Management's Discussion & Analysis
of
Financial Condition
and
Results of Operations

For the three and nine months ended December 31, 2011
Dated February 24, 2012

BCFerries

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Management's Discussion & Analysis of Financial Condition and Results of Operations For the three and nine months ended December 31, 2011 Dated February 24, 2012

The following is our discussion and analysis of the financial condition and results of operations for British Columbia Ferry Services Inc. as of February 24, 2012. This should be read in conjunction with our unaudited interim consolidated financial statements and related notes for the three and nine month periods ended December 31, 2011 and 2010, and our audited consolidated financial statements and related notes for the years ended March 31, 2011 (fiscal 2011) and March 31, 2010 (fiscal 2010), together with our fiscal 2011 Management's Discussion & Analysis. These documents are available on SEDAR at www.sedar.com and on our Investor webpage at http://www.bcferries.com/about/investors/index.html.

Except where indicated, all financial information herein is expressed in Canadian dollars and determined on the basis of Canadian generally accepted accounting principles.

BUSINESS OVERVIEW

British Columbia Ferry Services Inc. is an independent company providing ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world, providing frequent year-round transportation service on 25 routes, supported by 35 vessels and 47 terminals. We also manage ferry transportation service on other remote routes through contracts with independent operators.

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

We are a versatile company, providing a wide range of ferry services for our customers. During the three months ended December 31, 2011 (the third quarter of fiscal 2012), we provided 46,000 sailings, carrying 4.3 million passengers and 1.7 million vehicles.

In the third quarter of fiscal 2012, we experienced a decline of 3.6% (3.5% year-to-date) in vehicle traffic and 3.0% (2.9% year-to-date) in passenger traffic as compared to the same periods in the prior year. The third quarter decline was on the Major and Other Routes while the Northern Routes experienced an increase in traffic for the first time this fiscal year. The traffic decline has been relatively consistent throughout all three quarters of fiscal 2012, with the exception of the Northern Routes, and is the largest year-over-year traffic decline we've experienced in recent years. The traffic this fiscal year is the lowest vehicle traffic we've experienced in 11 years and the lowest passenger traffic we've experienced in 20 years. The year-to-date decline in vehicle and passenger traffic was experienced across the Major, Northern and Other Routes. (See discussion under "Financial and Operational Review" below).

Significant events during or subsequent to our third quarter of fiscal 2012:

- On November 1, 2011, we issued a Request for Expressions of Interest to determine whether an independent third party, under contract to us, can provide a passenger and vehicle cable ferry service, on one of our shortest routes between Buckley Bay and Denman Island, at a lower cost than we can provide the service, while maintaining high levels of safety, quality and reliability. We intend to issue a Request for Proposals as the next phase of the procurement process. The cable ferry initiative is part of our ongoing efforts to identify and pursue opportunities that have the potential to enhance our cost effectiveness in delivering safe, reliable and quality ferry service.

- On November 17, 2011, we reached a tentative agreement with the BC Ferry & Marine Workers' Union for a three year extension, to October 31, 2015, of the Collective Agreement. This tentative agreement has subsequently been ratified by the Union membership.

- On December 6, 2011, our Board announced the appointment of Michael J. Corrigan as President and CEO effective January 1, 2012. Mr. Corrigan was previously our Chief Operating Officer and has been a senior executive with us since joining the company in 2003 and was responsible for initiating and leading our SailSafe program, a joint initiative with the BC Ferry & Marine Workers' Union that has established a comprehensive safety culture. He was also responsible for our new vessel construction program, overseeing the construction and introduction of seven new and numerous upgraded vessels to the fleet as well as a host of terminal upgrades and improvements.

- On December 12, 2011, due to the increasing cost of fuel, the fuel surcharge on our Major Routes was increased from 2.5% to 5.0% of tariffs on average and a fuel surcharge of 2.5% of tariffs on average was implemented on the Horseshoe Bay – Langdale route. The fuel surcharge that has been in place on the other routes remained unchanged at 5% of tariffs on average while no surcharges or rebates were in place on our Northern Routes.

- On December 16, 2011, the *Queen of Burnaby* returned to service after completion of an $8 million refit and asset improvement project. The vessel underwent an extensive mechanical refit including the overhaul of generators, port main engine, bow thruster and propulsion system; modernization of the elevator system; steel renewal on the main car deck; installation of a new sewage treatment holding tank; abatement of asbestos containing material; new flooring in washrooms; and regulatory surveys. (See Investing in Our Capital Assets – Capital Expenditures for more detail).

- On December 20, 2011, the *Coastal Inspiration* experienced a hard landing at our Duke Point Terminal, which resulted in damage to the wingwalls, lower ramp and apron, and the hydraulics of the berth, as well as damage to the bow doors on the vessel. The vessel returned to service on January 25, 2012; however, the terminal repairs are not expected to be completed until mid-April. Although Duke Point Terminal is unavailable, we continue to provide the mid-island sailings from our Departure Bay Terminal in Nanaimo. Repairs to the vessel and terminal are expected to be approximately $2.5 million. We have a comprehensive insurance program designed to mitigate the financial impact of such incidents.

- On January 19, 2012, former B.C. Auditor General George Morfitt released a comprehensive report arising from his follow-up of the operational safety audit he conducted five years ago at our request. The report concluded that we continue to operate a safe system and it states:

  > "*There has been, since our 2007 report, a significant improvement in the safety culture and practices within the company. The company directors, management and staff have demonstrated their commitment to safety being number one both for the travelling public and for BC Ferries personnel.*"

  (see Financial and Operational Overview for more detail).

- On January 24, 2012, the British Columbia Ferries Commissioner (the Commissioner) issued his report to the British Columbia Minister of Transportation and Infrastructure (the Minister) as to how the *Coastal Ferry Act* (the Act) could be amended to balance the interests of ferry users with the financial sustainability of our company. The report states:

  > *"Amongst the publicly-owned [ferry] systems, BC Ferries appears to be relatively efficient based on the analysis. Indeed, many ferry operators appear to want to emulate some of BC Ferries' practices. The company compares well with farebox recovery and ancillary revenue. Costs appear to be reasonable based on a number of independent reviews and on substantial improvement in several areas since 2003."*

  The report makes 24 substantive recommendations covering a wide range of ferry related issues and is available on the Commissioner's website at www.bcferrycommission.com. We are awaiting the Province's response to the Commissioner's recommendations. (See Financial and Operational Overview below for more detail).

FINANCIAL AND OPERATIONAL OVERVIEW

This section provides an overview of our financial and operational performance for the three and nine months ended December 31, 2011 and 2010:

($ millions)	Three months ended December 31			Nine months ended December 31		
	2011	**2010**	**Variance**	**2011**	**2010**	**Variance**
Total revenue	161.3	162.3	(1.0)	600.0	598.6	1.4
Operating expenses	(166.4)	(165.6)	(0.8)	(517.4)	(510.5)	(6.9)
(Loss) Earnings from operations	(5.1)	(3.3)	(1.8)	82.6	88.1	(5.5)
Interest and other	(18.0)	(9.2)	(8.8)	(53.9)	(45.3)	(8.6)
Net (loss) earnings and comprehensive income	(23.1)	(12.5)	(10.6)	28.7	42.8	(14.1)

The net (loss) earnings for the three and nine months ended December 2010 included a one-time gain of $9.3 million from the sale of our former corporate office building.

Our 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 earnings of the year. The third and fourth quarters reflect a seasonal downturn in traffic and we utilize these off-peak periods to perform upgrades and major maintenance and refit programs, as well as to undertake mandatory inspections on the majority of our vessels.

Our commercial and discretionary travel markets continue to be negatively impacted by economic conditions including high vehicle fuel prices, a high Canadian dollar, ferry fares, and generally reduced consumer confidence. In the nine months ending December 31, 2011, our vehicle traffic levels declined 3.5% and passenger traffic declined 2.9% as compared to the same period in the prior year. The traffic this fiscal year is the lowest vehicle traffic we've experienced in 11 years and the lowest passenger traffic we've experienced in 20 years. We expect this traffic trend to continue through the balance of this fiscal year. We do not anticipate that economic conditions or our traffic levels will improve in the near future.

We had originally budgeted for a net loss estimated to be in the order of $20 million for this fiscal year, largely driven by significantly lower traffic levels than those included in setting our performance term two price caps. Although lower traffic levels are the major driver, other contributing factors to this loss are such items as the harmonized sales tax, additional Transport Canada requirements and freedom of information overhead expenses and other costs associated with the October 1, 2010 amendments to the Act resulting from the *Miscellaneous Statutes Amendment Act (No. 3), 2010*. Traffic levels to date this fiscal year have been even lower than originally budgeted. In response to this, we have implemented a major cost containment program, which we believe will largely offset this further traffic reduction. We also applied to the Province to reduce up to 400 round trips annually on our Major Routes in response to the reduced traffic levels. The Province decided it was unable to agree to our request at this time, but noted that they may be in a position to revisit our proposal once the Commissioner's recommendations from his review of the Act are released.

In March 2011, the Commissioner set preliminary price cap increases for each of the four years of performance term three of 4.15% on the Major Routes and 8.23% on all other routes, effective April 1, 2012. In making these determinations, the Commissioner excluded certain forecasted costs and incorporated a productivity challenge effectively further reducing our allowed costs. Economic conditions have worsened and financial conditions of the company have deteriorated from those existing when our submission was made in September 2010 and when the Commissioner made his ruling.

On May 19, 2011, the Province and the Commissioner announced a review of the Act to identify improvements which would better allow the Commissioner to balance the interests of ferry users with the financial sustainability of our company. On June 2, 2011, the *Coastal Ferry Amendment Act*, *2011 (*Bill 14) was enacted. Bill 14 established a price cap increase for each route group of 4.15% from the weighted average of the tariffs in place at March 31, 2012 (as established by the Commissioner) effective April 1, 2012, for the first year of performance term three. Bill 14 also prevents us, until October 1, 2012, from applying for extraordinary price cap increases as a result of unanticipated changes such as a significant deterioration in traffic levels, as we would have otherwise been permitted to do under the Act. Our current average fares on the non-Major Routes do not provide the full revenue allowed by the current price caps.

This legislation also provided the Commissioner with the mandate to conduct the review of the Act in the timeline established for this purpose. On January 24, 2012, the Commissioner issued his report to the Minister as to how the Act could be amended to balance the interests of ferry users with the financial sustainability of our company. The report states:

> *"Amongst the publicly-owned [ferry] systems, BC Ferries appears to be relatively efficient based on the analysis. Indeed, many ferry operators appear to want to emulate some of BC Ferries' practices. The company compares well with farebox recovery and ancillary revenue. Costs appear to be reasonable based on a number of independent reviews and on substantial improvement in several areas since 2003."*

The report makes 24 substantive recommendations covering a wide range of ferry related issues which include:

- The primary responsibility of the Commissioner to protect the interests of ferry users and the taxpayer with the secondary responsibility being to protect the ongoing financial sustainability of the ferry operator;
- Significant expansion of the Commissioner's authority and responsibilities, including
    - the authority to approve changes to service levels,
    - the authority to approve our long-term capital plan and all major capital investments,
    - the authority to set targets for equity levels and cash flows, sufficient to allow us to maintain our current rating for long-term bonds,
    - the authority to appoint ferry advisory committee members;
- Changes to the Act, including removal of the principles of
    - a greater reliance on a user pay system, and
    - not allowing cross subsidization from the Major Routes to other routes;
- Increase in provincial subsidies to hold price cap increases to the rate of inflation for the balance of performance term 3 (April 1, 2013 through March 31, 2016);
- Allowing local governments to "buy-down" ferry fares and to establish marketing surcharges on routes to and/or from their communities.

The Province is currently considering the report and its recommendations.

In the DBRS press release entitled "DBRS Comments on Review of *Coastal Ferry* Act: Potential Erosion in BC Ferries Autonomy" issued January 26, 2012, the rating agency concluded:

> *"The report highlights the importance of users maintaining realistic expectations regarding service levels and calls for increased support from the provincial government to ensure the financial sustainability of BC Ferries, which suggests that the operator alone would not be expected to protect service affordability. Nevertheless, if adopted in their entirety, the proposed changes would be viewed by DBRS as an erosion of an operating framework that has so far proved very effective at fostering service efficiency and preventing political interference, introducing an element of downside risk in the credit profile of BC Ferries."*

In the Standard & Poor's research update entitled "British Columbia Ferry Services Inc. Outlook To Negative On Long-Term Traffic Declines; 'A+' Ratings Affirmed" issued February 14, 2012, the rating agency affirmed our 'A+' long-term issuer credit and senior unsecured debt ratings. However, the rating agency also concluded that:

> "*The outlook revision reflects our view that recent traffic declines may continue over the near-to-medium term and the uncertainty that exists with respect to BCFS' regulatory framework and its subsequent impact on the company's funding model and ability to manage its business. In the next two years, favorable regulatory decisions by the government and the commissioner that bolster BCFS' operating and financial risk profile could result in an outlook revision to stable. Alternatively, adverse regulatory decisions or a continued deterioration in the company's financial performance could result in a downgrade.*"

We had originally expected to return to profitability in fiscal 2013, however, traffic levels this fiscal year have been much lower than anticipated in the performance term three submission and the constraints of Bill 14 will negatively impact our future financial performance. Also, there is uncertainty related to the Province's response to the Commissioner's recommendations.

As part of our ongoing efforts to identify and pursue opportunities that have the potential to enhance our cost effectiveness in delivering safe, reliable and quality ferry service, we are determining the feasibility of conversion of our vessels from marine diesel oil to liquefied natural gas (LNG). The LNG industry has an excellent safety record. The fuel has been used in the marine industry for more than a decade. We believe that conversion to LNG would reduce emissions and significantly reduce fuel costs. However, the costs to convert vessels to LNG are significant. We were proposing to implement a pilot project to convert the *Queen of Capilano* in the fall of 2012, but determined that the short timeline presented too much risk and are now in the process of planning for the potential conversion of the vessel during its life-extension expected to be completed in fiscal 2016. We will consider LNG for any new-build vessels and for any existing vessel life-extension or mid-life upgrade projects. Another vessel may be selected for conversion to LNG before the next opportunity to convert the *Queen of Capilano*.

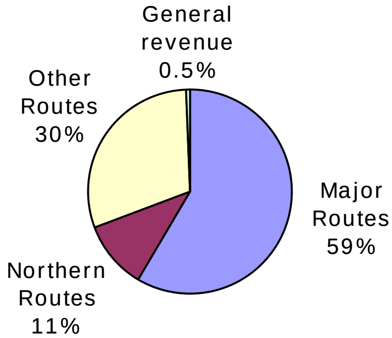
On January 19, 2012, former B.C. Auditor General George Morfitt released a comprehensive report arising from his follow-up review of the operational safety audit he conducted five years ago at our request. The 73-page report includes an assessment of our success in implementing the 41 recommendations made by Morfitt in his original 2007 report. His summary overview states:

> *"There has been, since our 2007 report, a significant improvement in the safety culture and practices within the company. The company directors, management and staff have demonstrated their commitment to safety being number one both for the travelling public and for BC Ferries personnel. We found that awareness about, and actions taken in regards to, safety have increased substantially since we carried out our last review. Considering that many of our recommendations were of a complex nature and necessarily would take a considerable time to implement, the progress to date made by the company in respect of the recommendations is highly commendable."*

The implementation of our SailSafe program, a joint safety initiative with the BC Ferry & Marine Workers' Union, and the desire and dedication of our employees to safety, facilitated a change to the corporate culture which has been vital to the success of many of the new safety programs we've initiated. Of the 41 original recommendations from the 2007 report, 28 have been fully or substantially implemented, 12 partially implemented and only one item remains outstanding. We are committed to continue to implement all of the recommendations made by Morfitt.

Revenue

Total revenues for the three months ended December 31, 2011 decreased 0.6% (increased 0.2% year-to-date) over the same periods in the previous year as shown in the table below:



In the nine months ended December 31, 2011, the greatest portion of our revenues, 59%, was earned on our three Major Routes connecting Vancouver Island to Vancouver and the Lower Mainland. The revenue from the Northern Routes contributed 11% and Other Routes contributed 30%.

Revenue ($ millions)	**Three months ended December 31**			**Nine months ended December 31**		
	2011	**2010**	**Increase (Decrease)**	**2011**	**2010**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle traffic (volume)	*1,746,536*	*1,812,219*	*(65,683)*	*6,335,688*	*6,563,859*	*(228,171)*
Vehicle tariff	62.0	62.3	(0.3)	231.3	230.1	1.2
Passenger traffic (volume)	*4,329,966*	*4,463,480*	*(133,514)*	*16,503,814*	*17,001,284*	*(497,470)*
Passenger tariff	36.6	36.8	(0.2)	144.7	142.9	1.8
Social program fees	6.3	5.8	0.5	20.9	19.0	1.9
Catering & on-board	16.3	16.8	(0.5)	61.8	64.1	(2.3)
Other revenue	4.2	4.7	(0.5)	16.6	20.0	(3.4)
Total Direct Route Revenue	125.4	126.4	(1.0)	475.3	476.1	(0.8)
Indirect Route Revenue						
Ferry transportation fees	28.1	28.2	(0.1)	101.4	99.9	1.5
Federal-Provincial subsidy	6.9	6.7	0.2	20.6	20.2	0.4
Total Route Revenue	160.4	161.3	(0.9)	597.3	596.2	1.1
Other general revenue	0.9	1.0	(0.1)	2.7	2.4	0.3
Total Revenue	161.3	162.3	(1.0)	600.0	598.6	1.4

Our largest revenue source is vehicle and passenger tariffs. The Commissioner authorized a price cap increase on the Major Routes of 2.7% plus 0.49 times the Consumer Price Index (CPI) (British Columbia) and 5.7% plus 0.73 times the CPI (British Columbia) on all other routes effective on each of April 1, 2010 and April 1, 2011. On April 1, 2011, the price caps increased by 3.38% on the Major Routes and 6.71% on all other routes. These price cap increases reflect a change in the CPI (British Columbia) of 1.39%. In response to the changes, we implemented tariff increases up to the new levels authorized.

Effective October 18, 2010, we implemented an across the board fare reduction of approximately 2% as a result of $119.4 million in duty remission and related GST announced by the Government of Canada on October 1, 2010.

From time to time, we utilize promotional fares designed to stimulate growth in traffic or direct traffic towards our less busy sailings. In calculating the price cap, vehicle and passenger tariffs are combined. The utilization of promotional fare incentives and the effects of being over or under the price cap may cause the average vehicle and passenger tariff rate to be under or over the allowed increase in any one period.

On December 12, 2011, the fuel surcharge on our Major Routes of 2.5% of tariffs on average implemented June 1, 2011 was increased to 5.0% and a fuel surcharge of 2.5% of tariffs on average was implemented on the Horseshoe Bay – Langdale Route due to the rising cost of fuel.

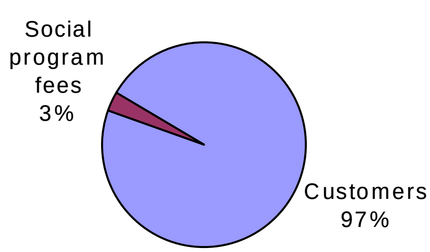
The fuel surcharge on the other routes of 5% of tariffs on average implemented June 1, 2011 remained unchanged. No fuel surcharges or rebates were in place on our Northern Routes.

Year to year changes for the three and nine months ended December 31 for our Major, Northern and Other Routes are discussed separately below:

Major Routes

Direct Route Revenue ($ thousands)	**Three months ended December 31**			**Nine months ended December 31**		
	2011	**2010**	**Increase (Decrease)**	**2011**	**2010**	**Increase (Decrease)**
Vehicle traffic (volume)	*779,381*	*814,247*	*(34,866)*	*2,904,774*	*3,027,643*	*(122,869)*
Vehicle tariff	46,871	47,576	(705)	171,208	169,827	1,381
Passenger traffic (volume)	*2,198,865*	*2,288,150*	*(89,285)*	*8,597,176*	*8,891,959*	*(294,783)*
Passenger tariff	27,414	27,839	(425)	104,626	102,769	1,857
Social program fees	3,033	2,858	175	10,212	9,434	778
Catering & on-board	13,568	14,175	(607)	50,083	52,217	(2,134)
Reservation fees	2,331	2,451	(120)	9,160	10,244	(1,084)
Parking	787	838	(51)	2,824	2,971	(147)
Assured loading	270	554	(284)	1,240	3,327	(2,087)
Other revenue	484	473	11	1,677	1,545	132
Total Direct Route Revenue	94,758	96,764	(2,006)	351,030	352,334	(1,304)
Indirect Route Revenue						
Ferry transportation fees	-	-	-	-	-	-
Federal-Provincial subsidy	-	-	-	-	-	-
Total Route Revenue	94,758	96,764	(2,006)	351,030	352,334	(1,304)

Our Major Routes consist of three regulated routes connecting Greater Vancouver with mid and southern Vancouver Island. In the three months ended December 31, 2011, vehicle traffic decreased by 4.3% (4.1% year-to-date) and passenger traffic decreased by 3.9% (3.3% year-to-date), compared to the same periods in the previous year. The general decline in vehicle traffic was partially offset by an increase in drop trailer traffic. Annual traffic levels on these routes are anticipated to be lower than the prior fiscal year.



In the nine months ended December 31, 2011, revenue from our Major Routes consisted of 97% from customers and 3% from social program fees.

For a period of 25 consecutive days during the second quarter of fiscal 2012, our “CoastSaver” program was in place, providing price discounts of more than 30% on passenger and passenger vehicle fares from Thursday through Sunday each week through the duration of the program. Despite this incentive program, traffic on these routes declined. This further reinforced our view that, while the level of ferry fares may be a contributing factor, other external factors are primarily responsible for declining traffic levels.

Major Routes, cont'd

Average tariff revenue per vehicle increased $1.71 or 2.9% in the quarter ($2.85 or 5.1% year-to-date) compared to the prior year. Average tariff revenue per passenger increased $0.30 or 2.5% ($0.61 or 5.3% year-to-date). The reduction in traffic, partially offset by the higher average fares, resulted in a decrease of $1.1 million for the quarter. Year-to-date, the higher average fares more than offset the traffic decline resulting in an increase of $3.2 million in tariff revenue.

On December 12, 2011, due to the increasing cost of fuel, the fuel surcharge on our Major Routes was increased to 5.0% of tariffs on average from 2.5% which had been in place since June 1, 2011.

Social program fees are reimbursements from the Province of discounts provided on fares for BC seniors, students travelling to and from school, persons with disabilities and persons travelling under the Ministry of Health Travel Assistance Program. Social program fees increased as a result of higher program usage and higher fares. Neither ferry transportation fees nor Federal-Provincial subsidies are received in support of services provided on our Major Routes.

All vessels that provide service on our Major Routes have a gift shop and options for food service. Food sales decreased both in the quarter and year-to-date as a result of lower passenger traffic. In the third quarter, an increase in average spending per passenger offset the effect of the lower passenger traffic on gift shop sales. Sales in our gift shops increased 1.1% in the third quarter (decrease of 1.6% year-to-date). Sales of quality apparel and giftware remain strong. Sales of quality apparel have increased from the prior year more than 11% year-to-date while magazine and book sales have decreased, following the industry trend.

The decrease in parking revenue reflects both lower passenger traffic and the impact of changes in transit services both on Vancouver Island and on the mainland.

The year-to-date decrease in assured loading revenue reflects the lower traffic levels and a gain recognized in the first quarter of the prior year relating to expired tickets. The gain was reversed in the fourth quarter of fiscal 2011 upon the decision to restore the value of these expired tickets. The annual assured loading revenue in fiscal 2012 is expected to be lower than the prior year.

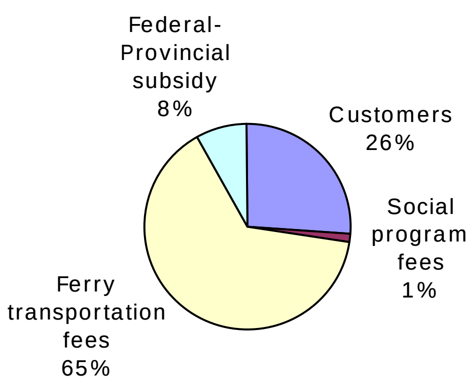
Other revenue increased mainly as a result of an increase in hostling[1] fees from our drop-trailer service for commercial customers.

[1] Loading and unloading of commercial trailers that are dropped off for transportation on a ferry route.

Northern Routes

Direct Route Revenue ($ thousands)	**Three months ended December 31**			**Nine months ended December 31**		
	2011	**2010**	**Increase (Decrease)**	**2011**	**2010**	**Increase (Decrease)**
Vehicle traffic (volume)	*4,192*	*4,051*	*141*	*24,093*	*25,946*	*(1,853)*
Vehicle tariff	958	845	113	7,077	7,210	(133)
Passenger traffic (volume)	*10,404*	*10,315*	*89*	*70,511*	*76,685*	*(6,174)*
Passenger tariff	548	500	48	6,564	6,902	(338)
Social program fees	176	175	1	798	824	(26)
Catering & on-board	170	166	4	1,958	2,061	(103)
Stateroom rental	197	159	38	874	859	15
Hostling & other	45	51	(6)	165	181	(16)
Total Direct Route Revenue	2,094	1,896	198	17,436	18,037	(601)
Indirect Route Revenue						
Ferry transportation fees	8,258	8,386	(128)	40,627	39,070	1,557
Federal-Provincial subsidy	1,700	1,665	35	5,100	4,995	105
Total Route Revenue	12,052	11,947	105	63,163	62,102	1,061

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



In the nine months ended December 31, 2011, revenue from our Northern Routes consisted of 26% from customers and 74% from the Province (1% social program fees, 65% ferry transportation fees, and 8% from payments under the Federal-Provincial subsidy agreement).

In the three months ended December 31, 2011 compared to the same period in the prior year, vehicle traffic increased 3.5% and passenger traffic increased 0.9%, reducing the year-to-date traffic decreases to 7.1% and 8.1%, respectively. Annual traffic levels on these routes are also anticipated to be lower than the prior fiscal year.

The average tariff revenue per vehicle increased $19.94 or 9.6% ($15.85 or 5.7% year-to-date) while the average tariff revenue per passenger increased $4.20 or 8.7% ($3.09 or 3.4% year-to-date). In the quarter, the increase in average rates and the increase in traffic levels resulted in a total tariff revenue increase of $0.2 million. Year-to-date, the reduction in traffic more than offset the increase in average rates, resulting in a total tariff revenue decrease of $0.5 million.

Reimbursements from the Province for social program fees in the quarter were at the same level as the same period in the prior year while fees decreased year-to-date due to lower usage partially offset by higher average fares.

Northern Routes, cont'd

Revenue from catering and on-board services in the quarter and year-to-date reflect the changes in traffic levels.

Both stateroom rental and hostling fees increased in the third quarter compared to the same quarter of the prior year due to higher usage. Year-to-date, stateroom rental increased 1.7% while hostling was at the same level as the prior year. Reservations and other miscellaneous income have dropped marginally.

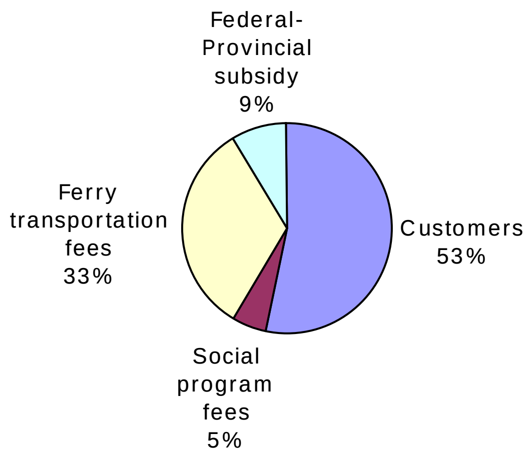
We receive ferry transportation fees for these routes under the Coastal Ferry Services Contract. These fees are higher year-to-date, reflecting an increase in funding this fiscal year related to the *Queen of Chilliwack* life extension, partially offset by the impact of lower net book value of the vessels used on these routes. The transportation fees decrease as these vessel assets are amortized. The total annual transportation fees are expected to be $1.4 million higher than the prior fiscal year.

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

Other Routes

Direct Route Revenue ($ thousands)	**Three months ended December 31**			**Nine months ended December 31**		
	2011	**2010**	**Increase (Decrease)**	**2011**	**2010**	**Increase (Decrease)**
Vehicle traffic (volume)	*962,963*	*993,921*	*(30,958)*	*3,406,821*	*3,510,270*	*(103,449)*
Vehicle tariff	14,151	13,939	212	53,035	53,101	(66)
Passenger traffic (volume)	*2,120,697*	*2,165,015*	*(44,318)*	*7,836,127*	*8,032,640*	*(196,513)*
Passenger tariff	8,659	8,388	271	33,550	33,199	351
Social program fees	3,102	2,685	417	9,880	8,696	1,184
Catering & on-board	2,332	2,326	6	8,838	8,946	(108)
Reservation fees	221	217	4	1,163	1,305	(142)
Parking & other	99	124	(25)	357	400	(43)
Total Direct Route Revenue	28,564	27,679	885	106,823	105,647	1,176
Indirect Route Revenue						
Ferry transportation fees	19,850	19,851	(1)	60,770	60,869	(99)
Federal-Provincial subsidy	5,171	5,066	105	15,515	15,198	317
Total Route Revenue	53,585	52,596	989	183,108	181,714	1,394

Our Other Routes consist of 19 regulated routes and eight small unregulated routes primarily serving the northern and southern Gulf Islands and the Sunshine Coast. One of the regulated routes and all of the unregulated routes are operated under contract by alternative service providers. We receive fees from the Province for the provision of service on the unregulated routes, which are included in the ferry transportation fees in the above table.



In the nine months ended December 31, 2011, revenue from our Other Routes consisted of 53% from customers and 47% from the Province (5% social program fees, 33% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

In the three months ended December 31, 2011, vehicle traffic decreased 3.1% (2.9% year-to-date) and passenger traffic decreased 2.0% (2.4% year-to-date), compared to the same periods in the previous year. Annual traffic levels on these routes are also anticipated to be lower than the prior fiscal year.

The average tariff revenue per vehicle increased $0.67 or 4.8% ($0.44 or 2.9% year-to-date) while the average tariff revenue per passenger increased $0.21 or 5.4% ($0.15 or 3.6% year-to-date). The higher average fares more than offset the reduction in traffic, resulting in a total tariff revenue increase of $0.5 million ($0.3 million year-to-date).

On December 12, 2011, a fuel surcharge of 2.5% of tariffs on average was implemented on the Horseshoe Bay – Langdale Route while the majority of the Other Routes maintained the 5% surcharge that was put in place on June 1, 2011, due to the increasing cost of fuel.

Reimbursements from the Province for social program fees increased as a result of higher fares and higher usage.

Revenue in the quarter and year-to-date from catering and on-board services as well as reservations reflect the changes in traffic levels on the routes where those services are offered.

The decrease in parking and other income reflects a reduction in parking revenue and retail commissions, partially offset by an increase from the installation of additional cash dispensing machines.

Total annual ferry transportation fees are expected to equal that of the prior fiscal year.

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

Expenses
Expenses for the three and nine months ended December 31, 2011 and 2010 are summarized in the tables below:

Operating expenses ($ millions)	**Three months ended December 31**			**Nine months ended December 31**		
	2011	**2010**	**Increase (Decrease)**	**2011**	**2010**	**Increase (Decrease)**
Operations	97.9	96.7	1.2	317.5	315.2	2.3
Maintenance	23.9	26.8	(2.9)	63.2	63.3	(0.1)
Administration	6.8	7.5	(0.7)	22.6	22.3	0.3
Total operations, maintenance & administration	128.6	131.0	(2.4)	403.3	400.8	2.5
Cost of retail goods sold	6.5	6.5	-	23.9	24.5	(0.6)
Amortization	31.3	28.1	3.2	90.2	85.2	5.0
Total operating expenses	166.4	165.6	0.8	517.4	510.5	6.9

The $1.2 million ($2.3 million year-to-date) increase in operations costs reflects an increase in labour costs of $1.4 million ($1.6 million year-to-date) primarily as a result of exclusions and increases in hours worked and benefit costs. Exclusions result from certain senior shipboard positions that are part of the management structure now being excluded from the bargaining unit. Benefit increases include an actuarial valuation of the residual workers' compensation unfinalized claims liability at March 31, 2011 totalling $1.0 million. There were also several premium increases on other benefits. Fuel expense increased $0.3 million or 1.2% ($3.4 million or 4.5% year-to-date) as a result of higher approved fuel prices, partially offset by a 1.1% (0.8% year-to-date) increase in fuel efficiency. These increases were partially offset by reductions of $0.4 million ($1.0 million year-to-date) in advertising, mail and telecommunications costs and $0.1 million ($1.7 million year-to-date) in many other operational areas.

In the third quarter, the $2.9 million decrease in maintenance costs reflects a decrease in both vessel and terminal maintenance as a result of variations in the timing of vessel refits and terminal maintenance projects.

In the third quarter, the $0.7 million decrease in administration expenses is mainly due to a reduction in materials, supplies and contracted services. Year-to-date, the $0.3 million increase is mainly due to $0.6 million in higher wages and benefits, partially offset by $0.3 million in lower contracted services.

Year-to-date, cost of retail goods sold was lower than the prior year as a result of reduced sales.

Amortization increased a total of $3.2 million ($5.0 million year-to-date), reflecting a $2.5 million ($3.0 million year-to-date) increase in vessel amortization and a $0.7 million ($2.0 million year-to-date) increase in terminal amortization reflecting the assets that have come into service. (See "Investing in our Capital Assets" below for more detail.)

Interest and other ($ millions)	**Three months ended December 31**			**Nine months ended December 31**		
	2011	**2010**	**Increase (Decrease)**	**2011**	**2010**	**Increase (Decrease)**
Interest expense						
Bond interest	16.0	16.0	-	47.7	47.7	-
KfW loans	2.3	2.6	(0.3)	7.2	8.0	(0.8)
Interest on capital lease	0.6	0.6	-	1.8	0.6	1.2
Short-term loans	0.1	0.1	-	0.2	0.1	0.1
Interest on deferred accounts	-	-	-	0.1	0.3	(0.2)
Structured Financing Facility Program	(0.4)	(0.1)	(0.3)	(1.3)	(0.3)	(1.0)
Capitalized interest	(0.6)	(0.8)	0.2	(1.6)	(2.0)	0.4
Total interest expense	18.0	18.4	(0.4)	54.1	54.4	(0.3)
Gain on foreign exchange	-	(0.1)	0.1	(0.2)	(0.2)	-
Gain on disposal of capital assets	-	(9.1)	9.1	-	(8.9)	8.9
Total interest and other	18.0	9.2	8.8	53.9	45.3	8.6

Interest expenses decreased $0.4 million ($0.3 million year-to-date) primarily due to:

- $0.3 million ($0.8 million year-to-date) lower interest on the 12-year amortizing KfW loans as a result of principal repayments of $45 million. (See “Liquidity and Capital Resources” below for more detail); and
- $0.3 million ($1.0 million year-to-date) more interest rate support received through the Structured Financing Facility Program offered by the Government of Canada, reflecting amounts relating to the life extension of the *Quadra Queen II*;

partially offset by:

- $0.2 million ($0.4 million year-to-date) less capitalized interest on major projects; and
- $1.2 million year-to-date increase in interest on the capital lease of our new corporate office building which took effect in the third quarter of the prior year;

Gain on disposal of capital assets in the prior fiscal year reflects the November 1, 2010 sale of our previous corporate office building, which was sold for $11.0 million, resulting in a gain on sale of $9.3 million.

LIQUIDITY AND CAPITAL RESOURCES

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.

Our ongoing capital expenditures are expected to be significantly lower than in the previous few years. Subject to changes that may result from the recommendations of the Commissioner in his January 24, 2012 report to the Minister, over the next five years we expect our operational cash requirements will be met through operating cash flows and by accessing our credit facility from time to time. At December 31, 2011, our unrestricted cash and cash equivalents totalled $28 million and short-term investments totalled $27 million.

Receipt of $119.4 million of duty remission on our four foreign built vessels provided us with financial flexibility. As a result of this flexibility, in the three months ended September 30, 2011, we paid down $45 million in debt consisting of the principal amounts outstanding on the second tranche of the two 12-year, 4.98% loans with KfW bank group. These loan agreements were also amended to transfer the principal payments on these loans for the next three years to the second tranche, on which interest only is paid at a floating rate. The principal on these second tranches is due at maturity (March 2020 and June 2020).

Principal repayments due in the next five years are:

Year ended	($000's)
2012 (January – March)	4,500
2013	9,000
2014	149,000
2015	270,250
2016	24,000
Thereafter	851,875
	1,308,625

Over the next few years, we have two bond issues totalling $390 million that will mature ($140 million in December 2013 and $250 million in May 2014). We anticipate that these issues will be refinanced. We also monitor the current market for opportunities to ensure that our debt structure continues to be efficient. We are subject to covenants established by a master trust indenture and other loan documents.

We target maintaining a strong investment-grade credit rating to allow capital market access at reasonable interest rates. Our credit ratings at December 31, 2011, were A (DBRS) with a stable trend and A+ (Standard & Poor's) with a stable outlook. On February 14, 2012, Standard & Poor's affirmed our 'A+' long-term issuer credit and senior unsecured debt ratings. However, the rating agency revised its outlook from stable to negative with the statement: "*The outlook revision reflects our view that traffic declines may continue over the near-to-medium term and the uncertainty that exists with respect to BCFS' regulatory framework and its subsequent impact on the company's business risk and financial risk profiles.*" Maintaining these credit ratings may be challenging, given the combination of declining traffic and the implications of Bill 14, particularly as it relates to the suspension of our ability to seek compensating extraordinary price cap increases.

Sources and Uses of Cash

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

Sources and uses of cash and cash equivalents for the three and nine months ended December 31, 2011 and 2010 are summarized in the table below:

Sources and uses of cash ($ millions)	**Three months ended December 31** 2011	2010	**Nine months ended December 31** 2011	2010
Net (loss) earnings	(23.1)	(12.5)	28.7	42.8
Items not involving cash:				
Amortization	31.3	28.1	90.2	85.2
Other non-cash charges	2.4	(8.8)	4.2	(7.1)
Long-term regulatory costs deferred	(1.8)	(1.6)	(2.5)	(6.9)
Change in non-cash operating working capital	1.4	7.9	(16.9)	(0.4)
Cash provided by operating activities	10.2	13.1	103.7	113.6
Cash used by financing activities	(0.3)	(0.3)	(56.1)	(5.2)
Cash (used in) provided by investing activities	(3.6)	20.4	(53.3)	(23.3)
Total increase (decrease) in cash and cash equivalents	6.3	33.2	(5.7)	85.1

Three Months Ended December 31, 2011

In the three months ended December 31, 2011, cash provided by operating activities included $1.8 million of cash used to reduce regulatory liabilities as follows:

- $5.6 million in fuel and interest costs deferred;

partially offset by:

- $3.4 million in fuel surcharges; and
- $0.4 million receivable from the Province relating to the Northern Routes.

Cash provided by operating activities also included a decrease in non-cash operating working capital of $1.4 million. This decrease in non-cash operating working capital was due to:

- $3.7 million decrease in accounts receivable, mainly due to $2.6 million in commercial travel cards receivable reflecting the seasonality of our business, and $1.0 million in social program fees receivable;
- $1.3 million increase in accrued employee costs;
- $0.5 million decrease in prepaid expenses primarily due to $1.3 million in property taxes as they are now in a payable position, $0.9 million in service contracts, and $0.3 million in insurance; partially offset by an increase of $1.8 million in fuel and $0.2 million in other miscellaneous items; and
- $0.3 million decrease in materials inventory.

The above items, which decreased working capital, were partially offset by:

- $2.9 million decrease in interest payable reflecting timing of interest and principal payments;
- $1.1 million decrease in deferred revenue mainly due to $0.8 million in assured loading ticket refunds and $0.2 million in reduced reservations reflecting the seasonality of the business; and
- $0.4 million decrease in payables and accrued liabilities relating to refit and maintenance and other operating activities.

Cash used in financing activities reflects $0.3 million payment of capital lease obligations.

Cash used in investing activities consisted of:

- $35.8 million used to purchase capital assets (See “Investing in Our Capital Assets” below for detail of significant purchases);

partially offset by:

- $32.2 million in proceeds from short-term investments.

Nine Months Ended December 31, 2011

In the nine months ended December 31, 2011, cash provided by operating activities included $2.5 million of cash used to reduce regulatory liabilities as follows:

- $14.2 million in fuel and interest costs deferred; and
- $0.1 million in performance term three submission costs;

partially offset by:

- $8.9 million in fuel surcharges;
- $1.5 million in other payments from the Province credited to deferred fuel accounts; and
- $1.4 million receivable from the Province relating to the Northern Routes.

Cash provided by operating activities also included an increase in non-cash operating working capital of $16.9 million. This increase in non-cash operating working capital was due to:

- $9.9 million decrease in payables and accrued liabilities relating to refit and maintenance and other operating activities;
- $2.9 million decrease in interest payable on long-term debt reflecting timing of interest and principal payments;
- $0.7 million increase in accounts receivable relating to operating activities, mainly due to $0.7 million in social program fees; $0.6 million of interest related to the Structured Financing Facility; and $0.5 million in accrued investment income; partially offset by $1.2 million due to receipt of a marine insurance no claims bonus and continuity credit;
- $2.0 million increase in prepaid expenses primarily due to $1.7 million in fuel; $0.4 million in insurance; and $0.1 million in service contracts; partially offset by $0.2 million in other miscellaneous items;
- $2.3 million decrease in deferred revenue primarily due to $1.6 million in assured loading ticket refunds and $1.3 million in reduced reservations reflecting the seasonality of the business; partially offset by an increase of $0.5 million in stored value cards;
- $1.1 million decrease in current regulatory liabilities reflecting the return to customers through discount fare promotions of tariff revenues collected in excess of price caps at March 31, 2011; and
- $0.6 million increase in inventory mainly due to an increase in materials for vessel refits reflecting the seasonality of the business.

The above items, which increased working capital, were partially offset by:

- $2.6 million increase in accrued employee costs.

Cash used in financing activities reflects a total of $51.4 million in long-term debt payments; $3.9 million repayment of short-term loans; and $0.8 million payment of capital lease obligations.

Cash used in investing activities consisted of:

- $91.6 million used to purchase capital assets (See "Investing in Our Capital Assets" below for detail of significant purchases); and
- $0.3 million used for finalization of the long-term loan to the developer of our corporate office leased property;

partially offset by:

- $37.2 million in proceeds from short-term investments;
- $1.3 million reduction in debt service reserves; and
- $0.1 million proceeds from disposal of property, plant and equipment.

INVESTING IN OUR CAPITAL ASSETS

Assets acquired under Capital Lease

In September 2010, agreements which constitute a capital lease for space in our new corporate office building in downtown Victoria took effect following the completion of construction of the new building.

In November 2010, we advanced $24.2 million to the developer of the property for a term of 15 years, secured by a second mortgage on the property. Incidental to the loan, we were granted an option to purchase up to 50% of the owner's equity interest in the new building at a price of $24.2 million. Final cost adjustments were made on April 15, 2011, bringing the total amount of the loan and the purchase option to $24.5 million.

The value of our capital assets was increased by $0.3 million in the three months ended June 30, 2011, to reflect the final cost adjustments.

Capital Expenditures

Capital expenditures in the three and nine months ended December 31, 2011, totalled $37.0 million and $93.8 million, respectively:

Capital expenditures ($ millions)	**December 31, 2011**	
	3 Months	**9 Months**
Terminal marine structures	12.4	38.5
Vessel upgrades and modifications	19.1	34.5
Information technology	4.5	12.5
Terminal and building upgrades and equipment	1.0	8.3
Total capital expenditures	37.0	93.8

Terminal Marine Structures

Capital expenditures for terminal marine structures in the three and nine months ending December 31, 2011, included the following:

Terminal marine structures ($ millions)		**December 31, 2011**	
Terminal	Description	**3 Months**	**9 Months**
Swartz Bay	Berth 4 and 5 replacement and refurbishment	4.5	12.3
Hornby Island	Replacement of ramp, wingwalls, towers & dolphins	3.3	8.3
Tsawwassen	Refurbishment of decks and berth 5 upgrades	0.7	7.8
Denman Island	Replacement of ramp, wingwalls, towers & dolphins	2.3	5.2
Tsawwassen	Berth 4 replacement and refurbishment	0.3	1.4
Vesuvius	Replacement of port wingwall and refurbishment of starboard trestle, wingwall, ramp and pontoon	1.0	1.1
Brentwood Bay	Modifications to accommodate the Klitsa	-	1.1
Various	Other projects	0.3	1.3
		12.4	38.5

The $19 million project at Swartz Bay for the upgrade of berths 4 and 5 includes replacement of ramps, ramp abutments, aprons, towers, wingwalls, dolphins and floating leads. Ship-to-shore electrical upgrades and a new waiting shelter are also included. Completion of berth 5 is expected before the end of the fiscal year and berth 4 is expected in mid 2012.

At Shingle Spit on Hornby Island and at Gravelley Bay on Denman Island, major marine structure replacement programs are underway. The combined $18 million multi-year projects include replacement of the wingwalls, ramps, ramp abutments, aprons, trestles, towers, and dolphins. These projects were completed in November 2011.

At Tsawwassen Terminal, a $9 million project to replace the dolphins, catwalk and sheet pile wall as well as refurbishment of the hydraulic systems at berth 5 is underway and a $1 million project for deck coating of two berths is now complete.

Also at Tsawwassen Terminal, the $35 million multi-year project for replacement and refurbishment of berth 4 is substantially complete. The project replaced all 13 dolphins and the port wingwall. The lower ramp was replaced with a new multi-apron ramp with two-lane commercial vehicle capacity and the foundations and ramp supports were upgraded and a new hydraulic lift system installed. Remaining work includes modification to the upper apron, changing winches to constant tension, paving, and the balance of the cathodic protection.

Vessel Upgrades and Modifications

Capital expenditures for vessel upgrades and vessel modifications in the three and nine months ended December 31, 2011, included the following:

Vessel upgrades and modifications ($ millions)	**December 31, 2011**	
	3 Months	**9 Months**
Sewage treatment upgrade program	6.7	11.9
Queen of Chilliwack life extension	0.3	5.0
Queen of Burnaby asset betterment	4.3	4.8
Queen of Alberni propeller hub replacement	2.0	2.0
Klitsa asset betterment with new lifesaving systems, right-angle drives and sewage pump-ashore system	-	2.0
Bowen Queen upgrades to lifesaving systems, washrooms and passenger accommodations	1.5	1.5
Queen of Oak Bay, *Queen of Surrey* and *Queen of Alberni* boiler replacements	0.9	1.0
Powell River Queen passenger upgrades	0.5	1.0
Electrical & navigational program for 19 vessels	0.2	0.8
Other projects	2.7	4.5
	19.1	34.5

Implementation of a multi-year sewage and waste water treatment program to upgrade 20 vessels and eight terminals for treatment of sewage generated onboard the vessels continues. The program involves major modifications and upgrades to ensure that all vessels comply with *Canada Shipping Act, 2001* sewage regulations, which will be effective July 1, 2012. Wherever possible, the vessels will convey sewage to a terminal through pump-ashore infrastructure. In all other cases, the vessels will be fitted with compliant marine sanitation devices. All vessels will be modified as part of this project or as part of their scheduled upgrade. Modification of the *Queen of Alberni*, *Queen of Cowichan, and Queen of Burnaby* were completed in the third quarter. The remaining five vessels are expected to be completed in a timely manner to ensure their compliance with the new regulations.

The project to extend the life of the 33-year-old *Queen of Chilliwack* began in December 2010, with the first phase of a two-phase project that will allow the vessel to continue in service until it is retired in 2017 or later. The vessel returned to service on June 14, 2011, following completion of the first phase of this $15 million project which included new car deck watertight doors, new propeller seals, new instrumentation and control systems, and new lifesaving systems. The second phase which began in early January 2012 will include the installation of three new generators, electrical and HVAC system upgrades, and renewal of the propulsion control system. Ferry transportation fees for the Northern Routes will increase $1.8 million in fiscal 2012 as a result of this life extension.

On December 16, 2011, the *Queen of Burnaby* returned to service after completion of a $5 million asset improvement project as well as a $3 million refit. The vessel underwent an extensive mechanical refit including the overhaul of generators, port main engine, bow thruster and propulsion system; modernization of the elevator system; steel renewal on the main car deck; installation of a new sewage treatment holding tank; abatement of asbestos containing material; new flooring in washrooms; and regulatory surveys.

Information Technology

Capital expenditures for information technology in the three and nine months ending December 31, 2011, included the following:

Information technology ($ millions)	**December 31, 2011** **3 Months**	 **9 Months**
Customer service program	1.5	4.5
Computer hardware upgrades	0.7	1.9
Bridge simulation training centres	0.1	1.5
Operational document management system	0.3	1.0
Payroll system replacement	0.8	1.0
Other projects	1.1	2.6
	4.5	12.5

The $39 million customer service program will replace our aged point of sale and reservations systems and allow us to respond in a more timely fashion to changing business needs and to support marketing, travel services, and pricing initiatives. This program will also include terminal ticketing automation and customer relationship management systems. This five year program will be completed and implemented by fiscal 2016, and will significantly improve our ability to efficiently respond to the changing needs of our customers.

Computer hardware upgrades continue as we proceed through our programs for replacement of aged computers, servers, cash registers and printers.

We have established bridge simulation training centres at three of our major terminals to enable the development and delivery of affordable, integrated and targeted bridge team training that reduces operational risk. The training program will leverage simulator best practices, minimize operational impacts and overhead, establish the infrastructure and lay the foundation for technical and team training for our bridge teams.

An electronic document management system for the control, revision and publication of operations manuals is underway. This will enable employees access to current policy and procedure documents electronically even when onboard a vessel. It is expected to be complete by March 31, 2012.

Other projects include enhancements for improved supply chain management and a payroll system replacement initiative to replace both our payroll and labour distribution systems to provide added reliability and significant processing efficiencies and flexibility.

Terminal and Building Upgrades and Equipment
Capital expenditures for terminal and building upgrades and equipment in the three and nine months ending December 31, 2011, included the following:

Terminal and building upgrades and equipment ($ millions)	**December 31, 2011**	
	3 Months	**9 Months**
Terminal waste water program	0.1	2.7
Vehicles, machinery & equipment	0.3	1.6
Terminal seismic upgrades	0.4	0.6
Security upgrades	0.1	0.5
Nanaimo Harbour Terminal waiting room & restrooms	-	0.4
Swartz Bay roadway reconstruction	-	0.4
Other terminal projects	0.1	2.1
	1.0	8.3

As part of the multi-year sewage and waste water treatment program for treatment of sewage generated onboard our vessels, installation of pump ashore infrastructure at Bear Cove, Langdale, Duke Point, Departure Bay and Powell River Terminals are in service and Nanaimo Harbour is in the preliminary investigation phase. As part of the federal government's Infrastructure Stimulus Fund program, we received $3.2 million in fiscal 2011 and estimate that we will receive a total of $8.7 million relating to sewage pump-ashore projects and other major terminal projects.

The costs incurred for vehicles, machinery, and equipment are primarily for upgrades to the electrical equipment at our maintenance facility and the purchase of a crane truck as well as electrical sub-metering at five of our terminals to take advantage of potential electricity conservation and reduction opportunities.

As part of a multi-year project to upgrade our facilities, seismic upgrades of the maintenance building at our Little River Terminal was completed this fiscal year and upgrades to the interior of the Sidney Terminal maintenance building is currently underway.

Our multi-year project to upgrade security at our terminals was completed in the third quarter. This project primarily involved fencing, gating, lighting, access controls and closed circuit television, as well as upgrades to foot passenger ticketing areas.

At Nanaimo Harbour Terminal, a new waiting room and restrooms were completed in the second quarter.

At Swartz Bay Terminal, reconstruction of the roadway at the vehicle entrance to the pick-up and drop-off areas was completed in the first quarter.

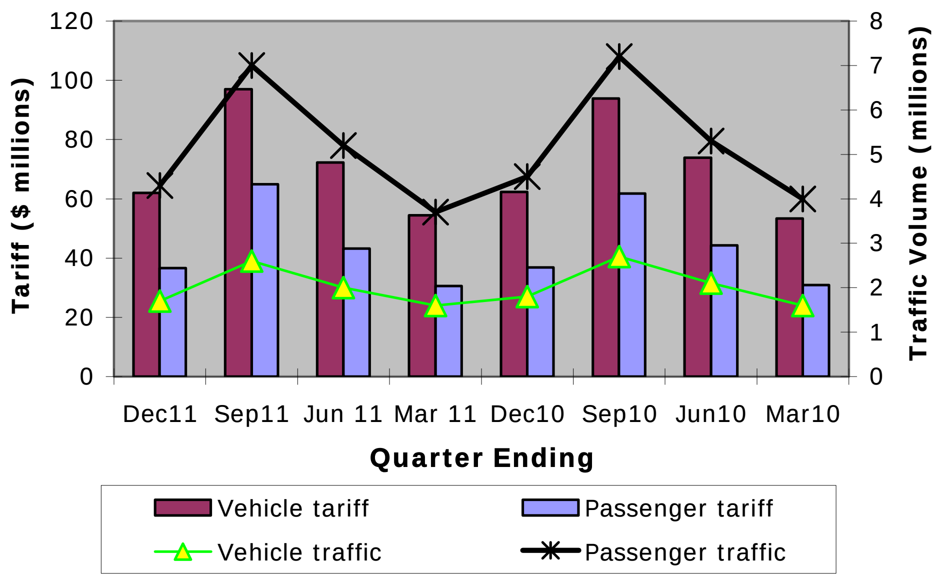
SUMMARY OF QUARTERLY RESULTS

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

	Quarter Ended (unaudited)							
($ millions)	**Dec 11**	**Sep 11**	**Jun 11**	**Mar 11**	**Dec 10**	**Sep 10**	**Jun 10**	**Mar 10**
Total revenue	161.3	252.1	186.7	140.7	162.3	246.1	190.2	142.3
Earnings (loss) from operations	(5.1)	75.4	12.4	(21.0)	(3.3)	72.5	18.9	(19.5)
Net earnings (loss) and comprehensive income	(23.1)	57.3	(5.5)	(39.0)	(12.5)	54.4	0.9	(36.8)

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:



FINANCIAL RISKS AND FINANCIAL INSTRUMENTS

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 36 through 38 of our fiscal 2011 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the nine months ended December 31, 2011.

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 39 through 45 of our fiscal 2011 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the nine months ended December 31, 2011. An update on the risk relating to customer demand is included below.

There exists uncertainty in regards to our future until such time as we know how the Province will respond to the recommendations as set out in the Commissioner's report. As part of our risk management strategies, we have considered many items such as profitability levels, cash generating potential, cash utilization requirements including debt repayment schedules and future capital expenditures, and working capital requirements. We have taken measures to allow us to weather the economic downturn and ensure our future financial sustainability.

Customer Demand

Our vehicle and passenger traffic levels in the nine months ending December 31, 2011, as compared to the same period in the prior year, declined 3.5% and 2.9%, respectively. The decline in traffic was experienced across the Major, Northern and Other Routes.

Impacting our traffic levels is the increased value of the Canadian dollar. More Canadians are travelling to the United States and fewer Americans are travelling to Canada. Many other factors affect customer demand, including current economic conditions, levels of tourism and discretionary travel. The cost of transportation, including the price of fuel at the pump and ferry fares (including the implementation and removal of fuel surcharges or rebates), disposable personal income, heightened global security and weather may have a negative effect on discretionary travel and levels of tourism.

We are uncertain as to the individual or cumulative impact these items may have on our revenues. No assurance can be given as to the level of traffic on our system and the resulting revenues.

Risk mitigation: We are constrained by the Coastal Ferry Services Contract, which stipulates, among other things, the number of round trips that must be provided for each regulated ferry route. Within these constraints, we actively manage our capacity in an efficient and effective manner to ensure we can react quickly to changing levels of demand. Vessel planning strategies are in place and we regularly review and update our short and long-term financial and operating plans to appropriately align expenses with revenue to the extent possible.

ACCOUNTING PRACTICES

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with Canadian generally accepted accounting principles.

Our significant accounting policies are contained in Note 1 to our March 31, 2011 and December 31, 2011 consolidated financial statements. Certain of these policies involve critical accounting estimates because they require us to make particularly subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts could be reported under different conditions or using different assumptions. These 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 46 through 48 of our fiscal 2011 Management's Discussion & Analysis. The following describes the changes to critical accounting policies we have used in the preparation of our consolidated financial statements for the three and nine months ended December 31, 2011, or expect to use in the future.

Adoption of New Accounting Standards

No new accounting standards have been adopted for fiscal 2012.

Future Accounting Changes

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

- In 2006, the Canadian Accounting Standards Board (AcSB) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian generally accepted accounting principles with International Financial Reporting Standards (IFRS) over an expected five year transitional period.

  Our changeover date for the conversion to IFRS was originally April 1, 2011. However, the AcSB has amended Part 1 of the CICA Handbook – Accounting to require:
  - Qualifying entities with rate-regulated activities to adopt IFRSs for the first time no later than annual periods beginning on or after January 1, 2012; and
  - Entities electing to defer the first-time adoption of IFRS to disclose that fact.

  The Canadian Securities Administrators' regulations have also been amended to incorporate the AcSB's one-year deferral.

  We have elected this option which defers our changeover date for conversion to IFRS to April 1, 2012.

  Transition to IFRS will require the restatement for comparative purposes of amounts reported by us for the year prior to changeover date. We expect that all standards that will be in effect for our changeover year have already been issued by the International Accounting Standards Board (IASB). However, we are continuing to monitor the IASB and the AcSB as well as the Canadian Securities Administrators, for any developments which may affect the timing, nature or disclosure relating to our adoption of IFRS.

  We commenced our IFRS transition project in 2007 and have established a formal project governance structure with regular reporting. We have also engaged a quality assurance advisor to assist in the project.

Our IFRS transition project consists of three phases:

1. Scoping and diagnostic phase, which has been completed, involved project planning and resourcing, high level impact assessment of differences between current Canadian GAAP and IFRS, and priority setting;
2. Analysis and development phase, which has also been completed, involved detailed analysis and evaluation of options and alternative methodologies available under IFRS, and the financial impact of these options; and
3. Implementation and review phase which involves implementing and approving changes to accounting policies, information systems, business processes and training, and developing IFRS-compliant financial statements.

We are currently in the final stages of the implementation and review phase.

The following table includes elements of our IFRS transition plan and an assessment of progress towards achieving the key milestones which have been amended to reflect our election to defer our changeover to IFRS by one year, to April 1, 2012. Though not expected, changes in regulation or timing of standard development throughout the project could result in changes to the transition plan.

Financial statement preparation
Key activities • Identify differences in Canadian GAAP/IFRS accounting policies • Select ongoing IFRS policies • Develop financial statement format • Select IFRS 1 exemptions for transition • Quantify effects of change at April 1, 2011 (for fiscal 2012 comparative financial statements)
Milestones • Senior management review of policy decisions and illustrative IFRS financial statements and disclosures by June 30, 2011 • Audit & Finance Committee approval of policy decisions and IFRS financial statement format, in principle, by September 30, 2011 • IFRS 1 exemptions finalized and quantified by September 30, 2011 • Policies and procedures in place by March 31, 2012
Status • Scoping and diagnostic phase completed in fiscal 2009, with high-level review of the major differences between Canadian GAAP and IFRS • Highest areas of impact identified, review prioritized, and in-depth analysis complete • Accounting policy alternatives analyzed and recommendations made for key accounting policy decisions • IFRS 1 exemptions reviewed and analyzed • Senior management review of policy decisions complete • Preparation of illustrative financial statements and note disclosures complete • Senior management review of illustrative financial statements complete • Audit & Finance Committee review of illustrative financial statements complete • IFRS 1 exemptions finalized and quantified • Policies and procedures are complete

Information technology infrastructure
Key activities • Confirm system upgrades required for IFRS reporting • Review/revise data gathering processes • Review/revise budgeting and forecasting processes
Milestones • System configuration changes complete by March 31, 2010 • System reporting changes required to accommodate both current Canadian GAAP and IFRS complete by August 31, 2010 • Changes to budgeting and forecasting processes complete by June 30, 2011
Status • Detailed reporting requirements to accommodate the transition to IFRS identified and documented • Overall system approach selected • System configuration to accommodate both current Canadian GAAP and IFRS complete • System changes to accommodate reporting requirements complete • Review to determine effects on the project of one-year deferral of changeover and absence of standard on rate-regulation complete • Changes required to budgeting and forecasting processes complete

Training, Education & Communication
Key activities • Determine required level of IFRS expertise within all areas of the company • Ensure appropriate training of key members within Finance • Provide appropriate education and communication to affected departments • Provide department specific training on revised policies and procedures • Provide timely communication to both internal and external stakeholders on impacts of the transition to IFRS
Milestones • Topic-specific training for IFRS working committee complete prior to March 31, 2010 • Department-specific training completed by March 31, 2012 • Impacts of transition to IFRS communicated to external stakeholders by March 31, 2012
Status • Core IFRS project team members completed topic-specific training, and successfully completed the "IFRS Award Program, Certificate Level" • Interdepartmental workshops provided on specific topics, including property, plant and equipment; IFRS 1; and the IFRS Framework • Ongoing communications with key stakeholders, including direct communication with the Commissioner, our Agent Bank, rating agencies, our Board of Directors, and with investors indirectly through our website • Interdepartmental training on specific topics complete • Impacts of transition communicated in December 31, 2011 MD&A

Control environment
Key activities • Accounting policy determination, documentation and implementation • MD&A ongoing communications
Milestones • All internal control process descriptions updated by March 31, 2012 • Publish quantitative effects of conversion on April 1, 2011 opening balance sheet in December 31, 2011 MD&A
Status • Analysis of control issues in progress as part of the detailed implementation plan • Review and update of process descriptions in progress • Policies and procedures complete • April 1, 2011 opening IFRS statement of financial position published in December 31, 2011 MD&A (included below at the end of this discussion of Future Accounting Changes)

Business policy assessment
Key activities • Financial covenants assessment • Compensation arrangements assessment • Customer and supplier contract evaluation
Milestones • Potential impact on compensation arrangements determined by December 31, 2011 • Impact on customer/supplier contracts determined by December 31, 2011 • Impact on financial covenants quantified by March 31, 2012
Status • All relevant GAAP-dependent covenants and contracts have been identified • Analysis to determine effects of IFRS on existing covenants and contracts is complete • Impact on compensation arrangements analyzed

A summary of the areas with the highest impact on our financial position and results of operations is as follows:

- Rate-regulated operations: IFRS does not currently provide specific guidance with respect to accounting for rate-regulated activities. In December 2008, the IASB initiated a project on accounting for rate-regulated activities that had an objective to develop a standard on rate-regulated activities that would clarify whether regulated entities could or should recognize assets or liabilities as a result of rate-regulation imposed by a regulatory body.

  In September 2010, the IASB staff released Agenda Paper 12 on rate-regulated activities. In their opinion, while the impact of regulators may have an economic impact on entities subject to rate-regulation:
  - o Regulatory assets do not meet the definition of a financial asset nor the definition of an intangible asset as specified in IAS 38; and
  - o Regulatory liabilities do not meet the definition of a financial liability nor the definition of a provision as specified in IAS 37.

  The IASB closed its project on rate-regulated activities. However, the IASB is in the process of consulting constituents to seek input on their strategic direction and preparation in setting work plans over the next three years. It has also provided constituents with suggestions for items to add to their agenda, including rate-regulated activities. We have provided a response in support of reinstating a project on rate-regulated activities.

It is our expectation that issues regarding rate-regulated activities will remain unresolved for some time and that we will not be reporting our regulatory assets or liabilities on the IFRS Statement of Financial Position. Accordingly, balances at March 31, 2011 of $3.7 million of current regulatory assets and $1.6 million of long-term regulatory liabilities will be derecognized on our transition date of April 1, 2011 with a net reduction in retained earnings of $2.1 million.

As future balances of our regulatory accounts are uncertain, we cannot reasonably estimate and conclude the impact on our future financial position and results of operations with respect to accounting for rate-regulated activities.

- Property, plant and equipment:
  - *Inspections and major overhauls:* The capitalization of inspections and major overhauls of our vessels is a significant change affecting us. A process to track these items has been finalized and necessary system configuration changes have been completed. We have defined, identified, and quantified inspection and major overhaul items for each class of vessel for reclassification at transition date and internal reporting solutions have been completed.

    This change has the potential to cause significant fluctuations in earnings over the reporting periods due to the level of inspections and major overhauls in any one period and the number of periods over which each will be amortized. Over the five years ending March 31, 2016, we estimate the net impact of this change to range from a decrease in annual net earnings of $1 million to an increase in annual net earnings of $14 million.

  - *Valuation subsequent to transition:* We have a choice under IFRS to value our property, plant and equipment using either a historical cost model or a revaluation model. We have decided to use a historical cost model for all property, plant and equipment with the exception of land. We will use a revaluation model for our land assets.

  - *Other rate-regulated impacts:* As a rate-regulated entity and prior to transitioning to IFRS, we capitalized some costs such as feasibility, research and training that directly related to a specific asset. Under IFRS these costs will no longer be capitalized. Over the five years ending March 31, 2016, we estimate the net impact to be a decrease in earnings of up to $2 million annually.

- IFRS 1 *First-Time Adoption of IFRS*: All elections and exemptions under IFRS 1 have been reviewed and the choices we have made will result in a net increase of $8.6 million in retained earnings on transition. The elections and exemptions that apply to us upon adoption are summarized as follows:
  - *Employee Benefits:* There is a choice to either recognize all cumulative actuarial gains and losses of defined benefit plans through opening retained earnings or recalculate the actuarial gains and losses under IFRS from the inception of the defined benefit plans. We have elected to recognize all cumulative actuarial gains and losses through opening retained earnings at April 1, 2011. The actuarial loss to be recognized in opening retained earnings is $3.6 million.
  - *Property, plant and equipment and Intangible assets:* There is a choice of valuation of property, plant and equipment and intangible assets at April 1, 2011, either to:
    - retrospectively apply IFRS to the valuation of the assets; or
    - to revalue items, on an asset by asset basis, at fair value and use that fair value as deemed cost; or
    - use previous GAAP carrying amounts at transition as the deemed cost for assets used in rate-regulated operations as detailed in the amendment to IFRS 1 published May 6, 2010.

    We have elected to use previous GAAP carrying amounts at transition as the deemed cost for all intangible assets and the majority of our property, plant and equipment with the exception of land. We have elected to revalue land at fair value at April 1, 2011. This revaluation will result in an increase in land value of $12.2 million.

The following is our April 1, 2011 opening IFRS Statement of Financial Position, including a reconciliation to our audited March 31, 2011 consolidated balance sheet prepared under current Canadian GAAP. This reconciliation distinguishes between existing GAAP/IFRS differences that are "adjustments" and those that are "reclassifications". Differences identified as adjustments increase or lower retained earnings whereas reclassifications have no retained earnings impact:

(thousands of Canadian dollars)	**March 31, 2011**			**April 1, 2011**
	Canadian GAAP Balances	IFRS Adjustments	IFRS Reclassifications	Opening IFRS Balances
Assets				
Current assets:				
Cash and cash equivalents	$ 33,335	$ -	$ -	$ 33,335
Restricted short-term investments	37,040	-		37,040
Other short-term investments	64,074	-		64,074
Accounts receivable	20,619	-		20,619
Prepaid expenses	5,648	-	-	5,648
Inventories	19,957	-	-	19,957
Regulatory assets	3,703	(3,703)	-	-
	184,376	(3,703)	-	180,673
Non-current assets:				
Long-term loan receivable	24,247	-	-	24,247
Long-term land lease	32,979	-	-	32,979
Property, plant & equipment	1,581,007	12,187	-	1,593,194
Intangible assets	34,929	-	-	34,929
	1,673,162	12,187	-	1,685,349
	1,857,538	8,484	-	1,866,022
Liabilities and Shareholders' Equity				
Current liabilities:				
Accounts payable and accrued liabilities	51,249	-	(1,377)	49,872
Short-term debt	3,949	-		3,949
Interest payable on long-term debt	18,261	-		18,261
Accrued employee costs	48,194	-	(48,194)	-
Deferred revenue	15,596	-		15,596
Derivative liabilities	23	-		23
Current portion of long-term debt	22,125	-		22,125
Current portion of accrued employee future benefits	1,200	-		1,200
Current portion of obligations under capital lease	1,040	-		1,040
Provisions	-	-	49,571	49,571
	161,637	-	-	161,637
Non-current liabilities:				
Accrued employee future benefits	10,907	3,552		14,459
Regulatory liabilities	1,558	(1,558)	-	-
Long-term debt	1,327,014	-		1,327,014
Obligations under capital lease	47,723	-		47,723
	1,387,202	1,994	-	1,389,196
Total liabilities:	1,548,839	1,994	-	1,550,833
Shareholders' equity:				
Share capital	75,478	-	-	75,478
Retained earnings	233,221	6,490		239,711
Total equity before reserves	308,699	6,490		315,189
Reserves	-		-	
	308,699	6,490	-	315,189
	$ 1,857,538	$ 8,484	$ -	$ 1,866,022

Impact on opening retained earnings	($ thousands)
Land revaluation	12,187
De-recognition of regulatory assets and liabilities	(2,145)
Cumulative actuarial loss on defined benefit plans	(3,552)
Increase in opening retained earnings	6,490

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 Coastal Ferry Services Contract.

Forward looking statements included in this document include statements with respect to: economic conditions and traffic levels; the extension of the Collective Agreement; a net loss in fiscal 2012 in the order of $20 million and our expectations of the impact of our cost containment program; our credit ratings and our future financial performance; the anticipated refinancing of at least one of the two bond issues maturing over the next few years; our short-term and long-range business plans, capital expenditure levels, asset renewal programs for vessels and terminals, the timing and cost of repairs to our Duke Point Terminal, our cable ferry initiative, and our LNG plans; our expectations of ferry transportation fee amounts; our estimates of funding under the Infrastructure Stimulus Fund program; our expectations regarding how our operational cash requirements will be met; and the impact of the Commissioner's recommendations, Bill 14 and IFRS. 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 traffic volume and tariff revenue risk, safety and security, asset risk, accident risk, tax risk, environmental risk, regulatory risk, labour disruption risk, limitations of vessel repair facilities, risk of default under material contracts and aboriginal land 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.