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

For the three and six months ended September 30, 2013

Dated November 21, 2013

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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 of British Columbia Ferry Services Inc. as of September 30, 2013. This discussion and analysis should be read in conjunction with our unaudited consolidated financial statements and related notes for the three and six months ended September 30, 2013 and 2012, and our audited consolidated financial statements and related notes for the years ended March 31, 2013 (fiscal 2013) and March 31, 2012, together with our Management's Discussion & Analysis for fiscal 2013. 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).

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, 2013 (the second quarter of fiscal 2014), we provided 48,000 sailings, carrying 6.9 million passengers and 2.5 million vehicles. We experienced a 0.7% decline in both vehicle and passenger traffic compared to the same quarter in the prior year. For a discussion of our traffic levels see "Financial and Operational Overview" below.

Significant events during or subsequent to our second quarter of the year ending March 31, 2014 (fiscal 2014) include the following:

- On July 19, 2013, the British Columbia Ferries Commissioner (the Commissioner) approved our application to construct three new intermediate class vessels to replace the 48-year old *Queen of Burnaby* and the 49-year old *Queen of Nanaimo*. Both of these vessels are scheduled for retirement in 2016. We intend to replace them with three open-deck vessels, two with the capacity to carry 145 automobile equivalents (AEQs) and a third with capacity to carry 125 AEQs. We expect this vessel replacement strategy will permit a more efficient deployment of our vessel assets. (See "Outlook" below for more detail.)

- On July 24, 2013, we completed the redemption of all $140 million of the outstanding Series 08-2 Bonds, formerly due December 19, 2013. This debt management initiative to reduce interest costs in the short term was funded with $55 million from cash on hand and $88 million in draws on our credit facility. Due to this early redemption, we expect approximately $0.3 million in interest savings, net of the redemption premium, in fiscal 2014 compared to the level originally projected.

- On October 25, 2013, we completed a private placement of $200 million of 30-year senior secured bonds with accredited investors. These bonds bear interest at 4.702%, payable semi-annually. As has been previously announced, it was our intention to refinance the redeemed $140 million Series 08-2 Bonds, and this issuance is partially related to that early redemption. The net proceeds of this new issue will partially fund capital expenditures, repay our credit facility, fund the debt service reserve related to these bonds and provide funding for general corporate purposes. These bonds were rated "A" (DBRS) and "A+" (Standard & Poor's).

- On November 18, 2013, the Province announced a service level adjustment plan to achieve $18.9 million in net savings over the remainder of performance term three (PT3). The plan includes the elimination of 6,961 underutilized round trips over 15 routes. The Province also announced that "The guiding principles behind all future decisions to affect the coastal ferry service will be based on an affordable, efficient and sustainable system which protects basic service to coastal communities for future generations." (See "Outlook" below for more detail.)

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 *Coastal Ferry Act* (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 the 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.

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 Statements 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.

We continually assess whether our regulatory assets are probable of future recovery by considering factors such as regulatory changes. We believe the regulatory assets at September 30, 2013 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 September 30, 2013 consolidated financial statements.

If IFRS permitted us to report regulatory assets and liabilities in our financial statements, the effect on our Statements of Comprehensive Income for the three months and six months ended September 30, 2013 and 2012 would be as follows:

($ millions)		**Three months ended September 30**		**Six months ended September 30**	
		2013	**2012**	**2013**	**2012**
Total comprehensive income		64.4	66.5	68.7	69.8
Regulatory asset or liability	**Statement line item**				
Deferred fuel costs (a)					
Fuel costs incurred	Operations expense	3.9	3.0	6.6	6.9
Fuel surcharges collected	Fuel surcharge revenue	-	(4.1)	-	(10.1)
Payments from the Province	Ferry transportation fees	(0.7)	(0.6)	(1.3)	(1.2)
		3.2	(1.7)	5.3	(4.4)
Tariffs in excess of price cap (b)					
Obligation settled during the period	Tariff revenue	0.5	-	-	2.5
Obligation incurred during the period	Tariff revenue	-	-	(2.2)	-
Increase (decrease) in total comprehensive income		3.7	(1.7)	3.1	(1.9)
Adjusted total comprehensive income		68.1	64.8	71.8	67.9

(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 actual fuel costs and approved fuel costs (including fuel hedge gains and losses) is deferred for settlement in future tariffs. Also, as prescribed by regulatory order, we collect fuel surcharges or provide fuel rebates from time to time which are applied against deferred fuel cost account balances.

(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.

FINANCIAL AND OPERATIONAL OVERVIEW

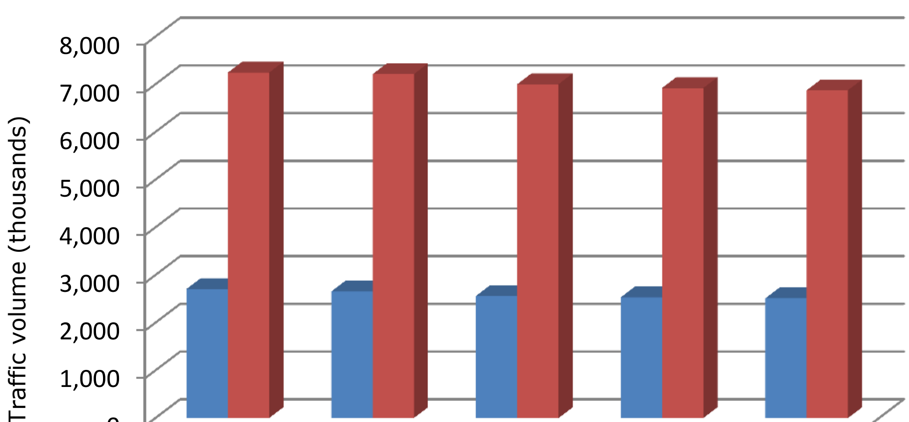
This section provides an overview of our financial and operational performance for the three and six months ended September 30, 2013 and 2012.

($ millions)	Three months ended September 30			Six months ended September 30		
	2013	**2012**	**Variance**	**2013**	**2012**	**Variance**
Total revenue	271.5	268.6	2.9	471.4	466.2	5.2
Operating expenses	(189.2)	(184.5)	(4.7)	(368.0)	(361.4)	(6.6)
Operating profit	82.3	84.1	(1.8)	103.4	104.8	(1.4)
Net finance and other	(18.0)	(17.6)	(0.4)	(34.8)	(35.0)	0.2
Net earnings	64.3	66.5	(2.2)	68.6	69.8	(1.2)
Other comprehensive income	0.1	-	0.1	0.1	-	0.1
Total comprehensive income	64.4	66.5	(2.1)	68.7	69.8	(1.1)

Our net earnings in the three months ended September 30, 2013 were $2.2 million lower ($1.2 million year-to-date) than in the same periods in the prior year. The second quarter and year-to-date net earnings in fiscal 2014 reflect the effects of reductions in fuel surcharges, lower traffic levels, lower ferry transportation fees and operating cost increases, partially offset by increased fares and lower year-to-date financing costs. During the three months ended September 30, 2013, we recognized a gain of $0.1 million in other comprehensive income. This reflects the actuarial valuation at March 31, 2013 of the residual liability for claims arising from the Workers' Compensation Board deposit class coverage system in which our predecessor entity participated prior to April 1, 2003. The accrued benefit obligation for these claims is $1.5 million at September 30, 2013.

In the second quarter of fiscal 2014, we experienced a 0.7% decline in both vehicle and passenger traffic compared to the same period in the prior year. The decline was due in part to storm activity at the end of the quarter and was partially offset by an increase in commercial traffic.

The following graph illustrates our vehicle and passenger traffic levels for the second quarter from fiscal 2010 through fiscal 2014:



	2010	2011	2012	2013	2014
Vehicles	2,706	2,653	2,560	2,529	2,510
Passengers	7,244	7,210	7,001	6,920	6,874

Safety
We continue to see a steady reduction in the number of employees injured at work. Time loss injuries in the six months ended September 30, 2013 were 31% lower than in the same period in the prior year and days lost were down 32%. Passenger injuries were also reduced by 7% during the same period.

With the objective of continuous improvement, we are launching our fifth annual SailSafe town hall sessions. These forums allow for open discussion between management and employees at all levels and from all areas and departments, and are a key element of safety culture change through our flagship SailSafe Program. Our current positive safety results are a testament to SailSafe's success in keeping safety awareness at the forefront of our operations.

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

Training
In our Standardized Education and Assessment (SEA) program, we plan to roll out training for a total of 33 job categories, of which we've completed 16 to date and expect to complete an additional 10 by the end of this fiscal year.

The Bridge Team Simulator (BTS) training program continues, with the completion of several Bridge Operations, Skills and Systems (BOSS) 1 and 2 courses during the second quarter. As of September 30, 2013, 79% of deck officers in the fleet have received BOSS 1 training and 18% of deck officers in the fleet have received the BOSS 2 training.

In the second quarter, covering the busy summer period, we conduct a lower level of training, compared to the other quarters in the fiscal year. We utilize this period to focus on annual program reviews and updates. Currently, plans are underway to expand our on-line resources and training options, including dangerous goods and risk awareness. Rescue boat training plans have been finalized, utilizing our new permanent training facility at our fleet maintenance unit. This training prepares deckhands for their role in operating rescue boats that are a crucial resource during emergencies, rescues and evacuations.

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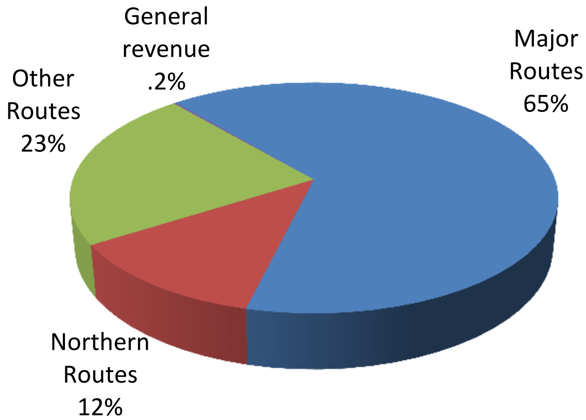
Revenue
The following discussion of revenues is based on IFRS results, with reference to the impacts of rate regulation.



In the six months ended September 30, 2013, the greatest portion of our revenues (65%) was earned on our Major Routes. The revenue from the Northern Routes contributed 12% and Other Routes contributed 23%.

Selected operational statistics and total revenues for the three and six months ended September 30, 2013 compared to the same periods in the prior year are shown in the tables below.

	Three months ended September 30		Six months ended September 30	
Operational Statistics	**2013**	**2012**	**2013**	**2012**
Vehicle traffic	2,510,390	2,528,988	4,470,015	4,523,831
Passenger traffic	6,873,948	6,920,063	11,854,135	11,969,158
On-time performance	86.9%	89.4%	88.8%	90.7%
Number of round trips	22,002	22,167	42,957	43,091
Capacity provided (AEQs)	4,833,141	4,872,744	9,217,245	9,301,815
AEQs carried	2,820,471	2,835,316	5,057,875	5,100,639
Capacity utilization	58.4%	58.2%	54.9%	54.8%

In the three months ended September 30, 2013, vehicle traffic decreased 0.7% (1.2% year-to-date) and passenger traffic decreased 0.7% (1.0% year-to-date) compared to the same periods in the prior year, partially due to storm activity at the end of the quarter and were partially offset by an increase in commercial traffic, including drop trailer traffic. We continue to experience an increase in drop trailer traffic on two of our Major Routes where commercial customers can drop their trailers off at one terminal and pick them up at another. Year-to-date traffic was negatively impacted by the timing of the Easter holiday and storm activity at the end of the second quarter. The first quarter of fiscal 2014 included only the Monday of the Easter holiday weekend while the first quarter of fiscal 2013 included the entire Easter holiday weekend.

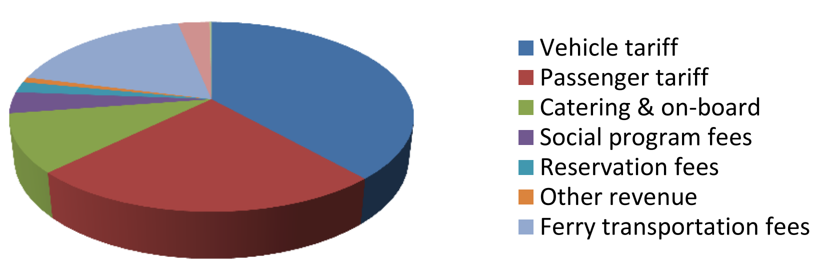
On-time performance is defined as the percentage of our sailings departing within 10 minutes of the scheduled time on the Major and Other routes. The on-time performance on the Northern Routes is defined as the percentage of our sailings arriving within 10 minutes of the scheduled time. On-time performance can be impacted by delays due to weather, vessel substitution and terminal dock maintenance or closures. Meeting customer service expectations is an important factor in our focus on on-time performance.

The capacity provided, measured in AEQs, is the available space on the vessel multiplied by the number of round trips. Round trips normally stay fairly stable as the Coastal Ferry Services Contract (CFSC) stipulates, among other things, the number of round trips to be provided for each regulated ferry service route. However, the number of round trips can be impacted by cancellations due to weather, vessel substitution, terminal dock closures and extra round trips made.

An AEQ is a standard unit of measure for an approximation of one car length. AEQs are calculated by using a conversion factor for each vehicle type. For example, a passenger vehicle would be one AEQ while a bus would be three AEQs. The change in AEQs from one period to the next may not be proportionate to the change in vehicle traffic due to variations in the types of vehicles carried.

Capacity utilization is calculated by taking the number of AEQs carried during the period divided by the AEQ capacity provided on the vessels. Capacity utilization is impacted by the number of vehicles carried; the mix of vehicle types (the relative number of buses, commercial vehicles, and passenger vehicles); the size of the vessels utilized; and the number of round trips in each period. Utilization during the second quarter and year-to-date ended September 30, 2013 remained at a similar level as the same periods in the prior year mainly as a result of reduced capacity provided in the current year, which offset the lower number of AEQs carried.

Revenue ($ millions)	**Three months ended September 30**			**Six months ended September 30**		
	2013	**2012**	**Increase (Decrease)**	**2013**	**2012**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	103.1	99.6	3.5	181.2	171.5	9.7
Passenger tariff	68.1	66.1	2.0	114.3	108.7	5.6
Fuel surcharges	-	4.1	(4.1)	-	10.1	(10.1)
Catering & on-board	27.5	26.5	1.0	46.7	45.2	1.5
Social program fees	8.7	8.1	0.6	17.2	15.7	1.5
Reservation fees	5.7	5.2	0.5	8.7	8.3	0.4
Other revenue	2.3	2.2	0.1	4.2	3.9	0.3
Total Direct Route Revenue	215.4	211.8	3.6	372.3	363.4	8.9
Indirect Route Revenue						
Ferry transportation fees	48.5	49.3	(0.8)	84.0	87.9	(3.9)
Federal-Provincial subsidy	7.1	7.0	0.1	14.2	14.0	0.2
Total Route Revenue	271.0	268.1	2.9	470.5	465.3	5.2
Other general revenue	0.5	0.5	-	0.9	0.9	-
Total Revenue	271.5	268.6	2.9	471.4	466.2	5.2



Our largest revenue source is vehicle and passenger tariffs. Our year over year tariff revenues may be impacted by such things as changes in overall traffic levels, approved price caps, the proportion of total traffic on routes with higher versus lower tariffs, and the implementation of promotional fare programs.

The Commissioner authorized a price cap increase of 4.1% effective April 1, 2013. In response, we implemented average tariff increases up to the new level authorized.

No fuel surcharges were in effect in the six months ended September 30, 2013. On November 30, 2012, as a result of declining fuel prices, all fuel surcharges were removed from our routes. Fuel surcharges were in place during the six months ended September 30, 2012. Until July 20, 2013, surcharges of 2.5% of tariffs on average were in place on our Horseshoe Bay – Langdale route and 5.0% on most of our other routes. All of these surcharges were reduced to 2.0% on July 20, 2012 due to declining fuel prices. No surcharges or rebates were in place on our Northern Routes. We continue to monitor trends in fuel prices and we anticipate a likely need to reintroduce fuel surcharges at some point during the current fiscal year.

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 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 in operational statistics and revenue for the three and six months ended September 30, 2013 and 2012 for the Major, Northern and Other Routes are discussed separately below.

Major Routes

Our Major Routes consist of three regulated routes connecting Greater Vancouver with mid and southern Vancouver Island and our regulated route connecting Horseshoe Bay and Langdale. These are our four busiest routes, carrying 60% of our vehicle traffic and 65% of our passenger traffic during the six months ended September 30, 2013 and 2012.

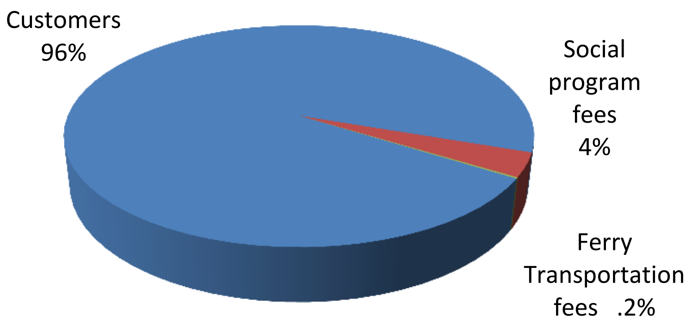
	Three months ended September 30		**Six months ended September 30**	
Operational Statistics	**2013**	**2012**	**2013**	**2012**
Vehicle traffic	1,528,944	1,539,946	2,684,415	2,724,853
Passenger traffic	4,530,573	4,542,472	7,708,184	7,779,384
On-time performance	78.3%	83.2%	78.9%	83.7%
Number of round trips	3,661	3,696	6,783	6,861
Capacity provided (AEQs)	2,619,638	2,643,948	4,871,424	4,925,240
AEQs carried	1,773,950	1,782,427	3,151,966	3,181,462
Capacity utilization	67.7%	67.4%	64.7%	64.6%

In the three months ended September 30, 2013, vehicle traffic decreased 0.7% (1.5% year-to-date) and passenger traffic decreased 0.3% (0.9% year-to-date) compared to the same periods in the prior year. Year-to-date, traffic was negatively impacted by the timing of the Easter holiday. The three months ended June 30, 2013 included only the Monday of the Easter holiday weekend while the three months ended June 20, 2012 included the entire Easter holiday weekend. The general decline in vehicle traffic was partially offset by an increase of 1.2% in commercial traffic during the quarter (3.0% year-to-date). In both the quarter and year-to-date, we experienced an 18% increase in drop trailer traffic on two of our Major Routes where commercial customers can drop their trailers off at one terminal and pick them up at another.

Major Routes cont'd

On-time performance during the three and six months ended September 30, 2013 was affected by significant maintenance activities at our Horseshoe Bay and Langdale terminals, resulting in berth closures and other conditions negatively impacting arrivals and departures.

Utilization on these routes during the three and six months ended September 30, 2013 remained at a similar level as the same periods in the prior year mainly as a result of reduced capacity from fewer round trips provided in the current year, which offset the lower number of AEQs carried.



In the six months ended September 30, 2013, revenue from our Major Routes consisted of 96% from customers and 4% from the Province (4% social program fees and 0.2% ferry transportation fees in support of our route connecting Horseshoe Bay and Langdale).

Revenue ($ thousands)	**Three months ended September 30**			**Six months ended September 30**		
	2013	**2012**	**Increase (Decrease)**	**2013**	**2012**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	84,329	81,512	2,817	149,651	140,948	8,703
Passenger tariff	53,713	51,700	2,013	91,116	85,639	5,477
Fuel surcharges	-	3,396	(3,396)	-	8,367	(8,367)
Catering & on-board	24,273	23,245	1,028	41,622	40,237	1,385
Social program fees	5,438	5,061	377	10,653	9,605	1,048
Reservation fees	5,627	5,068	559	8,513	8,121	392
Parking	1,339	1,178	161	2,356	2,108	248
Other revenue	848	844	4	1,705	1,571	134
Total Direct Route Revenue	175,567	172,004	3,563	305,616	296,596	9,020
Indirect Route Revenue						
Ferry transportation fees	261	1,096	(835)	522	1,753	(1,231)
Federal-Provincial subsidy	-	-	-	-	-	-
Total Route Revenue	175,828	173,100	2,728	306,138	298,349	7,789

Average tariff revenue per vehicle increased $2.22 or 4.2% ($4.02 or 7.8% year-to-date) compared to the same periods in the prior year. Average tariff revenue per passenger increased $0.47 or 4.17% ($0.81 or 7.4% year-to-date). The increase in average tariff revenues reflects the increases authorized by the Commissioner. The year-to-date increase also reflects the "CoastSaver" promotion in the first quarter of the prior year. "CoastSaver" price discounts of approximately 40% from regular passenger and passenger vehicle fares for Friday through Monday of each week were in effect from May 25 through June 25, 2012. Higher average fares more than offset the traffic decline, resulting in an increase in tariff revenue of $4.8 million ($14.2 million year-to-date).

Major Routes cont'd

No fuel surcharges were collected in the six months ended September 30, 2013. In the prior year, surcharges of 2.5% of tariffs on average were in place on our Horseshoe Bay – Langdale route and 5.0% on most of our three other Major Routes connecting Greater Vancouver with mid and southern Vancouver Island until July 20, 2012. At that time, all surcharges were reduced to 2.0% due to declining fuel prices and remained in place throughout the remainder of the period. 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 three months ended September 30, 2013, catering and on-board sales increased 4.4% (3.4% year-to-date) compared to the same periods in the prior year as a result of higher average sales per passenger, partially offset by lower passenger traffic levels. Sales of quality apparel continue to grow, increasing a total of 28.6% in the three months ended September 30, 2013 (19.4% year-to-date) compared to the same periods in the prior year. Sales of magazines, comics and newspapers continue to decline, following industry trends.

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 as a result of higher fares and higher senior and student travel.

Reservation fees increased primarily as a result of higher usage, partially offset by lower traffic levels.

Revenue from parking increased as a result of higher usage of our parking facilities.

Other revenue remained stable in the quarter. The increase year-to-date is mainly as a result of an increase in hostling[1] fees from our drop trailer service and retail display allowances.

Ferry transportation fees decreased $0.8 million ($1.2 million year-to-date) due to the elimination of fees in support of services provided on our Horseshoe Bay – Langdale route, effective April 1, 2013. Funds received from the Province related to the import duty remission on one of our foreign-built vessels remained at a similar level year-to-date. For regulatory purposes, this amount is applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

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

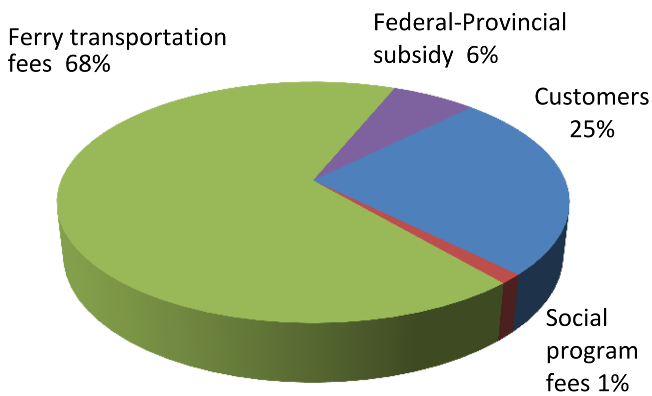
Northern Routes

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

Operational Statistics	Three months ended September 30		Six months ended September 30	
	2013	2012	2013	2012
Vehicle traffic	13,108	13,249	19,691	19,583
Passenger traffic	39,763	41,324	57,861	58,667
On-time performance	95.7%	94.6%	93.4%	94.0%
Number of round trips	147.5	148	233	232.5
Capacity provided (AEQs)	33,695	33,722	53,392	53,265
AEQs carried	15,317	15,542	23,472	23,410
Capacity utilization	45.5%	46.1%	44.0%	44.0%

In the three months ended September 30, 2013, vehicle traffic decreased 1.1% (0.6% increase year-to-date) and passenger traffic decreased 3.8% (1.4% year-to-date) compared to the same periods in the prior year.

Utilization on these routes during the three months ended September 30, 2013 is lower than the same period in the prior year mainly as a result of the lower number of AEQs carried. Utilization during the six months ended September 30, 2013 remained at a similar level as the same period in the prior year, reflecting the fact that both the capacity provided and number of AEQs carried were flat year over year.



In the six months ended September 30, 2013, 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).

Northern Routes cont'd

Revenue ($ thousands)	**Three months ended September 30**			**Six months ended September 30**		
	2013	**2012**	**Increase (Decrease)**	**2013**	**2012**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	4,168	4,106	62	6,117	5,932	185
Passenger tariff	4,133	4,292	(159)	5,654	5,776	(122)
Catering & on-board	1,241	1,237	4	1,687	1,674	13
Social program fees	413	393	20	745	657	88
Stateroom rental	463	426	37	767	674	93
Hostling & other	77	79	(2)	142	113	29
Total Direct Route Revenue	10,495	10,533	(38)	15,112	14,826	286
Indirect Route Revenue						
Ferry transportation fees	24,501	24,265	236	38,843	39,246	(403)
Federal-Provincial subsidy	1,820	1,801	19	3,640	3,602	38
Total Route Revenue	36,816	36,599	217	57,595	57,674	(79)

Average tariff revenue per vehicle increased $8.06 or 2.6% ($7.73 or 2.6% year-to-date) compared to the same periods in the prior year. Average tariff revenue per passenger increased $0.08 or 0.1% ($0.74 or 0.8% decrease year-to-date). The average revenue per passenger decreased year-to-date mainly as a result of a greater proportionate number of passengers on the shorter routes with lower fares. The changes in traffic levels and in average fares resulted in a total tariff revenue decrease of $0.1 million ($0.1 million increase year-to-date).

There were no fuel surcharges or rebates 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 other programs, as well as higher fares.

Revenue from catering and on-board services remained at a similar level as the same periods in the prior year as a result of higher average sales per passenger, offset by lower passenger traffic levels.

Stateroom rental increased due to higher usage.

Hostling and other revenues decreased marginally in the three months ended September 30, 2013. The increase year-to-date is as a result of increased use of hostling services, parking and reservations during the first quarter of fiscal 2014.

Ferry transportation fees increased $0.2 million in the quarter ($0.4 million decrease year-to-date) due to (see "Outlook" below for more detail):

- $0.3 million increase in the quarter and year-to-date representing the Northern Routes' portion of the monthly instalments towards the annual total of $7.1 million in additional fees to be paid by the Province in fiscal 2014;
- $0.1 million increase in the quarter and year-to-date for fees received from the Province related to the price of fuel. For regulatory purposes, the amounts received relating to the price of fuel are applied to our deferred fuel cost accounts (see "The Effect of Rate Regulation" above for more detail); and
- $0.2 million ($0.8 million year-to-date) reduction as a result of lower total ferry transportation fees received under the CFSC, partially offset by an increase in the percentage of these fees allocated to the Northern Routes.

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

Other Routes

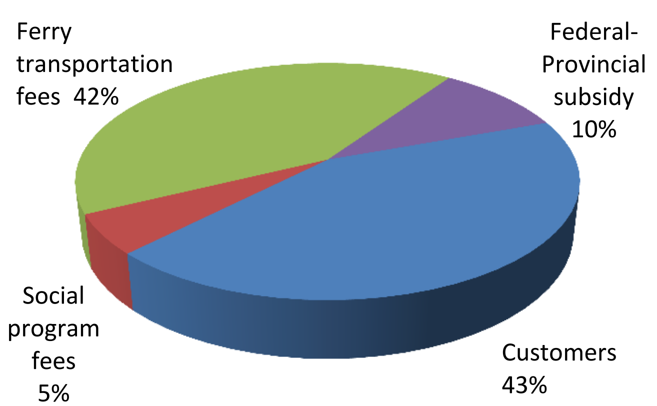
Our Other Routes consist of 18 regulated routes and eight small unregulated routes primarily serving the northern and southern Gulf Islands and the northern Sunshine Coast. One of the regulated routes and all of the unregulated routes are operated under contract by alternative service providers. We receive fees from the Province for the provision of contracted services on these routes, which are included in the ferry transportation fees in the table below.

	Three months ended September 30		Six months ended September 30	
Operational Statistics[2]	**2013**	**2012**	**2013**	**2012**
Vehicle traffic	968,338	975,793	1,765,909	1,779,395
Passenger traffic	2,303,612	2,336,267	4,088,090	4,131,107
On-time performance	88.4%	90.5%	90.4%	91.8%
Number of round trips	18,194	18,323	35,941	35,997
Capacity provided (AEQs)	2,179,808	2,195,074	4,292,429	4,323,310
AEQs carried	1,031,204	1,037,347	1,882,437	1,895,767
Capacity utilization	47.3%	47.3%	43.9%	43.8%

Vehicle traffic decreased 0.8% in the three and six months ended September 30, 2013 and passenger traffic decreased 1.4% (1.0% year-to-date) compared to the same periods in the prior year, partially due to storm activity at the end of the second quarter.

On-time performance during the three months ended September 30, 2013 was affected by the significant upgrades at our Westview terminal, resulting in berth closures, and vessel substitution due to planned vessel maintenance, both negatively impacting arrivals and departures.

Utilization on these routes during the three and six months ended September 30, 2013 remained at a similar level as the same periods in the prior year mainly as a result of reduced capacity provided in the current year, which offset the lower number of AEQs carried.



In the six months ended September 30, 2013, revenue from our Other Routes consisted of 43% from customers and 57% from the Province (5% social program fees, 42% ferry transportation fees, and 10% from payments under the Federal-Provincial subsidy agreement).

[2] The statistics provided exclude the unregulated routes

Other Routes cont'd

Revenue ($ thousands)	Three months ended September 30			Six months ended September 30		
	2013	2012	Increase (Decrease)	2013	2012	Increase (Decrease)
Direct Route Revenue						
Vehicle tariff	14,539	14,056	483	25,454	24,656	798
Passenger tariff	10,279	10,158	121	17,553	17,295	258
Fuel surcharges	-	704	(704)	-	1,763	(1,763)
Social program fees	2,816	2,642	174	5,774	5,450	324
Catering & on-board	1,563	1,541	22	2,587	2,569	18
Reservation fees	96	93	3	144	141	3
Parking & other	37	34	3	63	54	9
Total Direct Route Revenue	29,330	29,228	102	51,575	51,928	(353)
Indirect Route Revenue						
Ferry transportation fees	23,690	23,944	(254)	44,642	46,918	(2,276)
Federal-Provincial subsidy	5,273	5,219	54	10,546	10,437	109
Total Route Revenue	58,293	58,391	(98)	106,763	109,283	(2,520)

Average tariff revenue per vehicle increased $0.61 or 4.2% ($0.56 or 4.0% year-to-date) compared to the same periods in the prior year. Average tariff revenue per passenger increased $0.11 or 2.6% in the quarter and year-to-date. The increase in average fares, partially offset by the reduction in traffic, resulted in a total tariff revenue increase of $0.6 million ($1.1 million year-to-date).

No fuel surcharges were collected in the six months ended September 30, 2013. In the prior year, surcharges of 5.0% were in place on most of our Other Routes until July 20, 2012 when all surcharges were reduced to 2.0% due to declining fuel prices and remained in place throughout the remainder of the period. 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 as a result of higher fares and higher program usage, primarily senior and student travel.

Revenue from catering and on-board services increased due to higher average sales per passenger, partially offset by lower traffic levels on the routes where these services are offered.

Fees for reservations increased marginally due to higher usage mainly offset by lower traffic levels.

Parking and other revenues are higher than during the prior year, mainly due to higher charter fees and an increase in usage of our parking facilities.

Ferry transportation fees decreased $0.3 million in the quarter ($2.3 million year-to-date) due to (see "Outlook" below for more detail):

- $2.3 million ($4.3 million year-to-date) reduction in ferry transportation fees received under the CFSC for the 18 regulated routes; offset by:
- $2.0 million increase in the quarter and year-to-date representing the Other Routes' portion of the monthly instalments towards the annual total of $7.1 million in additional fees to be paid by the Province in fiscal 2014.

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

Expenses
Expenses for the three and six months ended September 30, 2013 and 2012 are summarized in the tables below:

Operating expenses ($ millions)	**Three months ended September 30**			**Six months ended September 30**		
	2013	**2012**	**Increase (Decrease)**	**2013**	**2012**	**Increase (Decrease)**
Operations	124.7	121.3	3.4	238.9	232.3	6.6
Maintenance	12.2	11.6	0.6	27.8	28.8	(1.0)
Administration	7.5	7.1	0.4	14.5	14.3	0.2
Total operations, maintenance & administration	144.4	140.0	4.4	281.2	275.4	5.8
Cost of retail goods sold	10.7	10.1	0.6	18.4	17.6	0.8
Depreciation and amortization	34.1	34.4	(0.3)	68.4	68.4	-
Total operating expenses	189.2	184.5	4.7	368.0	361.4	6.6

We continue to take proactive measures to contain and reduce expenses while ensuring that safety remains our top priority.

The $3.4 million ($6.6 million year-to-date) increase in operations expenses consists mainly of:

- $1.6 million increase in the quarter (no change year-to-date) in fuel expense reflecting an increase of $1.7 million ($0.2 million year-to-date) due to higher fuel prices and a $0.1 million ($0.2 million year-to-date) reduction in fuel consumption.
  For purposes of rate regulation, $3.9 million in the quarter ($6.6 million year-to-date) of our fuel expense is recorded in deferred fuel cost accounts for future recovery. In fiscal 2013, $3.0 million ($6.9 million year-to-date) was recorded in deferred fuel cost accounts for future recovery. (See "The Effect of Rate Regulation" above for detail.)
- $1.5 million ($4.2 million year-to-date) increase in wages and benefits due to bargaining unit wage rate increases of 1% at October 1, 2012 and 1.5% at April 1, 2013, in accordance with the Collective Agreement and an increase in overtime and in hours spent in training activities;
- $0.2 million ($0.6 million year-to-date) increase in training costs, other than wages;
- $0.1 million ($1.8 million year-to-date) increase in several other operational areas, including credit card fees, data communications, materials & contracted services, and training related travel costs.

The $0.6 million increase ($1.0 million decrease year-to-date) in maintenance costs reflects a $0.7 million increase ($0.2 million decrease year-to-date) in vessel maintenance as a result of variations in vessel refit scheduling and a $0.1 million decrease ($0.8 million year-to-date) in terminal maintenance.

The $0.4 million ($0.2 million year-to-date) increase in administration expenses is mainly due to costs of information systems.

Depreciation and amortization decreased $0.3 million in the quarter (no change year-to-date), reflecting the assets that are now available for use. (See "Investing in our Capital Assets" below for detail of significant purchases.)

Net finance and other expenses ($ millions)	**Three months ended September 30**			**Six months ended September 30**		
	2013	**2012**	**Increase (Decrease)**	**2013**	**2012**	**Increase (Decrease)**
Finance expenses						
Bond interest	16.7	15.9	0.8	32.5	31.7	0.8
KfW group (KfW) loans	1.9	2.1	(0.2)	3.9	4.3	(0.4)
Interest on finance lease	0.5	0.6	(0.1)	1.0	1.2	(0.2)
Short-term debt	0.3	0.1	0.2	0.4	0.2	0.2
Structured Financing Facility Program	-	(0.2)	0.2	-	(0.4)	0.4
Capitalized interest	(0.7)	(0.4)	(0.3)	(1.5)	(0.9)	(0.6)
Total finance expenses	18.7	18.1	0.6	36.3	36.1	0.2
Less: finance income	(0.7)	(0.6)	(0.1)	(1.5)	(1.2)	(0.3)
Net finance expenses	18.0	17.5	0.5	34.8	34.9	(0.1)
Loss on disposal of capital assets	-	0.1	(0.1)	-	0.1	(0.1)
Total net finance and other expenses	18.0	17.6	0.4	34.8	35.0	(0.2)

Net finance expenses increased $0.5 million ($0.1 million decrease year-to-date) primarily due to:

- $1.0 million, in the quarter and year-to-date, reflecting the premium paid to redeem $140 million of Series 08-2 Bonds with an interest rate of 6.21%, formerly due December 19, 2013, partially offset by interest savings. This fiscal year, we expect approximately $0.3 million in net interest savings from what was originally projected due to this early redemption (see "Liquidity and Capital Resources" below for more detail); and
- $0.2 million ($0.4 million year-to-date) decrease in 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*;

partially offset by:

- $0.3 million ($0.6 million year-to-date) increase in capitalized interest;
- $0.2 million ($0.4 million year-to-date) decrease in interest on KfW loans due to $9.0 million in principal repayments on the 2.95% loan;
- $0.1 million ($0.2 million year-to-date) decrease in interest on finance leases; and
- $0.1 million ($0.3 million year-to-date) increase in finance income.

Liquidity and Capital Resources
We fund our operations and capital acquisitions with cash flow generated from operations, as well as bank financing and debt issues.

We expect our cash requirements, in the near term, will be met through operating cash flows and by accessing our credit facility from time to time. At September 30, 2013, our unrestricted cash and cash equivalents and other short-term investments totalled $48 million.

On July 24, 2013, we completed the redemption of all $140 million of the outstanding Series 08-2 Bonds, formerly due December 19, 2013. This debt management initiative to reduce our interest costs in the short term was funded with $55 million cash on hand and $88 million in draws on our credit facility. Due to this early redemption, we expect approximately $0.3 million in net interest savings in fiscal 2014 compared to the level originally projected.

On October 25, 2013, we completed a private placement of $200 million of 30-year senior secured bonds with accredited investors. These bonds bear interest at 4.702%, payable semi-annually. As has been previously announced, it was our intention to refinance the redeemed $140 million Series 08-2 Bonds and this issuance is partially related to that early redemption. The net proceeds of this new issue will partially fund capital expenditures, repay our credit facility, fund the debt service reserve related to these bonds and provide funding for general corporate purposes. These bonds were rated “A” (DBRS) and “A+” (Standard & Poor’s).

In addition, we have a $250 million bond series that will mature in May 2014. It is our intention to refinance these bonds and we will be monitoring the capital markets for appropriate opportunities to do so.

Our $155 million credit facility was amended on March 15, 2013 to extend the maturity date of the facility from April 2017 to April 2018. The facility is available to fund capital expenditures and other general corporate purposes. At September 30, 2013, there were $40 million in 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, 2013, were “A” (DBRS) with a stable trend and “A+” (Standard & Poor’s) with a stable outlook.

Sources & Uses of Cash

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

Sources and uses of cash and cash equivalents for the six months ended September 30, 2013 and 2012 are summarized in the table below:

	Six months ended September 30		
($ millions)	**2013**	**2012**	**Increase (decrease)**
Cash and cash equivalents, beginning of period	36.6	7.7	28.9
Cash from operating activities:			
Net earnings	68.6	69.8	(1.2)
Items not affecting cash	99.8	104.4	(4.6)
Changes in non-cash operating working capital	(10.7)	(20.7)	10.0
Net interest paid	(38.4)	(35.9)	(2.5)
Cash generated by operating activities	119.3	117.6	1.7
Cash (used in) provided by financing activities	(105.0)	2.3	(107.3)
Cash used in investing activities	(37.0)	(84.6)	47.6
Net (decrease) increase in cash and cash equivalents	(22.7)	35.3	(58.0)
Cash and cash equivalents, end of period	13.9	43.0	(29.1)

Cash generated by operating activities in the six months ended September 30, 2013 was $1.7 million higher compared to the same period in the prior year mainly due to changes in non-cash operating working capital, offset by items not affecting cash, net interest paid and lower net earnings.

Cash used in financing activities in the six months ended September 30, 2013 was $105.0 million due to the redemption of our $140 million bond series, partially offset by $40.0 million proceeds from short-term debt. In the same period of the prior year, financing activities provided $2.3 million of cash as we received $25.0 million contributed surplus from the Province and repaid $17.7 million of short-term debt and $4.5 million of long-term debt.

Cash used in investing activities in the six months ended September 30, 2013 was $47.6 million lower than during the same period in the prior year mainly due to a $4.4 million reduction in debt service reserve and $8.9 million in proceeds from short-term investments versus $34.5 million used to purchase short-term investments in the first six months of the prior year. Cash used for capital expenditures was at a similar level as in the prior year. (See “Investing in Our Capital Assets” below for detail of significant capital expenditures.)

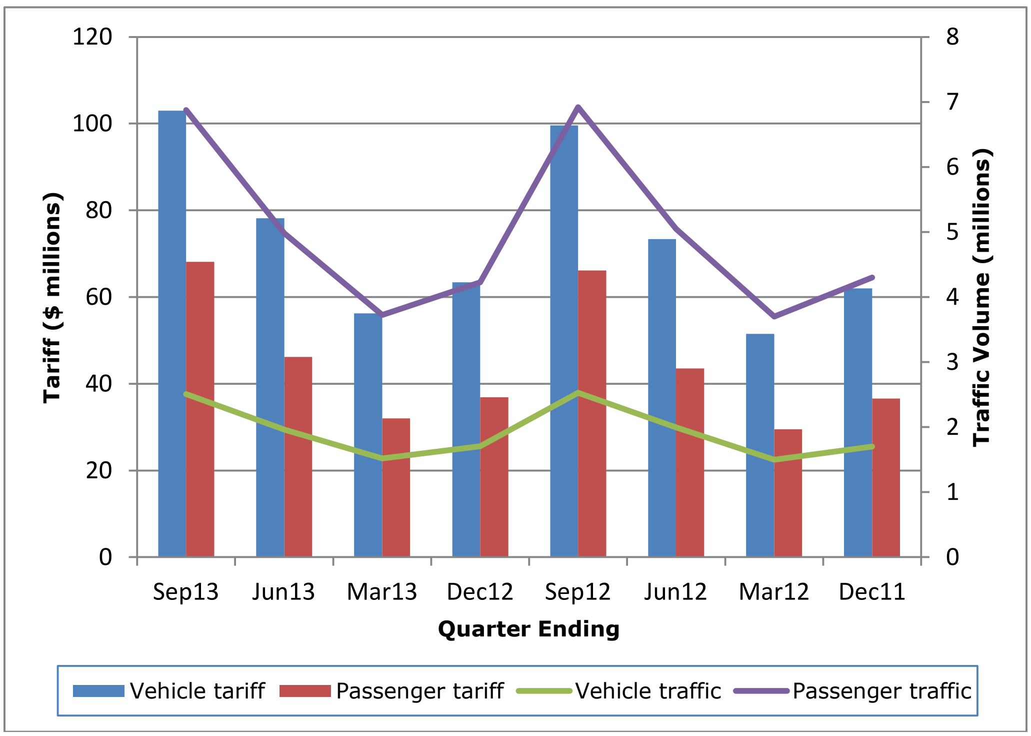
SUMMARY OF QUARTERLY RESULTS

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

	Quarter Ended (unaudited)							
($ millions)	**Sep 13**	**Jun 13**	**Mar 13**	**Dec 12**	**Sep 12**	**Jun 12**	**Mar 12**	**Dec 11**
Total revenue	271.5	200.0	150.5	169.6	268.6	197.7	145.0	164.9
Operating profit (loss)	82.3	21.3	(20.2)	0.2	84.1	20.7	(24.6)	(1.8)
Net earnings (loss)	64.3	4.3	(37.1)	(17.2)	66.5	3.3	(42.1)	(19.2)
Other comprehensive income	0.1	-	1.1	-	-	-	2.2	-
Total comprehensive income (loss)	64.4	4.3	(36.0)	(17.2)	66.5	3.3	(39.9)	(19.2)

Quarterly results are affected by the seasonality of leisure travel patterns. The second quarter, covering the summer period, experiences the highest traffic levels and the highest net earnings. The third and fourth quarters reflect a seasonal reduction in traffic. We utilize these periods to perform upgrades and major maintenance and refit programs, as well as to undertake mandatory inspections on the majority of our vessels.

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



INVESTING IN OUR CAPITAL ASSETS

Capital Expenditures
Capital expenditures in the three and six months ended September 30, 2013 totalled $25.0 million and $46.7 million, respectively.

($ millions)	September 30, 2013	
	3 Months	**6 Months**
Vessel upgrades and modifications	10.1	22.3
Terminal marine structures	11.4	17.0
Information technology	2.7	5.9
Terminal and building upgrades and equipment	0.8	1.5
Total capital expenditures	25.0	46.7

Vessel Upgrades and Modifications
Capital expenditures for vessel upgrades and vessel modifications in the three and six months ended September 30, 2013 included the following:

($ millions)	September 30, 2013	
	3 Months	**6 Months**
Tachek life extension	5.7	9.6
Major overhauls and inspections	2.4	8.5
Electrical and navigational equipment upgrades	0.3	0.9
Kwuna three-quarter life upgrade	0.3	0.4
Controllable pitch propeller rebuilds	0.2	0.4
Other projects	1.2	2.5
	10.1	22.3

A $19 million project to extend the life of the *Tachek* by an additional 15 years until retirement in 2029 started in the third quarter of fiscal 2013. This life-extension includes new engines and shafting, new generators, and upgrades to lifesaving equipment and passenger facilities. The project is expected to complete in the third quarter of this fiscal year.

Major overhauls and inspections completed in the six months ended September 30, 2013 or currently underway include:

- $2.1 million on the *Coastal Celebration*;
- $1.8 million on the *Skeena Queen*;
- $1.4 million on the *Mayne Queen*;
- $1.1 million on the *Powell River Queen*;
- $0.7 million on the *Queen of Chilliwack;*
- $0.5 million on the *Island Sky;* and
- $0.9 million on several other vessels.

A $2 million project representing the second year of a four-year program to upgrade 18 vessels with new electrical and navigational equipment including searchlights, gyro compasses, depth sounders, and radar equipment is underway. This takes us further towards bridge standardization.

A $5 million project for a three-quarter life upgrade on the *Kwuna* is expected to complete in the third quarter of this fiscal year. The upgrade will include the overhaul of both main engines, right angle drive units, and generators; the installation of two new evacuation slides to enhance safety; fire-fighting improvements; and improvements in passenger accommodations.

A $3 million project to refurbish and reinstall two sets of controllable pitch propeller hub systems on the *Queen of Coquitlam* and the *Queen of Cowichan* is expected to be complete in the third quarter of fiscal 2014.

Other ongoing projects include early costs of the mid-life upgrades on the *Queen of Capilano* and the *Spirit of British Columbia* and on the three-quarter life upgrade on the *Queen of Oak Bay*.

Terminal Marine Structures
Capital expenditures for terminal marine structures in the three and six months ending September 30, 2013 included the following:

($ millions)		**September 30, 2013**	
Terminal	Description	**3 Months**	**6 Months**
Westview	Replacement of trestle, ramp, apron and towers	5.7	6.7
Little River	Replacement of ramp, tower, wingwall and dolphin	3.5	3.6
Alert Bay	Replacement of wingwalls, towers, ramp and aprons	0.3	2.5
Denman Island and Buckley Bay	Modifications to accommodate the new cable ferry	0.7	1.2
Horseshoe Bay	Transfer deck life-extension	0.4	0.8
McLoughlin Bay	Berth modifications	0.4	0.7
Various	Install tie-up winches	0.1	0.5
Various	Other projects	0.3	1.0
		11.4	17.0

At Westview terminal, work continues on a $20 million project to replace the existing trestle with one designed for full highway bridge loading with an improved approach radius, two traffic lanes and a pedestrian sidewalk; replace the ramp, ramp abutment, apron and towers with active lift hydraulics; and replace the waiting shelter. This project is expected to be complete by the end of the current fiscal year.

At Little River terminal, work continues on a $10 million project to replace the ramp, ramp abutment and towers with active lift hydraulics, replace the wingwalls and dolphin. This project is expected to be complete by the end of the current fiscal year.

At Alert Bay terminal, a $7.5 million project to upgrade wingwalls, towers, aprons and ramp was substantially completed in the first quarter of the current fiscal year, in time for the busy summer season.

Work continues on modifications at Denman Island and Buckley Bay terminals as part of the project for our new cable ferry service. The cable ferry service 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.

At Horseshoe Bay terminal, a $3 million project to extend the life of the transfer deck to provide an additional seven years of useful life is underway. Due to poor weather and the busy summer season, completion of this project has been rescheduled to the third quarter of fiscal 2014.

At McLoughlin Bay, the $9 million project for berth modifications includes installation of two berthing dolphins and two tie-up dolphins and modification of the berth to improve ship-to-shore tie-up.

The installation of tie-up winches at Langdale, Horseshoe Bay and Tsawwassen terminals has been completed and test fitting for four vessels is scheduled to take place in the third quarter of fiscal 2014. The project is expected to total $1.8 million, of which $1.7 million has been incurred to the end of September 2013.

Other projects completed include a $0.6 million project to replace the double-sided floating lead at Village Bay terminal completed in the first quarter. Other projects in progress include a $13 million project at Port McNeill terminal to replace the trestle, wingwalls, ramp, apron, towers and dolphin and reposition the new ramp to accommodate all minor and intermediate vessels and a $0.5 million project at Crofton terminal to upgrade the ramp and life extend the starboard wingwall and trestle.

Information Technology
Capital expenditures for information technology in the three and six months ending September 30, 2013 included the following:

($ millions)	September 30, 2013	
	3 Months	**6 Months**
Customer service program	1.7	3.6
Payroll system replacement	0.5	1.1
Infrastructure relocation program	0.1	0.3
Computer hardware upgrades	0.4	0.6
Other projects	-	0.3
	2.7	5.9

Our $57 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 multi-year program will be implemented in stages starting in fiscal 2014, and is expected to be fully completed in fiscal 2017. We believe this program will significantly improve our ability to efficiently respond to the changing needs of our customers. A total of $4 million in software and hardware is currently in service.

Our $10 million payroll system replacement initiative will replace both our payroll and labour distribution systems to provide added reliability and significant processing efficiencies and flexibility.

The $5 million infrastructure relocation program will relocate our prime data centre facility to the interior of British Columbia to mitigate risk in the event of a major incident such as an earthquake. Our current infrastructure site will be expanded to house our pre-production infrastructure and serve as our production environment for disaster recovery in the unlikely event that the interior data centre production services are interrupted. Completion is expected by the end of fiscal 2015.

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

Projects completed to the end of September include a new internal control management system, upgrades to simplify the process for customers making a reservation on our website and enhancements for improved supply chain management.

Terminal and Building Upgrades and Equipment
Capital expenditures for terminal and building upgrades and equipment in the three and six months ending September 30, 2013 included the following:

($ millions)	September 30, 2013	
	3 Months	**6 Months**
Vehicles and other equipment	0.3	0.6
Terminal seismic upgrades	-	0.2
Building improvements at several terminals	0.3	0.4
Other terminal projects	0.2	0.3
	0.8	1.5

Vehicles include 8 additional hostling units to accommodate the demand for our drop trailer service. Other equipment consists primarily of items of equipment for our Richmond maintenance facility, including marine diagnostic equipment, a turntable washer, generator, electrical testing equipment, infrared measurement equipment, and several other items.

Other terminal projects include seismic upgrades at certain of our maintenance facilities; construction of a new training facility for training on life saving equipment; and the first year of a five year program to update signage at our terminals serving our Major Routes.

OUTLOOK

We expect to have positive net earnings in fiscal 2014, although somewhat lower than fiscal 2013 net earnings.

Traffic and tariff revenue
In the three months ended September 30, 2013, we experienced a 0.7% (1.2% year-to-date) decline in vehicle traffic and a 0.7% (1.0% year-to-date) decline in passenger traffic compared to the same periods in the prior year. This decline is discussed above in "Financial and Operational Overview". In the six months ended September 30, 2013, our commercial traffic has increased while discretionary traffic levels have declined somewhat. We have terminal upgrades planned that are expected to cause a temporary reduction in traffic on some of our routes later this fiscal year. We expect annual passenger traffic to be at a similar level as the prior year and vehicle traffic to be somewhat lower.

We continue to monitor trends in fuel prices and we anticipate a likely need to reintroduce fuel surcharges at some point during the current fiscal year.

Other revenue
In the six months ended September 30, 2013, compared to the same period in the prior year, catering and on-board revenues increased as a result of an increase in the average sales per passenger. We expect fiscal 2014 revenues to be somewhat higher than the prior year reflecting an increase in average sales per passenger.

In May 2012, the Province announced additional payments to us totalling $79.5 million in order to reduce the pressure for future fare and price cap increases. Of this, $25 million was received as contributed surplus and $21.5 million as additional ferry transportation fees in fiscal 2013. The remaining payments will be received as ferry transportation fees; $10.5 million in fiscal 2014, $11.0 million in fiscal 2015 and $11.5 million in fiscal 2016.

On April 3, 2013, an amendment to the CFSC was agreed to with the Province. This amendment extended the deadline for identifying service level adjustments required over the remainder of PT3. The Province also agreed to pay us ferry transportation fees in the amount of $7.1 million in 9 equal monthly instalments commencing July 2013. Based on the level of payments agreed with the Province for fiscal 2013 and 2014, we expect fiscal 2014 transportation fees under the CFSC to be $4.7 million less than the prior fiscal year.

On April 15, 2013, the Commissioner issued Order 12-02A, reducing the service level adjustments to achieve a total of $22.9 million in net savings during the remainder of PT3. This reflected the $7.1 million received from the Province, reducing net savings from service adjustments from $30 million to $22.9 million. He also acknowledged the reduction of $4 million in service reductions already implemented, leaving $18.9 million to be identified. The Commissioner also reconfirmed that we may apply for relief under section 42 of the Act if amendments made will not enable us to achieve the $22.9 million in net savings.

On November 18, 2013, the Province announced a service level adjustment plan to achieve the remaining $18.9 million in net savings over the remainder of PT3. Considerations for service reductions included: significant annual revenue shortfalls; low annual utilization; low round-trip utilization; basic levels of ferry service; routes requiring vessel replacement; and the complexity of multi-port routes.

Beginning April 1, 2014, 6,961 underutilized round trips over 15 Northern and Other Routes will be eliminated, providing a net savings of $14 million. A further $4.9 million in service reductions on the Major Routes is still to be identified and implemented by March 2015.

The Province also announced that, as of April 1, 2014, the current 100% passenger fare discount for BC seniors travelling Monday to Thursday will be reduced to 50% on Major and Other Routes. There will be no change to the current 33% discount offered to seniors on the Northern Routes. The Province will redirect the annual savings of approximately $6 million to reduce the pressure for future fare and price cap increases. The Province is also proposing the introduction of a pilot project to assess the viability of gaming on Major Routes connecting Greater Vancouver with mid and southern Vancouver Island. If successful, gaming revenue would also reduce the pressure for future fare and price cap increases.

We will continue to explore strategies to create an affordable and sustainable ferry system beyond 2016, including standardized and no-frills vessels, LNG propulsion, other alternative technologies, passenger only vessels, fixed links, a new reservation and point-of-sale system, increased operational efficiencies and seeking federal infrastructure funding to renew the fleet and terminals. The Province announced that "The guiding principles behind all future decisions to affect the coastal ferry service will be based on an affordable, efficient and sustainable system which protects basic service to coastal communities for future generations."

Expenses

We expect a modest increase in total expenses in fiscal 2014, reflecting higher depreciation and amortization, wage and benefit increases, higher fuel costs, costs of information systems, and other operational related costs. We expect these increases to be partially offset by cost reductions resulting from reductions of discretionary expenditures and the return to PST and GST from HST. We continue to manage our costs as prudently as possible without compromising safe operations.

Capital Expenditures

Our capital expenditures are expected to increase over the next five years as we begin to replace aged minor and intermediate-sized vessels, make significant improvements at our terminals serving our Major Routes and renew our information technology infrastructure.

We are currently in the detailed design phase for the new cable ferry for service on our Buckley Bay to Denman Island route and expect to conclude a procurement process for the construction of the vessel and terminal works by the end of the third quarter of this fiscal year. The new 50-car vessel is expected to be in service in early 2015. 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.

On July 19, 2013, the Commissioner approved our application to construct three new intermediate class vessels to replace the 48-year old *Queen of Burnaby* and the 49-year old *Queen of Nanaimo*. Both of these vessels are scheduled for retirement in 2016. We intend to replace them with three open-deck vessels; two with the capacity to carry 145 AEQs and a third with capacity to carry 125 AEQs. We expect this vessel replacement strategy will permit a more efficient deployment of our vessel assets. We intend to pursue a design-build contract with a shipyard that will be selected through a formal procurement process. Canadian and international shipyards have been invited to participate in this process and we expect to award a contract for this project before the end of fiscal 2014. While we are considering the acquisition of liquefied natural gas fuelled vessels, further technical and financial analysis will be required before a final decision is made. These analyses very much depend on the responses to the Request for Proposals. The two 145 AEQ vessels are expected to be in service in the spring and fall of 2016 and the 125 AEQ vessel is expected to enter service in the spring of 2017.

FINANCIAL RISKS

Exposure to credit risk, liquidity risk and market risk arises in the normal course of our business. We manage market risk arising from the volatility in foreign currency, interest rate and fuel price exposures in part through the use of derivative financial instruments including forward contracts, swaps and options. We do not utilize derivative financial instruments for trading or speculative purposes.

A discussion of financial risks can be found on pages 50 through 52 of our fiscal 2013 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the six months ended September 30, 2013. Our 2013 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/about/investors/index.html.

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 53 through 58 of our fiscal 2013 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the six months ended September 30, 2013. Our 2013 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/about/investors/index.html.

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 consolidated financial statements, which have been prepared in accordance with IFRS.

Our significant accounting policies are contained in note 1 to our March 31, 2013 and September 30, 2013 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 judgements, estimates and assumptions are subject to change as new events occur, as more experience is acquired, as additional information is obtained and as the general operating environment changes.

Discussion of the most critical accounting policies and estimates that we have used in the preparation of our consolidated financial statements can be found on pages 59 and 60 of our fiscal 2013 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, 2013, or expect to use in the future. Our 2013 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/about/investors/index.html.

Adoption of New Accounting Standards
The following is a discussion of mandatory accounting changes that were effective for us April 1, 2013:

IAS 19 *Employee Benefits* has been amended. As a result of the amendments, actuarial gains and losses of defined benefit plans 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 is no longer 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. The retrospective application of this amended standard did not have an impact on our consolidated financial statements.

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 have applied IFRS 13 prospectively effective April 1, 2013. Adoption of this standard had no impact on the recognition or measurement of any items in our consolidated financial statements but has added additional disclosure which can be found in note 4 to our September 30, 2013 consolidated financial statements.

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

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 do not expect the application of this standard to have any 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 CFSC.

Forward looking statements included in this document include statements with respect to: economic conditions, and traffic levels; positive net earnings for fiscal 2014, and our expectations of the impact of our cost containment program; whether our regulatory assets are probable of future recovery; our short-term and long-range business plans, capital expenditure levels, and asset renewal programs for vessels and terminals; our customer service program, payroll system replacement initiative, infrastructure relocation program, vessel replacement program for the *Queen of Burnaby* and the *Queen of Nanaimo*, cable ferry initiative, liquefied natural gas plans, and safety and training projects; our expectations regarding ferry transportation fee amounts; catering and on-board revenue and total expense projections, how our cash requirements will be met in the near term, the need to reintroduce fuel surcharges, our intention to refinance bonds maturing in May 2014, our expectations of interest savings net of the redemption premium in fiscal 2014 due to our Series 08-2 bond redemption, and how the net proceeds from the October 25, 2013 bond issuance will be used; the additional payments to be received from the Province over the following three fiscal years, the service level adjustment plan, and strategies to create an affordable and sustainable ferry system beyond 2016; and our intention to adopt IFRS 9 (2010). 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.

In addition to providing measures prepared in accordance with IFRS, we present certain supplemental non-IFRS measures. These include, but are not limited to, total comprehensive income adjusted for the effect of rate regulation, vehicle and passenger traffic, on-time performance, capacity provided and utilized, AEQs carried, number of round trips, and average tariff revenue per vehicle and per passenger. These measures do not have any standardized meaning prescribed by IFRS and therefore are unlikely to be comparable to similar measures presented by other companies. These supplemental non-IFRS measures are provided to assist readers in determining our ability to generate cash from operations and improve the comparability of our results from one period to another. We believe these measures are useful in assessing operating performance of our ongoing business on an overall basis.