to-date) towards the increased BC seniors' discount and $2.4 million ($8.9 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).

Revenue and Operational Statistics - Northern Routes

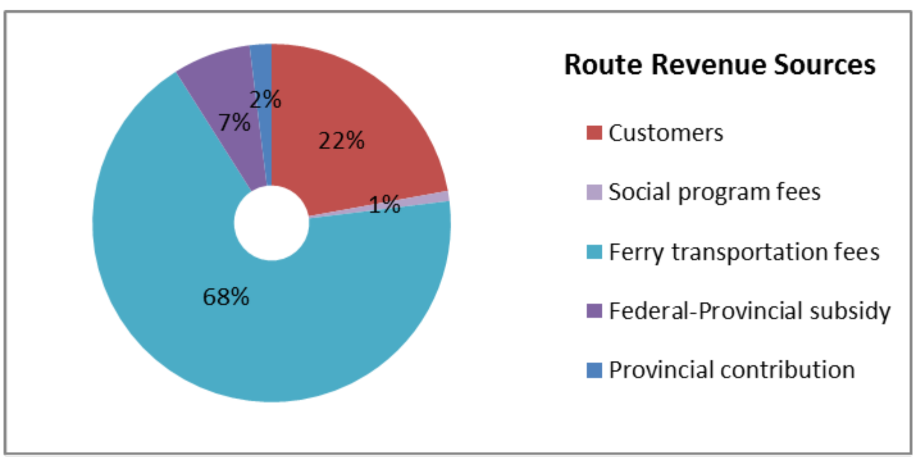
Our Northern Routes currently consist of three regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island. In the fall of 2018, we started service on a new route directly connecting Port Hardy and Bella Coola.

Operational Statistics	Three months ended December 31 2019	2018	Nine months ended December 31 2019	2018
Vehicle traffic	6,032	5,755	33,036	28,995
Passenger traffic	14,962	13,388	88,630	79,176
On-time performance	82.4%	85.2%	86.1%	84.7%
Number of round trips	72.5	64.5	312.5	230.0
Capacity provided (AEQs)	13,872	12,289	51,532	48,489
AEQs carried	7,439	7,276	39,897	35,359
Capacity utilization	53.6%	59.2%	77.4%	72.9%

In the three months ended December 31, 2019, vehicle traffic increased 4.8% (13.9% year-to-date) and passenger traffic increased 11.8% (11.9% year-to-date) compared to the same period in the prior year primarily as a result of the impact of the expanded service of the seasonal route connecting Port Hardy and Bella Coola and no increase in fares from the 15% reduction in fares introduced in the prior year. Year-to-date, we believe the decrease in passenger traffic was also somewhat offset by two more days of Easter holidays falling in the first quarter of fiscal 2020.

On-time performance in the three months ended December 31, 2019 decreased 2.8% (1.4% increase year-to-date) compared to the same period in the prior year, primarily due to more weather-related delays in the quarter but fewer weather-related delays year-to-date.

Capacity utilization on these routes during the three months ended December 31, 2019 decreased 5.6% primarily as a result of the higher capacity provided, somewhat offset by the higher AEQs carried. Year-to-date, capacity utilization was 4.5% higher than the same period in the prior year, primarily as a result of the increase in the number of AEQs carried, somewhat offset by the increased capacity provided, much of it related to the expanded service of the seasonal route connecting Port Hardy and Bella Coola.



In the nine months ended December 31, 2019, revenue from our Northern Routes consisted of 22% from customers and the remaining 78% is government funding.

Northern Routes (continued)

Revenue ($ thousands)	Three months ended December 31			Nine months ended December 31		
	2019	**2018**	**Increase (Decrease)**	**2019**	**2018**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	1,236	1,217	19	8,405	7,031	1,374
Passenger tariff	724	649	75	7,017	5,916	1,101
Net retail	248	182	66	1,689	1,415	274
Social program fees	199	257	(58)	783	843	(60)
Stateroom rental	358	339	19	1,726	1,495	231
Hostling & other	65	69	(4)	204	145	59
Fuel surcharge (rebate)	-	-	-	-	(104)	104
Total Direct Route Revenue	2,830	2,713	117	19,824	16,741	3,083
Indirect Route Revenue						
Ferry transportation fees	12,461	14,550	(2,089)	58,499	54,190	4,309
Federal-Provincial subsidy	2,010	1,957	53	6,031	5,870	161
Provincial contribution: Tariffs	202	146	56	1,709	1,253	456
Total Route Revenue	17,503	19,366	(1,863)	86,063	78,054	8,009

In the three months ended December 31, 2019, average tariff revenue per vehicle (tariff revenue divided by traffic volume) decreased $6.56 or 3.1% and average tariff revenue per passenger decreased $0.9 or 0.2% compared to the same period in the prior year. Year-to-date, average tariff revenue per vehicle increased $11.93 or 4.92% and average tariff revenue per passenger increased $4.45 or 6.0% compared to the same period in the prior year. Average tariff revenues reflect the impact of the expanded service of the Central Coast seasonal route and a change in the proportion of traffic on routes with higher versus lower tariffs. The increases in traffic levels and changes in average tariff revenue resulted in a total tariff revenue increase of $0.1 million ($2.5 million year-to-date) compared to the same period in the prior year.

In the three months ended December 31, 2019, revenue from net retail services increased $0.1 million ($0.3 million year-to-date) compared to the same period in the prior year, as a result of higher average sales per passenger and higher passenger traffic.

Social program fees for the three and nine months ended December 31, 2019 decreased compared to the same period in the prior year, mainly due to a decrease in the usage of the MTAP program.

Stateroom rental revenue increased due to higher utilization.

No fuel rebate or surcharge was in place during the three and nine months ended December 31, 2019 (fiscal 2020). A fuel rebate of 1.9% on the Northern Routes was in place during the first quarter of fiscal 2019 until it was discontinued, effective June 27, 2018 (fiscal 2019).

Ferry transportation fees received from the Province decreased $2.1 million in the three months ended December 31, 2019 compared to the same period in the prior year. Year-to-date, ferry transportation fees increased $4.3 million compared to the same period in the prior year, mainly as a result of differences in the monthly schedule of round trips and additional funding from the Province for the provision of additional services.

The Federal-Provincial subsidy increased based on the percentage increase in the annual Consumer Price Index ("CPI") (Vancouver).

The provincial contribution increase of $0.1 million ($0.5 million year-to-date) in the three months ended December 31, 2019 was due to a higher contribution towards the fare reduction initiative.

Revenue and Operational Statistics - Other Routes

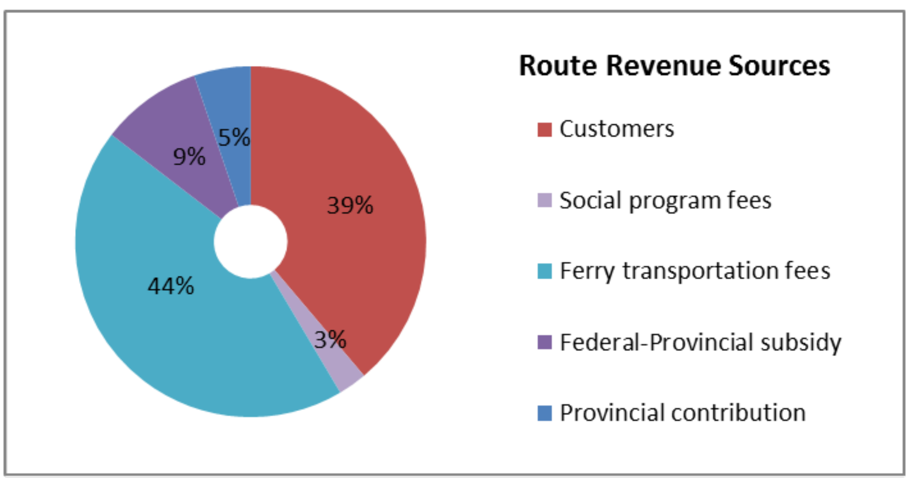
Our Other Routes primarily serve the northern and southern Gulf Islands and the northern Sunshine Coast. One of the 18 regulated routes and all eight of the unregulated routes are operated under contract by alternative service providers. We receive fees from the Province for the provision of contracted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

Operational Statistics	Three months ended December 31		Nine months ended December 31	
	2019	2018	2019	2018
Vehicle traffic	846,195	824,615	2,979,699	2,901,402
Passenger traffic	1,737,328	1,701,437	6,514,341	6,393,690
On-time performance	91.5%	91.3%	88.4%	87.8%
Number of round trips	16,942.0	16,406.5	51,928.0	50,430.0
Capacity provided (AEQs)	1,773,729	1,732,301	5,490,766	5,378,070
AEQs carried	905,365	885,075	3,193,625	3,109,787
Capacity utilization	51.0%	51.1%	58.2%	57.8%

During the three months ended December 31, 2019, vehicle traffic increased 2.6% (2.7% year-to-date) and passenger traffic increased 2.1% (1.9% year-to-date) compared to the same period in the prior year. We believe passenger and vehicle traffic were positively impacted by maintaining the 15% reduction in fares introduced in the prior year. In addition, there have been fewer sailing disruptions year-to-date and two more days of Easter holidays falling in the first quarter of fiscal 2020.

On-time performance in the three months ended December 31, 2019 increased 0.2% (0.6% year-to-date) compared to the same period in the prior year, primarily due to adjustments and/or expansion of sailing schedules.

Capacity utilization on these routes during the three months ended December 31, 2019 was very similar to the same period in the prior year (0.1% lower). For the nine months ended December 31, 2109, capacity utilization increased 0.4% primarily due to a higher number of AEQs carried, partially offset by an increase in capacity provided.



In the nine months ended December 31, 2019, revenue from our Other Routes consisted of 39% from customers and 61% is government funding.

Other Routes (continued)

Revenue ($ thousands)	Three months ended December 31			Nine months ended December 31		
	2019	2018	Increase (Decrease)	2019	2018	Increase (Decrease)
Direct Route Revenue						
Vehicle tariff	11,001	10,852	149	41,896	40,469	1,427
Passenger tariff	6,554	6,479	75	26,145	25,723	422
Social program fees	1,697	1,672	25	4,946	4,839	107
Net retail	916	777	139	3,532	3,102	430
Parking & other	69	104	(35)	250	302	(52)
Fuel surcharge (rebate)	243	-	243	790	(722)	1,512
Total Direct Route Revenue	20,480	19,884	596	77,559	73,713	3,846
Indirect Route Revenue						
Ferry transportation fees	26,017	25,365	652	82,219	80,162	2,057
Federal-Provincial subsidy	5,825	5,669	156	17,474	17,008	466
Provincial contribution: Tariffs	2,047	1,492	555	7,647	5,695	1,952
Provincial contribution: Seniors	598	562	36	2,108	2,011	97
Total Route Revenue	54,967	52,972	1,995	187,007	178,589	8,418

During the three months ended December 31, 2019, average tariff revenue per vehicle (tariff revenue divided by traffic volume) decreased $0.16 or 1.2% (an increase of $0.11 or 0.8% year-to-date) compared to the same period in the prior year, reflecting a change in the proportion of traffic on routes with higher versus lower tariffs. During the three months ended December 31, 2019, average tariff revenue per passenger decreased $0.04 or 0.9% (a decrease of $0.01 or 0.2% year-to-date) compared to the same period in the prior year. The change in average tariff revenue and the overall increase in traffic levels resulted in a total tariff revenue increase of $0.2 million ($1.8 million year-to-date) compared to the same period in the prior year.

Social program fees for the three and nine months ended December 31, 2019 increased compared to the same period in the prior year mainly as a result of an increase in the usage of the MTAP program and a higher number of students travelling under this program.

Net retail services revenue increased in the three and nine months ended December 31, 2019 compared to the same period in the prior year mainly due to higher average sales per passenger.

Fuel surcharges and rebates are implemented or removed due to changes in fuel market conditions. On June 1, 2019, a fuel surcharge of 1.5% on our Other Routes was in place until it was discontinued, effective December 16, 2019. A fuel rebate of 2.9% on our Other Routes was in place during the first quarter of fiscal 2019 until it was discontinued, effective June 27, 2018.

Ferry transportation fees received from the Province in the three months ended December 31, 2019, increased by $0.7 million ($2.1 million year-to-date) compared to the same period in the prior year, mainly as a result of differences in the monthly schedule of round trips and additional funding from the Province for the provision of additional services.

The Federal-Provincial subsidy increased based on the percentage increase in the annual CPI (Vancouver).

As previously agreed, the provincial contribution towards the fare reduction and increase to the BC seniors' discount increased by $0.6 million ($2.0 million year-to-date) compared to the same period in the prior year. The provincial contribution of $2.6 million in the three months ended December 31, 2019, ($9.7 million year-to-date) consisted of a $0.6 million ($2.1 million year-to-date) contribution towards the increased BC seniors' discount and $2.0 million ($7.6 million year-to-date) contribution towards the fare reduction initiative.

Expenses

Expenses for the three and nine months ended December 31, 2019 and 2018 are summarized in the table below:

Operating expenses ($ millions)	Three months ended December 31			Nine months ended December 31		
	2019	2018	Increase (Decrease)	2019	2018	Increase (Decrease)
Operations	128.4	122.8	5.6	421.3	401.3	20.0
Maintenance	22.2	22.4	(0.2)	61.9	60.3	1.6
Administration	9.2	9.6	(0.4)	27.2	29.3	(2.1)
Total operations, maintenance & administration	159.8	154.8	5.0	510.4	490.9	19.5
Depreciation and amortization	45.9	43.5	2.4	136.4	128.5	7.9
Total operating expenses	205.7	198.3	7.4	646.8	619.4	27.4

We provided 582.5 (1,676.5 year-to-date) additional round trips compared to the same period in the prior year to satisfy increased service levels agreed to with the Province, accommodate higher traffic volumes, and improve our customer experience. We introduced the *Northern Sea Wolf* and re-introduced the upgraded *Spirit of Vancouver Island* into service. These actions resulted in an increase in labour costs and a decrease in marine diesel fuel consumption. The increase in operating expenses also included the impact of wage rate increases in accordance with the Collective Agreement, higher benefit costs (Employer Health Tax, Workers Compensation and pension), and higher depreciation. We continue to take proactive measures to contain and manage expenses while operating a sustainable, safe and reliable service.

During the three months ended December 31, 2019, operations expense increased $5.6 million compared to the same period in the prior year due to:

- $4.7 million increase in labour costs, mainly due to a wage rate increase of 1.9% effective April 1, 2019 in accordance with the Collective Agreement, benefit costs (Employer Health Tax, Workers Compensation and pension) and staffing level changes for additional round trips provided;
- $1.0 million increase in contracted services, insurance premiums, and other miscellaneous costs; and
- $0.3 million increase mainly due to incident related repairs to various vessels and terminals;

Partially offset by:

- $0.4 million decrease in fuel expense, mainly due to a move to lower-cost LNG with the re-introduction of the upgraded *Spirit of Vancouver Island*.

Expenses (continued)

Year-to-date, operations expense increased $20.0 million compared to the same period in the prior year due to:

- $15.1 million increase in labour costs, mainly due to a wage rate increase of 1.9% effective April 1, 2019 in accordance with the Collective Agreement, benefit costs (Employer Health Tax, Workers Compensation and pension) and staffing level changes for additional round trips provided;
- $4.1 million increase mainly due to incident related repairs to various vessels and terminals; and
- $2.4 million increase in contracted services, credit card fees, insurance premiums, utilities and miscellaneous other costs;

partially offset by:

- $1.6 million decrease in fuel expense, mainly due to a reduction in marine diesel consumption and a move to lower-cost LNG.

In the three months ended December 31, 2019, maintenance costs decreased $0.2 million ($1.6 million increase year-to-date) compared to the same period in the prior year as a result of the cyclical nature of vessel refit activity.

The $0.4 million ($2.1 million year-to-date) decrease in administration costs compared to the same period in the prior year is primarily a result of reduced labour costs, materials and supplies and consulting and contracted services for information technology.

Depreciation and amortization increased $2.4 million ($7.9 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 December 31**			**Nine months ended December 31**		
	2019	**2018**	**Increase (Decrease)**	**2019**	**2018**	**Increase (Decrease)**
Finance expense	16.0	14.7	1.3	46.4	45.0	1.4
Less: finance income	(2.5)	(1.7)	(0.8)	(5.2)	(4.6)	(0.6)
Net finance expense	13.5	13.0	0.5	41.2	40.4	0.8
Loss (gain) on disposal and revaluation of property, plant and equipment, and intangible assets	-	0.1	(0.1)	(0.2)	0.2	(0.4)
Total net finance and other expenses	13.5	13.1	0.4	41.0	40.6	0.4

In the three and nine months ended December 31, 2019, net finance and other expenses increased $0.4 million compared to the same period in the prior year, primarily as result of increased interest of $1.4 million for our new bond issue, partially offset by higher interest income from investments and a gain on disposal of property, plant and equipment.

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. In addition, from time to time we receive funding from external sources. Our financial position could be adversely affected if we fail to arrange sufficient and cost-effective financing to fund, among other things, capital expenditures and the repayment of maturing debt. This is subject to numerous factors, including the results of our operations, our financial position, conditions in the capital and bank credit markets, ratings assigned by rating agencies and general economic conditions.

We expect that our cash requirements will be met through positive operating cash flows, accessing our existing credit facility from time to time, debt issuances and other funding opportunities.

On October 15, 2019, we completed a private placement of $250 million of 30-year senior secured bonds. These bonds bear interest at a rate of 2.794% per annum, payable semi-annually. The net proceeds of this new issue will be used, together with additional cash on hand, to provide for capital expenditures, general corporate purposes and to fund the series' debt service reserve account. These bonds were rated “A (high)” by DBRS and “AA-” by S&P.

At December 31, 2019, our unrestricted cash and cash equivalents and other short-term investments totalled $227 million and $121 million, respectively (at March 31, 2019 - $60 million and $75 million, respectively).

Under our credit agreement with a syndicate of Canadian banks, we have available a revolving facility in the amount of $155 million. Our $155 million credit facility was renewed on March 6, 2019 to extend the maturity date of the facility from April 2023 to April 2024. The facility is available to fund capital expenditures and for other general corporate purposes. At December 31, 2019, 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. On December 6, 2019, S&P's affirmed our credit rating at “AA-” with a stable outlook and on January 24, 2020 DBRS reaffirmed our credit rating at “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 our credit agreement. Under our Master Trust Indenture, securing this facility, we are subject to an additional indebtedness test that prohibits additional borrowing if our leverage ratio exceeds 85%. At December 31, 2019, we achieved a debt service coverage ratio of 2.97 and a leverage ratio of 69.7%.

In fiscal 2017, the Government of Canada approved funding of up to $15.1 million towards a new seasonal direct ferry service between Port Hardy and Bella Coola, $28.3 million towards the purchase of two new Island Class vessels and $17.1 million towards 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 $29.5 million had been received as of December 31, 2019.

Sources & Uses of Cash

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

Sources and uses of cash and cash equivalents for the nine months ended December 31, 2019 are summarized in the table below:

	Nine months ended December 31		
($ millions)	**2019**	**2018**	**Increase (Decrease)**
Cash and cash equivalents, beginning of period	59.9	69.9	(10.0)
Cash from operating activities:			
Net earnings	98.9	93.2	5.7
Items not affecting cash	181.8	170.9	10.9
Changes in non-cash operating working capital	(25.6)	(7.5)	(18.1)
Net interest paid	(45.2)	(46.8)	1.6
Cash generated by operating activities	209.9	209.8	0.1
Cash generated by (used in) financing activities	177.5	(25.8)	203.3
Cash used in investing activities	(219.9)	(144.3)	(75.6)
Net increase in cash and cash equivalents	167.5	39.7	127.8
Cash and cash equivalents, end of period	227.4	109.6	117.8

For the nine months ended December 31, 2019, cash generated by operating activities increased $0.1 million primarily due to an increase in net earnings and items not affecting cash, partially offset by changes in non-cash working capital.

Cash generated by financing activities in the nine months ended December 31, 2019 was $177.5 million. The amount consisted of proceeds of $250 million from our October 2019 bond Series 19-1 issuance offset by $69.2 million repayment of loans from KfW IPEX-Bank GmbH, $1.7 million in repayment of lease obligations and $1.6 million in bond financing costs.

Cash used in financing activities in the nine months ended December 31, 2018 was $25.8 million. This amount consisted of $24.2 million repayment of KfW loans and $1.6 million in repayment of finance lease obligations.

Cash used in investing activities for the nine months ended December 31, 2019 increased by $75.6 million, mainly due to increases of $69.7 million in cash used for short-term investing, $3.5 million in capital expenditures and $2.4 million in debt service reserve. (See “Investing in Our Capital Assets” below for detail of significant capital expenditures.)

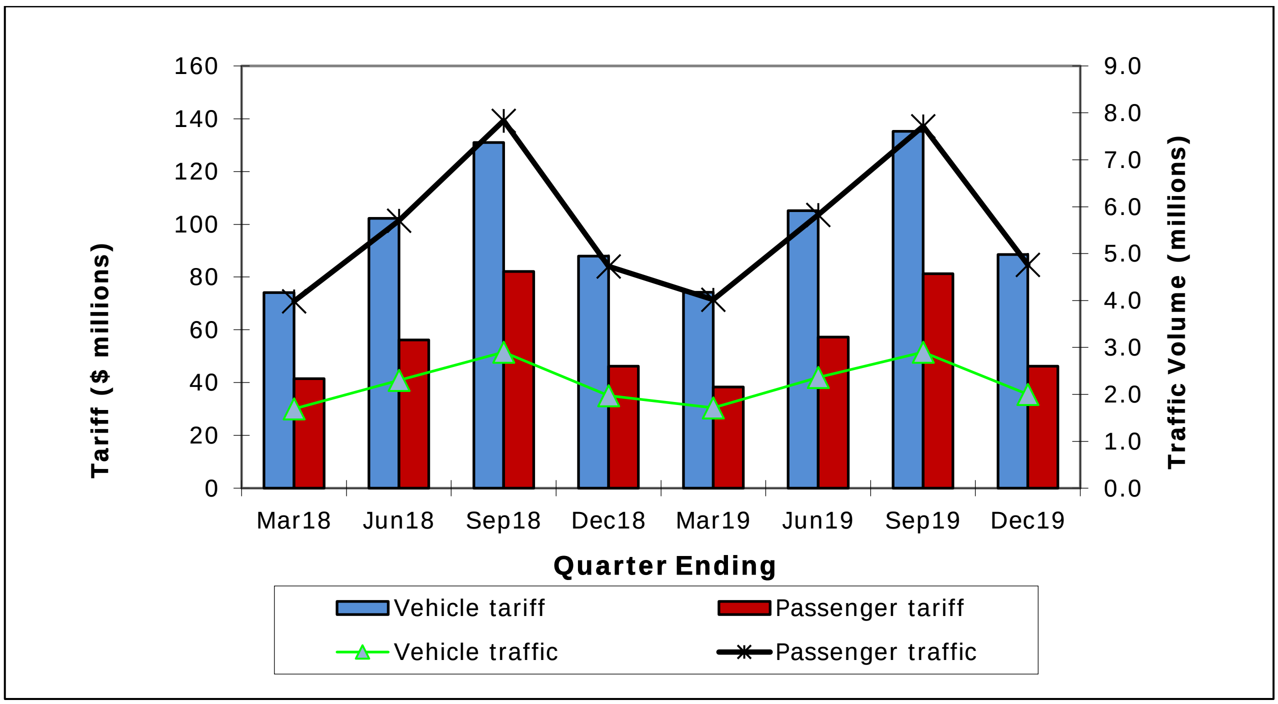
SUMMARY OF QUARTERLY RESULTS

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

	Quarter Ended (unaudited)							
($ millions)	**Mar 18**	**Jun 18**	**Sep 18**	**Dec 18**	**Mar 19**	**Jun 19**	**Sep 19**	**Dec 19**
Total revenue	168.8	229.7	315.8	207.7	172.5	246.4	329.3	210.9
Operating (loss) profit	(27.8)	19.8	104.6	9.4	(28.8)	26.0	108.6	5.2
Net (loss) earnings	(41.0)	6.0	90.9	(3.7)	(41.0)	12.2	95.0	(8.3)

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.

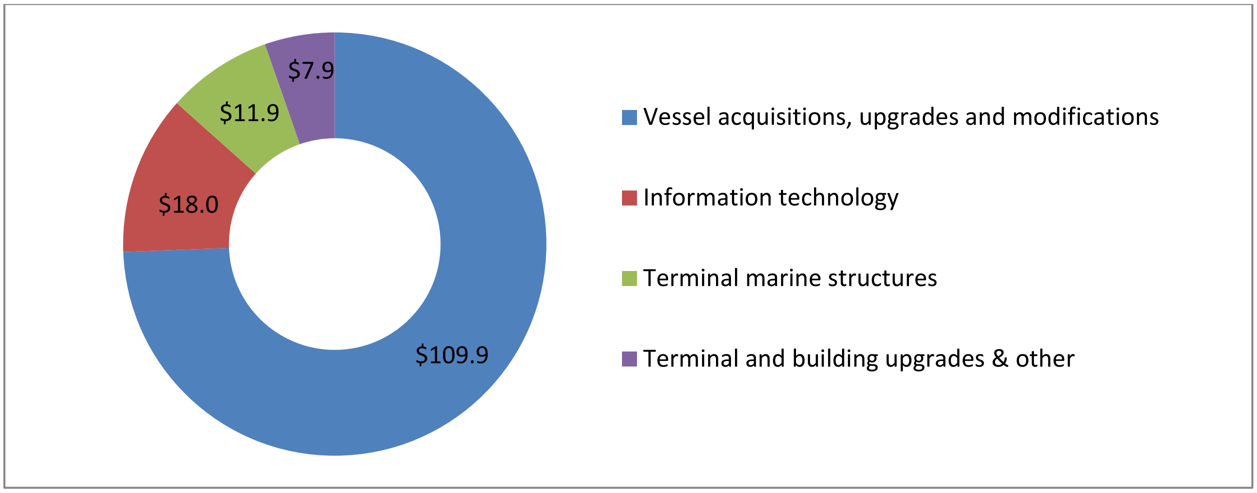
The following graph demonstrates the seasonality of our revenue and shows the relationship of traffic volume and tariff revenue over the most recent eight quarters:



INVESTING IN OUR CAPITAL ASSETS

Capital Expenditures

Capital expenditures, net of funding from the New Building Canada Fund and FortisBC, in the nine months ended December 31, 2019 totalled $147.7 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 Island Class vessel project and $17.1 million for the Langdale terminal development project. To date we have received a total of $29.5 million comprised of $15.1 million for the *Northern Sea Wolf* project and $14.4 million for the Island Class vessel project.

Capital expenditures, net of funding from the New Building Canada Fund and FortisBC, in the three and nine months ended December 31, 2019, included the following:

($ millions)	**Three months ended**	**Nine months ended**
	December 31, 2019	
Island Class vessels (vessel 1 & 2)	4.6	16.2
Island Class vessels (additional 4 vessels)	63.8	63.8
Skeena Queen mid-life upgrade	5.1	8.4
Customer experience program	1.9	6.8
Spirit Class mid-life upgrades	0.9	6.6
Major overhauls and inspections	3.9	6.0
Hardware upgrades	1.2	5.4
Blubber Bay-wingwall replacement	-	3.9
Central Coast ferry service	-	2.9
Time collection & crew scheduling	1.0	2.7
Langdale upgrades	-	2.1
Fleet maintenance facility	0.5	1.5
Various other projects	9.0	21.4
	91.9	147.7

Island Class vessels

On April 13, 2017, we entered into design and build contracts with Damen Shipyard Group of Netherlands 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 $4.2 million in the three months ended December 31, 2019 ($6.4 million year-to-date), $11.3 million in fiscal 2019 and $3.1 million in fiscal 2018. These vessels have been outfitted with hybrid diesel-electric propulsion and have a capacity of up to 450 passengers and crew and approximately 47 vehicles. These two Island Class vessels arrived in Canada on January 18, 2020 and are expected to go into service in the first quarter of fiscal 2021. 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. The addition of new vessels will allow us to retire the 62-year old *North Island Princess* in fiscal 2021. The 54-year old *Howe Sound Queen* was retired during the first quarter of fiscal 2020.

Island Class vessels (additional four vessels)

On October 25, 2019, contracts became effective with Damen Shipyard Group of Netherlands for the construction of four new Island Class vessels expected to enter service during fiscal 2023. The Island Class vessels will be outfitted with hybrid diesel-electric propulsion and will each have a capacity of up to 450 passengers and approximately 47 vehicles. The total project budget for the four additional vessels, including financing and project management costs, is approximately $200 million. Two of these new vessels will service the route between Campbell River - Quadra Island and the other two will service the route between Nanaimo Harbour - Gabriola Island and all four vessels are expected to enter service during fiscal 2023.

Skeena Queen mid-life upgrade

The mid-life upgrade of the *Skeena Queen*, including propulsion, electrical, bridge equipment, safety equipment and interior modernization is expected to be completed in fiscal 2020.

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. The main elements of this program will be implemented in stages during 2020. 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. We have implemented our new internal reservations system as well as enhancements to our customer relationship management system and point of sale system.

Spirit Class mid-life upgrades

On June 6, 2018, the *Spirit of British Columbia* and on April 18, 2019, the *Spirit of Vancouver Island* returned to service on our Tsawwassen – Swartz Bay route. These mid-life upgrades will enable the vessels to be in service for another 25 years. The conversions of these vessels to dual-fuel have resulted in substantial savings as LNG costs are considerably less than marine diesel. The conversion has also resulted in significant environmental benefits, such as reducing carbon, sulphur and nitrogen dioxide emissions from our vessels. FortisBC committed to providing 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 ($7.0 million has been received as of December 31, 2019) 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 cost of the vessels as LNG is purchased. In the three months ended December 31, 2019, $0.2 million ($0.6 million year-to-date) was recorded to reduce the capital costs. In fiscal 2019, $0.3 million was recorded to reduce the capital costs.

Major overhauls and inspections

In the three months ended December 31, 2019, we had capital expenditures of $3.9 million ($6.0 million year-to-date) in respect of major overhauls and inspections of components of hull, propulsion and generators for three vessels that were completed or underway.

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.

Blubber Bay terminal

At Blubber Bay terminal, a project to replace wingwalls, increase capacity of a floating lead, upgrade mechanical and electrical systems, and replace the fencing around the terminal was completed in September 2019. These upgrades enable the Salish Class vessels to dock at Blubber Bay and thereby provide direct service between Texada Island and Comox.

Central Coast ferry service

On April 7, 2017, we finalized an agreement to acquire a 75-metre used vessel built in 2000, to provide the new seasonal direct ferry service between Port Hardy and Bella Coola. This project, which is now complete, included the acquisition and upgrading of the used vessel as well as modifying our terminal marine structures as necessary. 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 towards the capital costs of this vessel 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 fiscal 2019. On May 18, 2019, the *Northern Sea Wolf* entered service in the Central Coast and on June 3, 2019, started the direct seasonal service between Port Hardy and Bella Coola. The *Northern Sea Wolf* accommodates approximately 35 vehicles and 150 passengers and crew.

Time collection and crew scheduling

A project to replace and enhance our aged time collection and crew scheduling system is underway.

Langdale terminal

Our Langdale terminal redevelopment project, to be constructed in phases, includes plans for parking lot and pick-up and drop-off area upgrades, an overhead passenger walkway, a new terminal building, as well as a ticketing plaza.

Fleet maintenance facility

In Richmond, a project to redevelop and modernize our ship repair and maintenance facility is in the design stage.

Various other projects

Various other projects include, among others, upgrades to our vessel navigational equipment, digital signage at various terminals, marine structures at Tsawwassen terminal and the replacement of floating leads at Bear Cove terminal. It also includes the three-quarter life upgrade of the *Klitsa,* which was completed in May 2019.

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

Financial
We expect positive net earnings in fiscal 2020. Total revenue is expected to increase over the prior year as a result of higher vehicle traffic levels, net catering and retail revenues and ferry transportation fees from the Province.

We expect an increase in total expenses in fiscal 2020, reflecting an increase in labour costs, mainly due to a wage rate increase in accordance with the Collective Agreement and increased benefit costs and higher staffing levels for increased service. In addition, costs will increase from the expanded service on a Central Coast route and other service plan changes, higher depreciation, partially offset by savings from operating the Spirit Class vessels and the Salish Class vessels on LNG. We continue to manage our costs prudently without compromising safe operations.

On September 30, 2019, the Commissioner issued Order 19-04, which established final price cap increases of 2.3% for each of the four years of PT5. In the report released assessing our PT5 submission, the Commissioner forecasts declining net earnings, based on this price cap increase, by the end of PT5. Order 19-04 also:

- maintains the existing fuel deferral accounts;
- sets an efficiency target equivalent to 1% of annual operating, maintenance and administration costs; and
- sets the price per litre for the operation of the fuel deferral accounts at $1.03 per litre for marine diesel and 46.9 cents per litre for LNG in the first year of PT5, inflated in each case by 2% per year for the balance of PT5.

We believe that this price cap decision, being lower than expected, will make it more challenging to achieve our corporate objectives, which include replacing our aging fleet, upgrading technology, providing operational resiliency and delivering improved customer service.

Major Investments
Our 12-year capital plan for fiscal 2019 through fiscal 2030 is $3.9 billion. This plan addresses the need to replace our aged assets and includes expenditures on up to 17 new vessels and significant upgrades to our terminals, IT systems and our fleet maintenance facility. The plan emphasizes system capacity, operational efficiency, resiliency and flexibility to ensure safe, reliable and efficient operations and to deliver an exceptional customer-focused travel experience. All major capital expenditures as defined by the Commissioner require approval.

Our cash forecasts indicate that, due to the significant capital expenditures planned, incremental long-term borrowing will be required. On October 15, 2019, we completed a $250 million private placement of 30-year senior secured bonds.

As we procure new vessels, with emphasis on standardizing our fleet, the following projects are underway:

Salish Class

On December 20, 2019, a contract became effective with Remontowa Shipbuilding S.A. of Gdansk, Poland to build a new Salish Class vessel. The new vessel will be identical to our three existing Salish Class vessels which are dual-fuel capable, designed to run primarily on LNG with marine diesel fuel as a backup. The vessel design is part of our standardization strategy which we believe strengthens safety practices and improves interoperability with standardized bridges, engine rooms and life-saving equipment. This fourth Salish Class vessel will replace the 55-year old *Mayne Queen* and is expected to enter service in fiscal 2023.

Island Class

Construction for two Island Class vessels is complete and the vessels are expected to enter into service in the first quarter of fiscal 2021. The Island Class vessels are outfitted with hybrid diesel-electric propulsion. They are built to be capable of conversion to all-electric propulsion as the technology permits and the necessary infrastructure is available. 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.

On October 25, 2019, contracts became effective with Damen Shipyard Group of Netherlands for the construction of four additional Island Class vessels reinforcing our plan for operational efficiency, resiliency and flexibility. Two of these new vessels will service the route between Campbell River - Quadra Island and the other two will service the route between Nanaimo Harbour - Gabriola Island and all four vessels are expected to enter service during fiscal 2023.

New Major Vessels

The next phase of vessel renewal will include replacement of four major vessels that will have an average age of over 50 years when their replacements are anticipated to begin service on our Major Routes. The new vessels will add capacity to the fleet, with vehicle and passenger capacity expected to be similar to the existing Spirit Class vessels. In August 2019, we issued a Request for Proposal ("RFP") for the design, build and delivery of four new major vessels with options for additional vessels, reinforcing our plan for operational efficiency, resiliency and flexibility. We received responses to our RFP in January 2020 which we are currently evaluating.

Fare Flexibility and Digital Experience

Our Fare Flexibility and Digital Experience Initiative will be rolled out in fiscal 2021. It will offer more fare choices and an improved online booking experience. The new website will enable customers to quickly compare fare choices on the dates they are looking to travel. We expect these changes will help shift traffic to sailings that typically run with lower 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 50 through 51 of our fiscal 2019 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the nine months ended December 31, 2019. Our 2019 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 52 through 55 of our fiscal 2019 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the nine months ended December 31, 2019. Our 2019 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

As part of our risk management strategies, we have considered many items such as level of earnings, cash generating potential, cash utilization requirements including debt repayment schedules and future capital expenditures, and working capital requirements. We have taken measures to allow us to adapt to changes in the economic environment and ensure a viable, sustainable future. We do not believe that material uncertainties exist in regard to our future as we believe our risk mitigation strategies are sufficient.

Critical Accounting Policies and Estimates
Our discussion and analysis of our financial condition and financial performance is based upon our unaudited condensed interim consolidated financial statements, which have been prepared in accordance with IFRS.

Our significant accounting policies are contained in Note 1 to our March 31, 2019 audited consolidated financial statements and our December 31, 2019 condensed interim consolidated 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 56 and 57 of our fiscal 2019 Management's Discussion & Analysis. The following describes the changes to critical accounting policies we have used in the preparation of our condensed interim consolidated financial statements for the three and nine months ended December 31, 2019, 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, 2019:

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. We adopted IAS 19 effective April 1, 2019. The application of this standard had no impact on our condensed interim 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. A price cap sets the ceiling on the weighted average level of fares that can be charged. 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. 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 December 31, 2019 unaudited condensed interim consolidated financial statements.

If IFRS permitted us to report regulatory assets and liabilities in our financial statements, the effect on our net earnings for the three and nine months ended December 31, 2019 and 2018 would be as follows:

($ millions)	**Three months ended December 31**		**Nine months ended December 31**	
	2019	**2018**	**2019**	**2018**
Net earnings	(8.3)	(3.7)	98.9	93.2
Changes in net earnings:				
Regulatory asset or liability				
Deferred fuel costs				
Fuel costs over (under) set price	0.6	2.2	(1.6)	1.1
Fuel (surcharge) rebates	(1.6)	-	(5.4)	4.6
(Decrease) increase in total net earnings	(1.0)	2.2	(7.0)	5.7
Adjusted net earnings	(9.3)	(1.5)	91.9	98.9

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.

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, sailings, capacity utilization, fares, fuel costs, ferry transportation fees from the Province, the effects of rate regulation, our short-term and long-range business plans, our 12-year capital plan, capital expenditures, asset renewal and upgrade programs for our vessels, terminals, fleet maintenance facility, and our customer experience program, which includes our Fare Flexibility and Digital Experience Initiative, FortisBC incentive funding, the New Building Canada Fund, contributions from the Province, LNG costs, benefits and usage, long-term borrowing, total revenue and expense projections, and cash requirements. 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 Aboriginal rights and title 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.