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

For the three and six months ended September 30, 2012
Dated November 16, 2012

BCFerries

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of Financial Condition and Financial Performance
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The following is our discussion and analysis of the financial condition and financial performance for British Columbia Ferry Services Inc. as of November 16, 2012. This should be read in conjunction with our unaudited interim consolidated financial statements and related notes for the three and six month periods ended September 30, 2012 and 2011, and our audited consolidated financial statements and related notes for the years ended March 31, 2012 (fiscal 2012) and March 31, 2011 (fiscal 2011), together with our fiscal 2012 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 International Financial Reporting Standards (IFRS) and have been subject to an interim review by our external auditors, KPMG LLP. Note 11 to the unaudited interim consolidated financial statements contains a reconciliation of key components of our financial statements previously prepared under Canadian GAAP to those under IFRS as at and for the six months ended September 30, 2011, for the year ended March 31, 2012 and as at our transition date of April 1, 2011. Although the adoption of IFRS resulted in adjustments to our financial statements, it did not materially impact the underlying cash flows or long-term profitability trends of our operating performance.

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. We provide frequent year-round transportation service with 35 vessels operating on 25 routes out of 47 terminals spread over 1,000 miles of coastline. We also manage ferry transportation service on other remote routes through contracts with independent operators.

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

We provide a wide range of ferry services for our customers. During the three months ended September 30, 2012 (the second quarter of fiscal 2013), we provided over 48,000 sailings, carrying approximately seven million passengers and two and a half million vehicles. In the second quarter of fiscal 2013, we experienced a decline of 1.2% in vehicle and passenger traffic as compared to the same period in the prior year. (See discussion under "Financial and Operational Review" below).

Significant events during or subsequent to our second quarter of fiscal 2013:

- On July 20, 2012, as a result of declining fuel prices, fuel surcharges were reduced from 2.5% to 2.0% on our route connecting Horseshoe Bay and Langdale and from 5.0% to 2.0% on our other regulated routes with the exception of the Northern Routes. We are actively monitoring deferred fuel cost account balances and believe that these fuel surcharges are likely to be removed in the third quarter. No surcharges or rebates were in place on our Northern Routes.

- On September 30, 2012, the British Columbia Ferries Commissioner (the Commissioner) released the final price caps for the remaining three years of performance term three, April 1, 2013 to March 31, 2016. These price caps represent increases averaging 4.0% per annum. The order indicated the Commissioner has the intention of allowing us to achieve, by the end of the third performance term, equity not lower than 17.5% of total capitalization and a Debt Service Coverage Ratio (DSCR) of 2.5 or higher. (See "Financial and Operational Overview – Economic Regulatory Environment" for more detail).

- On September 30, 2012, the Commissioner also released two additional orders; one establishes the terms and conditions for use of fuel price deferral accounts and the other establishes the criteria for determining major capital expenditures which require pre-approval by the Commissioner. (See "Financial and Operational Overview – Economic Regulatory Environment" for more detail).

- On October 29, 2012, the Province announced the beginning of their public consultation and engagement process for input on ferry service adjustments and on a long-term vision for ferry service and noted that the consultation will run through to December 21, 2012. We will provide technical and subject matter support throughout this process. (See "Financial and Operational Overview – Economic Regulatory Environment" for more detail)

- On October 29, 2012, the Property Assessment Appeal Board of British Columbia issued its decision on our property assessment appeal relating to our Horseshoe Bay terminal. It ruled that the land and improvements, previously assessed at $42 million, $45 million and $48 million for years 2010, 2011 and 2012, respectively, have a nominal value of $20 dollars for each year. The decision is likely to be appealed and the outcome of such an appeal is uncertain.

FINANCIAL AND OPERATIONAL OVERVIEW

As of April 1, 2012, we are reporting our financial position and financial performance under IFRS. The prior year has been restated under IFRS for comparative purposes.

This section provides an overview of our financial and operational performance for the three and six months ended September 30, 2012 and 2011.

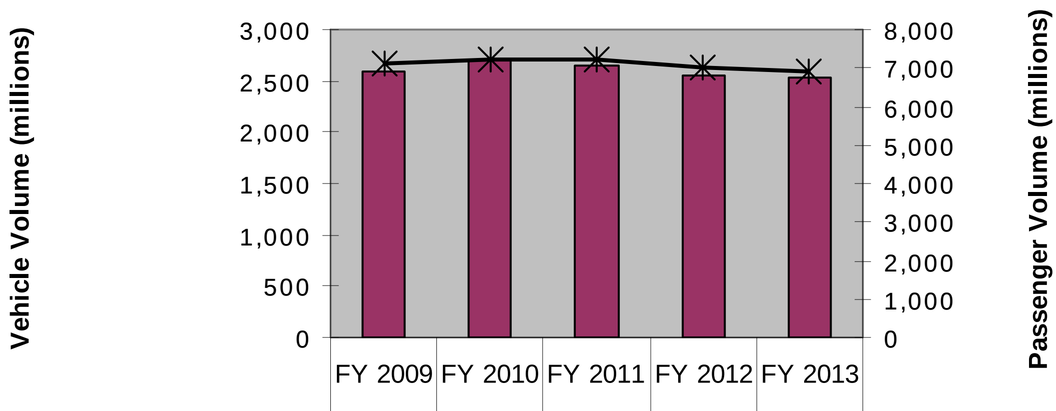
($ millions)	**Three months ended September 30**			**Six months ended September 30**		
	2012	**2011**	**Variance**	**2012**	**2011**	**Variance**
Total revenue	268.6	256.9	11.7	466.2	443.9	22.3
Operating expenses	(184.5)	(183.4)	(1.1)	(361.4)	(356.7)	(4.7)
Operating profit	84.1	73.5	10.6	104.8	87.2	17.6
Net finance and other	(17.6)	(17.7)	0.1	(35.0)	(34.9)	(0.1)
Net earnings and comprehensive income	66.5	55.8	10.7	69.8	52.3	17.5

Our operating profit in the three months ended September 30, 2012, was $10.6 million ($17.6 million year-to-date) higher than the same periods in the prior year while net earnings were $10.7 million ($17.5 million year-to-date) higher.

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.

In the second quarter of fiscal 2013, we experienced a decline in vehicle traffic of 1.2% (1.4% year-to-date) as compared to the same period in the prior year. Passenger traffic also declined 1.2% (1.7% year-to-date). In July, traffic levels were very poor. However, in August and September, the traffic levels recovered, improving to a similar level as in the prior year. These traffic improvements were primarily on our Major Routes. We anticipate some improvement in our traffic levels in the coming months, compared to our original expectations, however; we do not expect that our annual vehicle or passenger traffic levels will reach those of the prior year.

The following graph illustrates our vehicle and passenger traffic levels for the second quarter from fiscal 2009 through fiscal 2013:



	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Vehicles	2,593	2,706	2,653	2,560	2,529
Passengers	7,126	7,244	7,210	7,001	6,920

Safety and Training

With the ongoing improvements to our safety culture and our move towards world class safety performance, we are launching our fourth annual SailSafe town hall group of sessions. These forums allow for open discussion between management and employees at all levels and from all areas and departments, and have become the cornerstone of SailSafe's success in keeping safety awareness at the forefront of our operations. Additionally, our operations risk management process is now being strengthened. The process includes task analyses and risk assessments, safety impact assessments on all significant initiatives, as well as operational risk registers.

Overall, we continue to invest substantial effort to continually improve our safety culture primarily through training and workforce engagement.

Economic Regulatory Environment

On January 24, 2012, the Commissioner issued his report, including 24 substantive recommendations, to the Province as to how the Act could be amended to balance the interests of ferry users with the financial sustainability of our company.

Effective April 1, 2012, for the first year of performance term three, the *Coastal Ferry Amendment Act, 2011* (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. The Province agreed to make us whole for the resulting change in the price cap from what the Commissioner originally determined in his preliminary price cap order. The value of this price cap change is $11.5 million, which the Province agreed to provide as part of the $21.5 million increase in transportation fees for fiscal 2013 detailed below. In response to Bill 14, we implemented tariff increases up to the new levels authorized. Bill 14 also provided that the Commissioner establish price caps for the balance of the third performance term.

In May 2012 and in response to the Commissioner's report, the Province enacted the *Coastal Ferry Amendment Act, 2012* (Bill 47). The amendments were designed to move toward striking a balance among the interests of ferry users, taxpayers and the sustainability of the ferry operator. The changes cover a wide range of ferry related issues including:

- Allowing cross subsidization from the Major Routes to other routes;
- Changing the primary responsibility of the Commissioner from priority placed on the financial sustainability of the ferry operations, to responsibility to protect the interests of ferry users, the taxpayers, and the financial sustainability of the ferry operator;
- Expanding the Commissioner's authority and responsibilities, to include:
  - Approval of permanent changes to service levels;
  - Authority to order a temporary or permanent service reduction and or deferral of a planned capital expenditure in response to an extraordinary situation, in addition to or instead of an approval of extraordinary price cap increases;
  - The ability to require us to seek the Commissioner's approval in advance of making certain capital expenditures;
  - The responsibility to set price caps sufficient to enable us to meet our debt obligations and maintain access to borrowing rates that in the opinion of the Commissioner are reasonable;
  - Specific legislative authority to establish the deferred fuel cost accounts and the terms and conditions for their use, including fuel surcharges or rebates; and
  - The authority to conduct routine performance reviews and to require us to review our policies and undertake public consultation.

Together with the introduction of amendments to the Act, the Province announced additional payments totalling $79.5 million in order to reduce the pressure for future fare and price cap increases. The first payment of $25.0 million, approved on March 30, 2012, was received April 20, 2012, as a contribution to our equity. A further $54.5 million will be received as follows: $21.5 million in fiscal 2013 (which includes $11.5 million as compensation for price cap adjustments as detailed above); $10.5 million in fiscal 2014; $11.0 million in fiscal 2015; and $11.5 million in fiscal 2016.

In addition, the Province announced that it will conduct public consultation with ferry dependent communities about adjustments to service levels and trade-offs between service adjustments, fare increases and potential community contributions. The Province also announced that it will seek public input to develop strategies to support a long-term vision for connecting coastal communities. This process will conclude December 21, 2012. We will provide technical assistance to support this process.

During the first quarter, amendments to the Coastal Ferry Services Contract (CFSC) were agreed to with the Province. These amendments, effective April 1, 2012, include:

- Grouping our route connecting Horseshoe Bay and Langdale with the three Major Routes connecting Greater Vancouver with mid and southern Vancouver Island;
- A reduction of up to 400 round trips in the minimum service requirement on our Major Routes as well as principles and targets for further service level reductions system wide.
- Implementation of principle-based service adjustments to achieve $30 million in net savings over the third performance term. These include:
    - Reductions in round trips already identified on three of our Major Routes reflecting a net savings of $4 million; and
    - Service adjustments to be determined on regulated routes to achieve an additional $26 million in net savings over the third performance term;
    - An amending CFSC agreement to be in place by June 30, 2013, specifying the $26 million service adjustments;
    - If the service level amending agreement is not in place by the stipulated date, the Province agreed that the circumstances would support us applying to the Commissioner for relief; and
- Ferry transportation fee enhancements of $54.5 million through performance term three as detailed above.

In response to the agreed reduction in the minimum service requirement on our Major Routes, we have implemented reductions in round trips on three of our Major Routes where the traffic levels no longer warranted extra service or where service was significantly under-utilized. These reductions are expected to result in $4 million in operating cost reductions from fuel savings and reduced requirements for casual employees during the off-season. There will be no reduction in our regular workforce. These identified reductions equate to 1% of our annual round trips on these routes. Further adjustments to service levels are required in order to attain the total objective of $30 million in efficiencies and these adjustments are expected to result from the Province's consultation process discussed above.

On September 30, 2012, the Commissioner issued Order 12-02 which established the following price cap increases for each route group: 4.1% at April 1, 2013; 4.0% at April 1, 2014; and 3.9% at April 1, 2015.

The order states "The commissioner has established price caps with the intention of allowing the ferry operator to achieve by the end of the third performance term equity not lower than 17.5 per cent of total capitalization and a Debt Service Coverage Ratio ("DSCR") of 2.5 or higher."

In addition, the Commissioner reset the price caps for each route group to an index level of 100 as of April 1, 2012 based on the weighted average tariffs that existed as of March 31, 2012. The established price caps incorporate efficiency targets of $54.2 million over and above the benefits associated with the service level adjustments to be achieved by us over the four years of performance term three.

In his order, the Commissioner stated "The price caps have been determined based on the expectation that the CFSC will be amended by June 30, 2013 to implement service level adjustments to achieve net savings of $30 million during PT3. If the CFSC is not amended by June 30, 2013, or the amendments will not enable BC Ferries to achieve the target of $30 million in net savings, BC Ferries may apply for relief under Section 42 of the Act."

On September 30, 2012, the Commissioner issued Order 12-03 which establishes the terms and conditions for the continued use of fuel price deferral accounts, including the per litre cost of fuel included in the determination of price caps (the set price) for performance term three. This was in response to our application filed in June 2012 seeking approval to establish a new fuel cost deferral mechanism under section 41.1 of the amended Act.

Also, on September 30, 2012, the Commissioner issued Order 12-04 which establishes the criteria for determining major capital expenditures which require advance approval from the Commissioner.

The Effect of Rate Regulation

We are regulated by the Commissioner to ensure, among other things, that our tariffs are fair and reasonable. Under the terms of the Act, the tariffs we charge our customers over a performance term are subject to price caps set by the Commissioner. The Commissioner may, under certain circumstances, allow increases in price caps over the set levels. Certain decisions and orders of the Commissioner may give rise to 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 continually assess whether our regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes and we believe the regulatory assets at September 30, 2012 are probable of future recovery and that the obligations as represented by the regulatory liabilities will be settled through future tariff reductions. These regulatory assets and regulatory liabilities are detailed in note 9 to our interim consolidated financial statements.

IFRS differs significantly from previous accounting standards. IFRS does not have a standard for rate-regulated activities and therefore, does not permit us to report in our financial statements, the assets and liabilities that result from the regulated price cap setting process, such as our deferred fuel cost accounts. Rather than being charged to regulatory asset accounts on our Statement of Financial Position, fuel surcharges collected or rebates granted are now included in revenue, and increases or decreases in fuel prices from those approved in price caps are now included in operating expenses. While this is a significant accounting change for us, it does not change the treatment of these types of assets and liabilities for regulatory purposes.

If IFRS permitted us to report regulatory assets and liabilities in our financial statements, the effect on our Statement of Comprehensive Income (Loss) for the three months ended September 30, 2012 and 2011 would be as follows:

($ millions)		**Three months ended September 30**		**Six months ended September 30**	
		2012	**2011**	**2012**	**2011**
TOTAL COMPREHENSIVE INCOME		66.5	55.8	69.8	52.3
Regulatory Asset or Liability	**Statement line item**				
Deferred fuel costs (a)					
Fuel costs incurred	Operations expense	3.0	5.1	6.9	8.7
Fuel surcharges collected	Fuel surcharge revenue	(4.1)	(4.3)	(10.1)	(5.5)
Payments from the Province	Ferry transportation fees	(0.6)	(1.0)	(1.2)	(1.8)
Amortization of first performance term accounts	Amortization expense	-	(1.2)	-	(2.4)
		(1.7)	(1.4)	(4.4)	(1.0)
Tariffs in excess of price cap (b)					
Obligation settled during the period	Tariff revenue	-	-	2.5	1.1
(Decrease) increase in total comprehensive income		(1.7)	(1.4)	(1.9)	0.1
ADJUSTED TOTAL COMPREHENSIVE INCOME		64.8	54.4	67.9	52.4

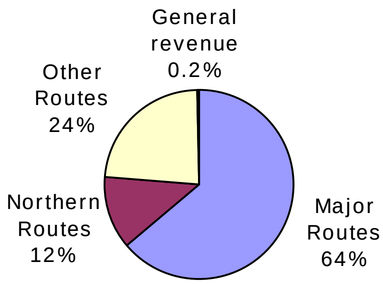
(a) *Deferred fuel costs:* As prescribed by regulatory order, we defer differences between actual fuel costs and approved fuel costs which were used to develop the regulated price caps. The difference between the approved fuel costs and the actual fuel costs (including fuel hedge gains and losses) is deferred for settlement in future tariffs. Also 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.

(b) *Tariffs in excess of price cap:* The Act contains provisions which ensure that if tariffs that we charge exceed established price caps, the excess amounts collected will be returned to customers through future tariffs.

Revenue

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

Total revenues for the three months ended September 30, 2012 increased 4.6% (5.0% year-to-date) over the same periods in the previous year as shown in the table below:



In the six months ended September 30, 2012, the greatest portion of our revenues, 64%, was earned on our Major Routes. The revenue from the Northern Routes contributed 12% and Other Routes contributed 24%.

(As per the amended CFSC the route connecting Horseshoe Bay and Langdale, previously included in Other Routes is now a Major Route)

Revenue ($ millions)	**Three months ended September 30**			**Six months ended September 30**		
	2012	**2011**	**Increase (Decrease)**	**2012**	**2011**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle traffic (volume)	*2,528,988*	*2,559,823*	*(30,835)*	*4,523,831*	*4,589,152*	*(65,321)*
Vehicle tariff	99.6	97.1	2.5	171.5	168.7	2.8
Passenger traffic (volume)	*6,920,063*	*7,001,389*	*(81,326)*	*11,969,158*	*12,173,848*	*(204,690)*
Passenger tariff	66.1	64.9	1.2	108.7	107.7	1.0
Fuel surcharges (rebates)	4.1	4.4	(0.3)	10.1	5.5	4.6
Catering & on-board	26.5	26.5	-	45.2	45.5	(0.3)
Social program fees	8.1	7.4	0.7	15.7	14.6	1.1
Reservation fees	5.2	5.3	(0.1)	8.3	8.7	(0.4)
Other revenue	2.2	2.0	0.2	3.9	3.6	0.3
Total Direct Route Revenue	211.8	207.6	4.2	363.4	354.3	9.1
Indirect Route Revenue						
Ferry transportation fees	49.3	41.9	7.4	87.9	75.0	12.9
Federal-Provincial subsidy	7.0	6.9	0.1	14.0	13.8	0.2
Total Route Revenue	268.1	256.4	11.7	465.3	443.1	22.2
Other general revenue	0.5	0.5	-	0.9	0.8	0.1
Total Revenue	268.6	256.9	11.7	466.2	443.9	22.3

Our largest revenue source is vehicle and passenger tariffs. Effective April 1, 2012, for the first year of performance term three, 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. In response to the changes, we implemented tariff increases up to the new levels authorized. On September 30, 2012, the Commissioner released the final price caps for the remaining three years of performance term three, April 1, 2013 to March 31, 2016. (See "Financial and Operational Overview – Economic Regulatory Environment" above for more detail)

On July 20, 2012, as a result of declining fuel prices, fuel surcharges were reduced from 2.5% to 2.0% on our route connecting Horseshoe Bay and Langdale and from 5.0% to 2.0% on our other regulated routes with the exception of the Northern Routes. We are actively monitoring deferred fuel cost account balances and believe that these fuel surcharges are likely to be removed in the third quarter. No surcharges or rebates were in place on our Northern Routes.

From time to time, we utilize promotional fares designed to stimulate growth in traffic or direct traffic towards our less busy sailings, while ensuring compliance with approved price cap orders. In calculating the price cap, vehicle and passenger tariffs as well as reservation fees 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.

Year to year changes for the three and six months ended September 30 for our Major, Northern, and Other Routes are discussed separately below. The CFSC was amended, effective April 1, 2012, to include our route connecting Horseshoe Bay and Langdale with the Major Routes and as a consequence, it has been removed from Other Routes in our discussion below. For comparative purposes, we also made this change in our prior year results.

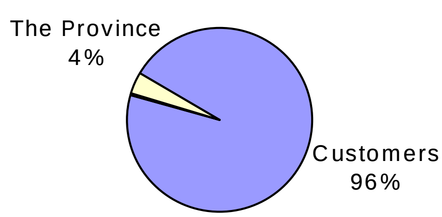
Major Routes

Direct Route Revenue ($ thousands)	**Three months ended September 30**			**Six months ended September 30**		
	2012	**2011***	**Increase (Decrease)**	**2012**	**2011***	**Increase (Decrease)**
Vehicle traffic (volume)	*1,539,946*	*1,551,696*	*(11,750)*	*2,724,853*	*2,752,954*	*(28,101)*
Vehicle tariff	81,512	78,692	2,820	140,948	137,636	3,312
Passenger traffic (volume)	*4,542,472*	*4,589,464*	*(46,992)*	*7,779,384*	*7,901,245*	*(121,861)*
Passenger tariff	51,700	50,414	1,286	85,639	84,555	1,084
Fuel surcharges (rebates)	3,396	3,019	377	8,367	3,835	4,532
Catering & on-board	23,245	23,168	77	40,237	40,370	(133)
Social program fees	5,061	4,649	412	9,605	8,967	638
Reservation fees	5,068	5,256	(188)	8,121	8,598	(477)
Parking	1,178	1,174	4	2,108	2,133	(25)
Other revenue	844	732	112	1,571	1,333	238
Total Direct Route Revenue	172,004	167,104	4,900	296,596	287,427	9,169
Indirect Route Revenue						
Ferry transportation fees	1,096	1,101	(5)	1,753	2,115	(362)
Federal-Provincial subsidy	-	247	(247)	-	493	(493)
Total Route Revenue	173,100	168,452	4,648	298,349	290,035	8,314

**Fiscal 2012 has been restated to include our route connecting Horseshoe Bay and Langdale.*

Our Major Routes consist of three regulated routes connecting Greater Vancouver with mid and southern Vancouver Island and, effective April 1, 2012, our regulated route connecting Horseshoe Bay and Langdale. These are our four busiest routes, carrying approximately 60% of our vehicle traffic and 65% of our passenger traffic during the first six months of both fiscal 2013 and 2012.

In the three months ended September 30, 2012, vehicle traffic decreased 0.8% (1.0% year-to-date), compared to the same period in the previous year while passenger traffic decreased 1.0% (1.5% year-to-date). In the month of July, total traffic was very poor, decreasing 5.2% over the prior year. However, in August and September, traffic significantly recovered, resulting in a 1.4% higher level of total traffic than August and September of the prior year. Based on the improved traffic levels in August and September, we now anticipate annual traffic levels on these routes will be slightly lower than the prior fiscal year.



In the six months ended September 30, 2012, revenue from our Major Routes consisted of 96% from customers and 4% from the Province (3% social program fees and 1% ferry transportation fees in support of our route connecting Horseshoe Bay and Langdale).

Average tariff revenue per vehicle increased $2.22 or 4.4% in the quarter ($1.73 or 3.5% year-to-date) compared to the prior year. Average tariff revenue per passenger increased $0.40 or 3.6% ($0.31 or 2.9% year-to-date). Higher average fares more than offset the traffic decline, resulting in an increase in tariff revenue of $4.1 million for the quarter ($4.4 million year-to-date).

Major Routes, cont'd

Fuel surcharges collected were $0.4 million higher in the quarter ($4.5 million year-to-date). On July 20, 2012, surcharges on all of our Major Routes were reduced to 2% of tariffs on average to reflect declining fuel prices. Surcharges of 5.0% were in place on the three Major Routes connecting Greater Vancouver with mid and southern Vancouver Island and a surcharge of 2.5% was in place on our Horseshoe Bay – Langdale route from December 12, 2011 through to July 20, 2012. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail).

All vessels that provide service on our Major Routes have a gift shop and options for food service. In the second quarter, both food sales and gift shop sales increased, reflecting higher average sales per passenger, partially offset by lower passengers. Year-to-date, food sales are lower primarily as a result of lower passenger traffic, mainly offset by an increase in gift shop sales. Sales of quality apparel and giftware continue to grow, increasing a total of 7.2% in the quarter (13.6% year-to-date). Sales of magazines, comics and newspapers continue to decline following industry trend.

Social program fees are reimbursements from the Province of discounts provided on fares for BC seniors, students travelling to and from school, persons with disabilities and persons travelling under the Ministry of Health Travel Assistance Program (MTAP). These fees increased both in the second quarter and year-to-date as a result of higher program usage and higher fares. The number of individuals travelling with vehicles under the MTAP program and the number of seniors travelling have both increased.

Reservation fees decreased as a result of the lower traffic levels and lower usage while parking remains at a similar level to 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. This service has been well received in the commercial market place. Although we had an increase in drop-trailer traffic, it was offset by a decrease in other commercial traffic.

Ferry transportation fees are received in support of services provided on our Horseshoe Bay – Langdale route. While total ferry transportation fees from the Province increased, a lower portion of the total fees has been allocated by the Province to support the Horseshoe Bay – Langdale route this fiscal year. Annual ferry transportation fees for this route are expected to be $1.4 million lower than the prior fiscal year.

Also included in ferry transportation fees allocated to the Horseshoe Bay – Langdale route are funds received from the Province related to the import duty remission on one of our foreign-built vessels. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail).

The allocation of the Federal-Provincial subsidy to the Horseshoe Bay – Langdale route was eliminated effective April 1, 2012, the beginning of the third performance term. These funds were reallocated to the Northern and Other Routes.

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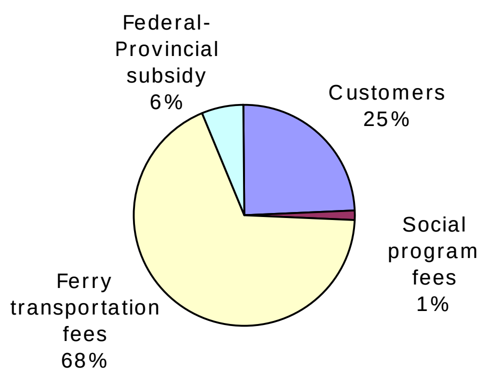
[1] Loading and unloading of commercial trailers that are dropped off for transportation on a ferry route

Northern Routes

Direct Route Revenue ($ thousands)	**Three months ended September 30**			**Six months ended September 30**		
	2012	**2011**	**Increase (Decrease)**	**2012**	**2011**	**Increase (Decrease)**
Vehicle traffic (volume)	*13,249*	*13,353*	*(104)*	*19,583*	*19,901*	*(318)*
Vehicle tariff	4,106	4,191	(85)	5,932	6,119	(187)
Passenger traffic (volume)	*41,324*	*42,264*	*(940)*	*58,667*	*60,107*	*(1,440)*
Passenger tariff	4,292	4,421	(129)	5,776	6,016	(240)
Social program fees	393	335	58	657	622	35
Catering & on-board	1,237	1,318	(81)	1,674	1,788	(114)
Stateroom rental	426	424	2	674	677	(3)
Hostling & other	79	84	(5)	113	120	(7)
Total Direct Route Revenue	10,533	10,773	(240)	14,826	15,342	(516)
Indirect Route Revenue						
Ferry transportation fees	24,265	20,424	3,841	39,246	33,370	5,876
Federal-Provincial subsidy	1,801	1,700	101	3,602	3,400	202
Total Route Revenue	36,599	32,897	3,702	57,674	52,112	5,562

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



In the six months ended September 30, 2012, revenue from our Northern Routes consisted of 25% from customers and 75% from the Province (1% social program fees, 68% ferry transportation fees, and 6% from payments under the Federal-Provincial subsidy agreement).

In the three months ended September 30, 2012, vehicle traffic decreased 0.8% (1.6% year-to-date), compared to the same period in the previous year while passenger traffic decreased 2.2% (2.4% year-to-date). Annual traffic levels on these routes are also anticipated to be lower than the prior fiscal year.

The average tariff revenue per vehicle decreased $3.95 or 1.3% ($4.55 or 1.5% year-to-date) while the average tariff revenue per passenger decreased $0.74 or 0.7% ($1.64 or 1.6% year-to-date) mainly as a result of a greater proportionate number of vehicles and passengers on the shorter routes with lower fares. The reduction in traffic and in average rates resulted in a total tariff revenue decrease of $0.2 million ($0.4 million year-to-date).

No fuel surcharges or rebates were in place on our Northern Routes.

Reimbursements from the Province for social program fees increased primarily as a result of higher usage of MTAP and higher fares, partially offset by lower usage of other programs.

Revenue from catering and on-board services decreased as a result of lower traffic levels and lower average sales per passenger.

Stateroom rental, hostling and other revenues remain at a level similar to the prior year.

We receive ferry transportation fees for these routes under the CFSC. These fees increased $4.2 million in the quarter ($6.5 million year-to-date) as a result of additional funding from the Province as well as a larger portion of the total fees allocated by the Province to these routes. Annual ferry transportation fees for these routes are expected to be $10.6 million higher than the prior fiscal year as a result of additional funding from the Province described in "Financial and Operational Overview – Economic Regulatory Environment" above.

Also included in ferry transportation fees are funds received from the Province related to the price of fuel. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail). As a result of changes in fuel prices, these amounts were $0.4 million lower in the quarter ($0.6 million year-to-date).

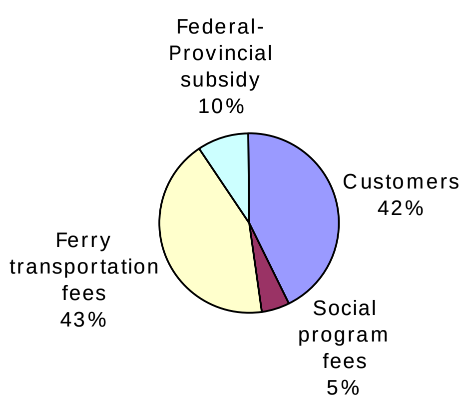
The Federal-Provincial subsidy has increased by the change in the annual Consumer Price Index (CPI) (Vancouver) and an increase in the allocation of the total subsidy.

Other Routes

Direct Route Revenue ($ thousands)	**Three months ended September 30**			**Six months ended September 30**		
	2012	**2011***	**Increase (Decrease)**	**2012**	**2011***	**Increase (Decrease)**
Vehicle traffic (volume)	*975,793*	*994,774*	*(18,981)*	*1,779,395*	*1,816,297*	*(36,902)*
Vehicle tariff	14,056	14,180	(124)	24,656	24,913	(257)
Passenger traffic (volume)	*2,336,267*	*2,369,661*	*(33,394)*	*4,131,107*	*4,212,496*	*(81,389)*
Passenger tariff	10,158	10,087	71	17,295	17,148	147
Fuel surcharges (rebates)	704	1,341	(637)	1,763	1,680	83
Social program fees	2,642	2,404	238	5,450	4,990	460
Catering & on-board	1,541	1,596	(55)	2,569	2,651	(82)
Reservation fees	93	96	(3)	141	143	(2)
Parking & other	34	33	1	54	52	2
Total Direct Route Revenue	29,228	29,737	(509)	51,928	51,577	351
Indirect Route Revenue						
Ferry transportation fees	23,944	20,458	3,486	46,918	39,557	7,361
Federal-Provincial subsidy	5,219	4,925	294	10,437	9,851	586
Total Route Revenue	58,391	55,120	3,271	109,283	100,985	8,298

*Fiscal 2012 has been restated to exclude our route connecting Horseshoe Bay and Langdale.

Our Other Routes consist of 18 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 contracted services on these routes, which are included in the ferry transportation fees in the above table.



In the six months ended September 30, 2012, revenue from our Other Routes consisted of 42% from customers and 58% from the Province (5% social program fees, 43% ferry transportation fees, and 10% from payments under the Federal-Provincial subsidy agreement).

In the three months ended September 30, 2012, vehicle traffic decreased 1.9% (2.0% year-to-date), compared to the same period in the previous year while passenger traffic decreased 1.4% (1.9% year-to-date). Annual traffic levels on these routes are also anticipated to be lower than the prior fiscal year.

The average tariff revenue per vehicle increased $0.15 or 1.1% ($0.14 or 1.0% year-to-date) while the average tariff revenue per passenger increased $0.09 or 2.1% ($0.12 or 2.8% year-to-date). The reduction in traffic was mainly offset by the increase in average fares, resulting in lower total tariff revenue for the quarter and year-to-date of $0.1 million.

Fuel surcharges collected were $0.6 million lower during the quarter ($0.1 million higher year-to-date). On July 20, 2012, surcharges on the majority of our Other Routes were reduced to 2% from 5% of tariffs on average to reflect declining fuel prices. Fuel surcharges of 5% had been in place on these routes since June 1, 2011. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail).

Reimbursements from the Province for social program fees increased both in the second quarter and year-to-date as a result of higher program usage and higher fares. The number of individuals travelling with vehicles under the MTAP program and the number of seniors travelling have both increased.

Decreases in revenue in the quarter and year-to-date from catering and on-board services reflect the lower traffic levels on the routes where those services are offered.

Fees for parking and other revenues are at the same level as the prior year.

Ferry transportation fees increased $3.5 million in the quarter ($7.4 million year-to-date). They include:

- Ferry transportation fees for the 18 regulated routes. These fees increased $3.8 million ($7.5 million year-to-date) as a result of additional funding from the Province as well as a larger portion of the total fees allocated by the Province to these routes. Annual ferry transportation fees for these routes are expected to be $14.5 million higher than the prior fiscal year as a result of additional funding from the Province described in "Financial and Operational Overview – Economic Regulatory Environment" above.
- Fees from the Province for the provision of contracted service increased $0.1 million during the quarter ($0.3 million year-to-date) and are expected to be $0.8 million higher than the prior year.
- Funds from the Province related to the import duty remission on one of our foreign-built vessels. These funds were $0.4 million lower in the quarter and year-to-date as a result of the reallocation among the routes. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail).

The Federal-Provincial subsidy has increased by the change in the annual CPI (Vancouver) and by an increase in the allocation of the total subsidy.

Expenses

Expenses for the three and six months ended September 30, 2012 and 2011 are summarized in the tables below:

Operating expenses ($ millions)	**Three months ended September 30**			**Six months ended September 30**		
	2012	**2011**	**Increase (Decrease)**	**2012**	**2011**	**Increase (Decrease)**
Operations	121.3	119.7	1.6	232.3	228.5	3.8
Maintenance	11.6	12.6	(1.0)	28.8	30.3	(1.5)
Administration	7.1	8.5	(1.4)	14.3	15.9	(1.6)
Total operations, maintenance & administration	140.0	140.8	(0.8)	275.4	274.7	0.7
Cost of retail goods sold	10.1	10.0	0.1	17.6	17.5	0.1
Depreciation and amortization	34.4	32.6	1.8	68.4	64.5	3.9
Total operating expenses	184.5	183.4	1.1	361.4	356.7	4.7

The $1.6 million ($3.8 million year-to-date) increase in operations expenses consists mainly of:

- $1.0 million ($4.2 million year-to-date) in fuel expense reflecting an increase of $1.1 million ($4.8 million year-to-date) due to higher fuel prices, partially offset by a $0.1 million ($0.6 million year-to-date) reduction in fuel consumption. While IFRS does not permit accounting for rate-regulated entities, we are in fact rate-regulated. For purposes of rate regulation, $3.0 million ($6.9 million year-to-date) of our fuel expense for the three and six months ended September 30, 2012 is recorded in deferred fuel cost accounts for future recovery ($5.1 million for the quarter and $8.7 million year-to-date recorded for the same periods in the prior year); (See "The Effect of Rate Regulation" above for detail);
- $1.6 million ($0.7 million year-to-date) increase in wage and benefit costs and differences in timing between the first and second quarters;

Partially offset by:

- $0.5 million ($1.0 million year-to-date) decrease in insurance premiums and claims;
- $0.3 million ($0.2 million year-to-date) decrease in the cost of employee uniforms; and
- $0.2 million decrease ($0.1 million increase year-to-date) in several other operational areas.

The $1.0 million ($1.5 million year-to-date) decrease in maintenance costs reflects reduced vessel maintenance as a result of variations in vessel refit scheduling and lower terminal maintenance in the second quarter, partially offset by higher terminal maintenance in the first quarter.

The $1.4 million ($1.6 million year-to-date) decrease in administration expenses is mainly due to lower wages and benefits, including executive compensation which is, in part, due to a reduced number of senior executive positions, and lower contracted services.

Depreciation and amortization increased $1.8 million ($3.9 million year-to-date), reflecting new assets available for use. (See "Investing in our Capital Assets" below for detail of significant capital expenditures).

Interest and other ($ millions)	**Three months ended September 30**			**Six months ended September 30**		
	2012	**2011**	**Increase (Decrease)**	**2012**	**2011**	**Increase (Decrease)**
Interest expense						
Bond interest	15.9	16.0	(0.1)	31.7	31.7	-
KfW loans	2.1	2.4	(0.3)	4.3	5.0	(0.7)
Interest on finance lease	0.6	0.6	-	1.2	1.2	-
Short-term loans	0.1	0.1	-	0.2	0.1	0.1
Structured Financing Facility Program	(0.2)	(0.4)	0.2	(0.4)	(0.9)	0.5
Capitalized interest	(0.4)	(0.5)	0.1	(0.9)	(1.0)	0.1
Less: finance income	(0.6)	(0.5)	(0.1)	(1.2)	(1.2)	-
Net finance expense	17.5	17.7	(0.2)	34.9	34.9	-
Loss on disposal of capital assets	0.1	-	0.1	0.1	-	0.1
Total net finance and other expenses	17.6	17.7	(0.1)	35.0	34.9	0.1

Net finance expenses decreased $0.2 million (no change year-to-date) primarily due to:

- $0.3 million ($0.7 million year-to-date) less interest due to lower interest rates on the Tranche B than on the Tranche A components of the 12-year KfW bank group (KfW) loans and a $9 million principal repayment on the 2.95% KfW loan;

Partially offset by:

- $0.2 million ($0.5 million year-to-date) less interest rate support received through the Structured Financing Facility Program offered by the Government of Canada, reflecting the completion of the funding related to the life extension of the *Quinsam*.

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 May 2012, the Province announced additional payments totalling $79.5 million in order to reduce the pressure for future fare and price cap increases. Of this, $25 million is a contribution to our equity and was received in April 2012. The remaining $54.5 million will be received over fiscal years 2013 through 2016.

Fiscal 2013 capital expenditures are expected to be at a similar level as each of the last three years. Over the next several years, we expect our cash requirements will be met through operating cash flows and by accessing our credit facility from time to time. At September 30, 2012, our unrestricted cash and cash equivalents and other short-term investments totalled $43 million and $61 million, respectively.

We have two bond issues totalling $390 million that will mature within the next two years ($140 million in December 2013 and $250 million in May 2014). As we approach these dates, we will be assessing our cash position and monitoring the capital market place with the view to taking appropriate steps to ensure that our debt structure continues to be efficient.

Our $155 million credit facility was amended on April 20, 2012 to extend the maturity date of the facility from May 2013 to April 2017, as well as to modify certain other terms of the facility. The facility is available to fund capital expenditures and other general corporate purposes. At September 30, 2012, there were no draws on this credit facility.

We target maintaining a strong investment-grade credit rating to allow capital market access at reasonable interest rates. Our credit ratings at September 30, 2012, were A (DBRS) with a stable trend and A+ (Standard & Poor’s) with a negative outlook.

On September 30, 2012, the Commissioner issued Order 12-02 which established price cap increases for the balance of performance term three. These price cap increases are intended to allow us to meet our debt obligations and maintain our credit ratings. The order indicated the Commissioner has the intention of allowing us to achieve, by the end of the third performance term, equity not lower than 17.5% of total capitalization and a DSCR of 2.5 or higher.

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 six months ended September 30, 2012 and 2011 are summarized in the table below:

	Six months ended September 30	
($ millions)	**2012**	**2011**
Cash and cash equivalents, beginning of period	7.7	33.3
Cash from operating activities:		
Net earnings	69.8	52.3
Items not affecting cash	104.4	102.2
Changes in non-cash operating working capital	(20.7)	(18.5)
Net interest paid	(35.9)	(36.5)
Cash generated by operating activities	117.6	99.5
Cash generated by (used in) financing activities	2.3	(55.9)
Cash used in investing activities	(84.6)	(55.5)
Cash and cash equivalents, end of period	43.0	21.4

For the six months ended September 30, 2012, cash generated by operating activities increased $18.1 million from the same period in the prior year mainly due to $17.5 million higher net earnings.

Cash provided by financing activities was $58.2 million higher reflecting:

- receipt of $25.0 million contributed surplus from the Province in the current period and
- $46.9 million additional long-term debt payments on KfW loans maturing March 2020 and June 2020 made in the prior year;

partially offset by $13.8 million additional repayments of short-term loans in the six months ended September 30, 2012.

Cash used in investing activities was $29.1 million higher mainly due to a $40.8 million swing in cash used for short-term investing partially offset by $11.4 million lower capital expenditures. In the current period we invested $34.6 million in short-term investments compared to $6.3 million of proceeds received from short-term investments in the prior year. Purchases of property, plant, equipment and intangibles in the current period totalled $50.2 million compared to $61.6 million in the same period of the prior year. (See “Investing in Our Capital Assets” below for detail of significant capital expenditures).

INVESTING IN OUR CAPITAL ASSETS

Capital Expenditures

Capital expenditures in the three and six months ended September 30, 2012, totalled $18.3 million and $39.5 million, respectively:

Capital expenditures ($ millions)	**September 30, 2012**	
	3 Months	**6 Months**
Vessel upgrades and modifications	6.6	17.6
Terminal marine structures	5.9	10.0
Information technology	3.6	8.2
Terminal and building upgrades and equipment	2.2	3.7
Total capital expenditures	18.3	39.5

Vessel Upgrades and Modifications

Capital expenditures for vessel upgrades and vessel modifications in the three and six months ended September 30, 2012, included the following:

($ millions)	**September 30, 2012**	
	3 Months	**6 Months**
Major overhauls and inspections	4.3	7.4
Queen of Chilliwack life extension	0.5	3.2
Sewage treatment upgrade program	0.5	2.4
Kahloke right angle drive replacement	0.2	2.2
Other projects	1.1	2.4
	6.6	17.6

The capitalization of major overhauls and inspections of our vessels is a significant IFRS change affecting us. (See “Accounting Practices – Adoption of New Accounting Standards” below). The $2.2 million major overhaul and inspection of the *Coastal Inspiration* was completed in the first quarter ended June 30, 2012; $3.0 million of the expected $4.4 million major overhaul and inspection on the *Queen of Coquitlam* has been incurred and it is expected to be completed by the end of the third quarter; the *Kahloke* was completed in conjunction with a $3 million project to replace two right angle drives and purchase a spare one for expected future replacement; the *Nimpkish* was completed; and inspections began on the *Bowen Queen* and the *Queen of Coquitlam* during this quarter.

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 first phase of this $15 million project, completed during the first quarter of fiscal 2012, included new car deck watertight doors, new propeller seals, new instrumentation and control systems, new sewage treatment holding tank and pump out system, and new lifesaving systems. The second phase began in early January 2012 and included the installation of three new generators, electrical and HVAC system upgrades, and renewal of the propulsion control system. The vessel returned to service in May 2012, in time for the summer season. Fiscal 2013 ferry transportation fees for the Northern Routes will increase $4.2 million as a result of this life extension.

Implementation of a $43 million multi-year sewage and waste water treatment program to upgrade 27 vessels for treatment of sewage generated onboard the vessels is now complete. The final two vessels, the *Nimpkish* and the *Kahloke* were completed by the end of the second quarter. The program involved major modifications and upgrades to ensure that all vessels comply with *Canada Shipping Act, 2001* sewage regulations, which were effective May 3, 2012. Wherever possible, the vessels convey sewage to a terminal through pump-ashore infrastructure. In all other cases, the vessels have been fitted with compliant marine sanitation devices. All vessels in service are in compliance with the new regulations.

August 17, 2012 was the closing date for receipt of proposals in response to the Request for Proposals for third parties interested in providing passenger and vehicle cable ferry service on one of our shortest routes between Buckley Bay and Denman Island. We have been evaluating whether this service can be provisioned by an alternate service provider, under contract to us, at a lower cost than we can provide the service, while maintaining a high level of safety, quality and reliability. In tandem with this process, we have been analyzing and developing initial design criteria for a cable ferry system so we will be in a position to deliver cable ferry service should an alternate service provider not be selected. We expect to make announcements regarding these matters in the near future. The cable ferry is an innovative initiative and 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.

Terminal Marine Structures

Capital expenditures for terminal marine structures in the three and six months ending September 30, 2012, included the following:

($ millions)		**September 30, 2012**	
Terminal	Description	**3 Months**	**6 Months**
Swartz Bay	Berth 4 and 5 replacement and refurbishment	1.4	3.0
Tsawwassen	Berth 3 mid-life upgrade	1.5	2.0
Prince Rupert	Tie-up dolphins and catwalk	1.2	1.2
Horseshoe Bay	Upgrades at three berths	0.7	1.1
Tsawwassen	Apron modifications on berth 4	-	0.4
Tsawwassen	Refurbishment of decks and berth 5 upgrades	-	0.3
Various	Other projects	1.1	2.0
		5.9	10.0

The $20 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 as well as electrical upgrades and a new waiting shelter. This project was completed at the end of August 2012.

At Tsawwassen terminal:

- Work is underway on a $3 million project to upgrade the hydraulics, electrical and control systems and replace some structural and mechanical components on berth 3 and is expected to be complete by the end of the third quarter;
- Apron modifications on berth 4 were completed in first quarter; and
- The majority of the $9 million project to replace the dolphins, catwalk and sheet pile wall as well as refurbishment of the hydraulic systems at berth 5 was completed in fiscal 2012 with the final items, including egress stairs, expected to be complete by the end of the third quarter of fiscal 2013.

At Prince Rupert terminal a $1.6 million project to install new tie-up dolphins and a new catwalk will improve safety during the vessel mooring process. This project went into service in early October.

At Horseshoe Bay terminal, a $3 million project to upgrade the ramps at berths 1, 2 and 3 is in progress and is expected to be complete by the end of this fiscal year.

Information Technology

Capital expenditures for information technology in the three and six months ending September 30, 2012, included the following:

($ millions)	**September 30, 2012**	
	3 Months	**6 Months**
Customer service program	1.5	4.4
Payroll system replacement	1.2	1.9
Computer hardware upgrades	0.3	0.7
Other projects	0.6	1.2
	3.6	8.2

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 in stages starting in fiscal 2014, and is expected to be fully completed by fiscal 2016. It will significantly improve our ability to efficiently respond to the changing needs of our customers.

Our payroll system replacement initiative will replace both our payroll and labour distribution systems to provide added reliability and significant processing efficiencies and flexibility.

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

Other projects currently underway include enhancements for improved supply chain management, upgrades to simplify the process for customers making a reservation on our website, and upgrades to our computer operating systems and office software.

Terminal and Building Upgrades and Equipment

Capital expenditures for terminal and building upgrades and equipment in the three and six months ending September 30, 2012, included the following:

($ millions)	September 30, 2012	
	3 Months	**6 Months**
Tsawwassen shoreline stabilization	1.1	1.1
Terminal waste water program	0.1	0.6
Horseshoe Bay electronic sign replacement	0.2	0.5
Terminal seismic upgrades	0.1	0.4
Equipment and other terminal projects	0.7	1.1
	2.2	3.7

Shoreline stabilization at Tsawwassen terminal is a $1.4 million project to install a filter layer and rip rap to increase the stability and drainage along the causeway shoreline. It is expected to be complete by the end of the third quarter.

As part of the $20 million multi-year sewage and waste water treatment program for treatment of sewage generated onboard our vessels, installation of pump ashore infrastructure is in service at seven terminals where sewage is collected and transferred to the municipal infrastructure. At most of these terminals, we pay ongoing fees to the local municipality based on volume transferred. A treatment plant has been installed at one terminal where there is no municipal infrastructure to connect with. As part of the federal government's Infrastructure Stimulus Fund program, we received $3.2 million in fiscal 2011 and a further $5.5 million in fiscal 2012, relating to sewage pump-ashore projects and other major terminal projects.

Other projects include replacement of our electronic signs at Horseshoe Bay terminal and seismic upgrades at certain of our maintenance facilities.

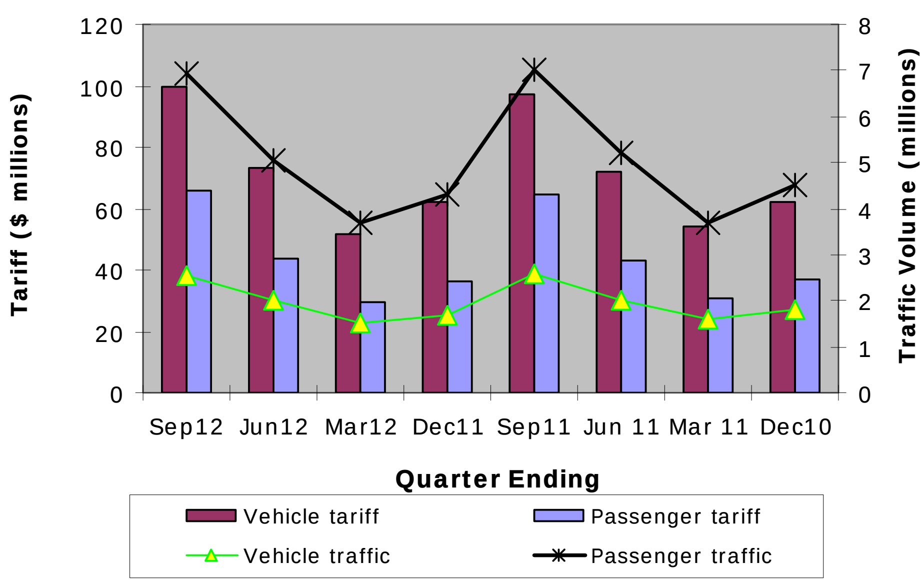
SUMMARY OF QUARTERLY RESULTS

The table below compares earnings by quarter for the most recent eight quarters. The most recent six quarters are reported under IFRS while the prior two quarters are reported under pre-IFRS standards (then existing Canadian generally accepted accounting principles (CGAAP)):

($ millions)	Quarter Ended (unaudited)							
	Sep 12	**Jun 12**	**Mar 12**	**Dec 11**	**Sep 11**	**Jun 11**	**Mar 11**	**Dec 10**
	IFRS	*IFRS*	*IFRS*	*IFRS*	*IFRS*	*IFRS*	*CGAAP*	*CGAAP*
Total revenue	268.6	197.6	144.6	164.9	257.3	187.0	140.7	162.3
Operating profit (loss)	84.1	20.7	(25.0)	(1.8)	73.9	13.7	(20.9)	(3.3)
Net earnings (loss)	66.5	3.3	(42.5)	(19.2)	56.2	(3.5)	(39.0)	(12.4)
Land revaluation	-		2.2					
Comprehensive income (loss)	66.5	3.3	(40.3)	(19.2)	56.2	(3.5)	(39.0)	(12.4)

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 40 through 42 of our fiscal 2012 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the six months ended September 30, 2012.

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 43 through 49 of our fiscal 2012 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the six months ended September 30, 2012.

We do not believe that material uncertainties exist in regards to our future. 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 a viable, profitable future.

Critical Accounting Policies and Estimates

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

Our significant accounting policies are contained in note 1 to our September 30, 2012 interim 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 50 through 52 of our fiscal 2012 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 six months ended September 30, 2012, or expect to use in the future.

Adoption of New Accounting Standards

We have adopted IFRS with a changeover date of April 1, 2012. Prior year comparatives have been restated under IFRS from our transition date of April 1, 2011. The significant accounting policy changes are as follows:

- Rate-regulated operations: IFRS does not currently provide specific guidance with respect to accounting for rate-regulated activities. 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:
    - Regulatory assets do not meet the definition of a financial asset nor the definition of an intangible asset as specified in IAS 38; and
    - Regulatory liabilities do not meet the definition of a financial liability nor the definition of a provision as specified in IAS 37.

  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 were 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 financial performance with respect to accounting for rate-regulated activities.

- Property, plant and equipment:
    - *Major overhauls and inspections:* The capitalization of major overhauls and inspections of our vessels is a significant change affecting us. We have defined, identified, quantified and reclassified major overhaul and inspection items for each class of vessel at transition date.

      This change has the potential to cause significant differences in earnings over the reporting periods due to the level of major overhauls and inspections 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 had a choice under IFRS to value our property, plant and equipment using either a historical cost model or a revaluation model. We decided to use a historical cost model for all property, plant and equipment with the exception of land. We are using a revaluation model for our land assets. At March 31, 2012, we recorded a revaluation reserve of $2.2 million to recognize a further increase in land values subsequent to transition.

    - *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 are no longer 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 resulted in a net increase of $8.6 million in retained earnings on transition. The elections and exemptions that applied to us upon adoption are summarized as follows:
    - *Employee Benefits:* There was 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 elected to recognize all cumulative actuarial gains and losses through opening retained earnings at April 1, 2011. The actuarial loss recognized in opening retained earnings was $3.6 million.
    - *Property, plant and equipment and Intangible assets:* There was 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 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 elected to revalue land at fair value at April 1, 2011. This revaluation resulted in an increase in land value of $12.2 million.

Future Accounting Changes

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

IAS 19 *Employee Benefits* has been amended and becomes effective for us on April 1, 2013. As a result of the amendments, actuarial gains and losses will be immediately recognized in other comprehensive income rather than net earnings and the option to use the corridor approach to recognize these costs over time will no longer be available. The amendments also introduce the net interest approach where the discount rate used to measure the obligation is applied to the net defined benefit liability (asset). In addition, the amendments change the definition of both short-term and long-term employee benefits so it is clear that the distinction between the two depends on when we expect the benefits to become due to be settled. We are analyzing the impact of this amended standard on our consolidated financial statements.

IFRS 9 *Financial Instruments (2010)* replaces the guidance in IAS 39 *Financial Instruments: Recognition and Measurement*, on the classification and measurement of financial assets. Financial assets will be classified into one of two categories on initial recognition: financial assets measured at amortized cost; or financial assets measured at fair value. We intend to adopt IFRS 9 *(2010)* in our financial statements for the annual period beginning on April 1, 2015. We have not yet determined the extent of the impact of adoption of IFRS 9 *(2010)*.

IFRS 13 *Fair Value Measurement* replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We intend to adopt IFRS 13 prospectively in our financial statements for the annual period beginning on April 1, 2013. We do not expect IFRS 13 to have a material impact on our consolidated financial statements.

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, traffic levels, fuel surcharges, and the property assessment appeal relating to our Horseshoe Bay terminal; our short-term and long-range business plans, capital expenditure levels, asset renewal programs for vessels and terminals, our customer service program, and our cable ferry initiative; our expectations of ferry transportation fee amounts; our expectations regarding how our cash requirements will be met; the additional payments to be received from the Province, the amount of savings to be achieved through service level adjustments, the efficiency target to be achieved by us, and the Province's role regarding service levels and a long term vision for connecting coastal communities; and our expectations regarding the impacts of Bill 14, 47 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.