BCFerries

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

For the three and nine months ended December 31, 2013

Dated February 20, 2014

Table of Contents

BUSINESS OVERVIEW 3
The Effect of Rate Regulation 5
FINANCIAL AND OPERATIONAL OVERVIEW 7
Safety 8
Training 8
Revenue 9
Expenses 19
LIQUIDITY AND CAPITAL RESOURCES 21
SUMMARY OF QUARTERLY RESULTS 23
INVESTING IN OUR CAPITAL ASSETS 24
OUTLOOK 28
FINANCIAL RISKS 30
BUSINESS RISK MANAGEMENT 30
ACCOUNTING PRACTICES 31
FORWARD LOOKING STATEMENTS 33

Management's Discussion & Analysis
of Financial Condition and Financial Performance
For the three and nine months ended December 31, 2013
Dated February 20, 2014

The following is our discussion and analysis of the financial condition and financial performance of British Columbia Ferry Services Inc. as of December 31, 2013. This discussion and analysis should be read in conjunction with our unaudited consolidated financial statements and related notes for the three and nine months ended December 31, 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/investors/financial_reports.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 passenger and vehicle ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world. We provide frequent year-round transportation service with 35 vessels operating on 25 routes out of 47 terminals spread over 1,000 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 December 31, 2013 (the third quarter of fiscal 2014), we provided 45,000 sailings, carrying 4.3 million passengers and 1.7 million vehicles. We experienced a 0.8% increase in vehicle traffic and a 1.0% increase in 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 and financial and operational highlights during or subsequent to our third quarter of the year ending March 31, 2014 (fiscal 2014) include the following:

- 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 a rate of 4.702% per annum, payable semi-annually. This issuance was partially related to the early redemption of our $140 million Series 08-2 Bonds. 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 December 9, 2013, we issued a Request for Proposals (RFP) to five pre-qualified shipyards, including one Canadian proponent, to build 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. The RFP stipulates that these three vessels be designed to operate as dual-fuel capable, so they can run on liquefied natural gas (LNG) or marine diesel fuel. (See "Outlook" below for more detail.)

- On January 17, 2014, due to the rising cost of fuel, we implemented a fuel surcharge of 3.5% on average on our Major Routes and our regulated Other Routes. No surcharges were put in place on our unregulated or Northern Routes.

- On February 5, 2014, after further public consultation, the Province confirmed the implementation of its service level reduction plan beginning this spring to better align service levels to demand. The plan, announced on November 18, 2013, is designed to achieve the remaining $18.9 million in net savings over the remainder of performance term three (PT3), which ends March 31, 2016. The plan includes the elimination of approximately 6,900 round trips over 15 routes, including a significant adjustment in how summer service is provided to mid-coast destinations. The Province also confirmed its plan to reduce the current 100% passenger fare discount for BC seniors travelling Monday to Thursday to 50% on the Major and Other Routes as of April 1, 2014 and its proposal to proceed with a gaming pilot project on one of our Major Routes. (See "Outlook" below for more detail.)

- On February 20, 2014, in response to our December 20, 2013 application, we received a decision from the British Columbia Ferries Commissioner (the Commissioner) confirming that the expenditures required to implement the cable ferry system on the route connecting Buckley Bay and Denman Island are reasonable and prudent. In conjunction with this decision, the Commissioner included reasonable conditions which we are confident we will be able to meet.

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 that applies to us. In January 2014, the International Accounting Standards Board issued an interim standard, IFRS 14 *Regulatory Deferral Accounts*, which permits first-time adopters of IFRS to continue to recognize amounts related to rate regulation in accordance with their previous GAAP requirements. This standard is not applicable to those entities that have already transitioned to IFRS, as we have.

IFRS 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 the purposes of rate regulation.

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 December 31, 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 December 31, 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 nine months ended December 31, 2013 and 2012 would be as follows:

($ millions)		Three months ended December 31		Nine months ended December 31	
		2013	2012	2013	2012
Total comprehensive (loss) income		(12.3)	(17.2)	56.4	52.6
Regulatory asset or liability	**Statement line item**				
Deferred fuel costs (a)					
Fuel costs incurred	Operations expense	3.1	1.4	9.8	8.3
Fuel surcharges collected	Fuel surcharge revenue	-	(1.3)	-	(11.5)
Payments from the Province	Ferry transportation fees	(0.9)	(0.5)	(2.2)	(1.6)
		2.2	(0.4)	7.6	(4.8)
Tariffs in excess of price cap (b)					
Obligation settled (incurred) during the period	Tariff revenue	0.6	-	(1.7)	2.5
Performance term submission costs (c)					
Amortization	Amortization expense			(0.1)	(0.1)
Increase (decrease) in total comprehensive income		2.8	(0.4)	5.8	(2.4)
Adjusted total comprehensive (loss) income		(9.5)	(17.6)	62.2	50.2

(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.

(c) Performance term submission costs: Costs for incremental contracted services relating to our third performance term submission. Our regulator has approved recovery of these costs over the third performance term ending March 31, 2016.

FINANCIAL AND OPERATIONAL OVERVIEW

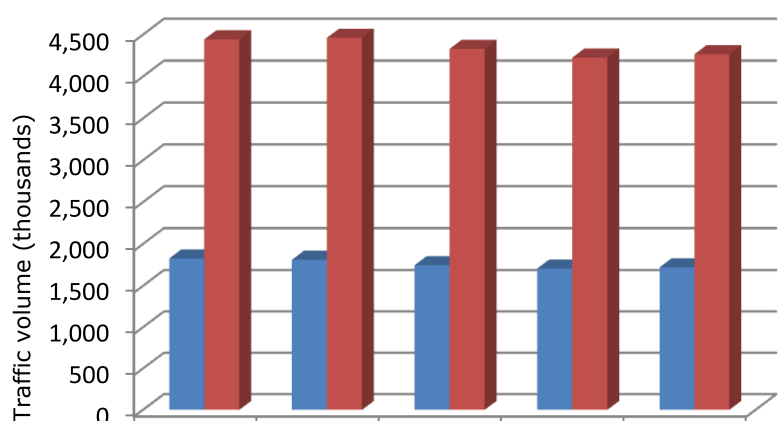
This section provides an overview of our financial and operational performance for the three and nine months ended December 31, 2013 and 2012.

($ millions)	Three months ended December 31			Nine months ended December 31		
	2013	**2012**	**Variance**	**2013**	**2012**	**Variance**
Total revenue	174.8	169.6	5.2	646.3	635.8	10.5
Operating expenses	(171.1)	(169.4)	(1.7)	(539.1)	(530.8)	(8.3)
Operating profit	3.7	0.2	3.5	107.2	105.0	2.2
Net finance and other	(16.0)	(17.4)	1.4	(50.9)	(52.4)	1.5
Net (loss) earnings	(12.3)	(17.2)	4.9	56.3	52.6	3.7
Other comprehensive income	-	-	-	0.1	-	0.1
Total comprehensive (loss) income	(12.3)	(17.2)	4.9	56.4	52.6	3.8

In the three months ended December 2013, we generated an operating profit of $3.7 million, an improvement of $3.5 million compared to the same period in the prior year, and our net loss in the quarter was $12.3 million, an improvement of $4.9 million compared to the same period in the prior year. Year-to-date, net earnings were $56.3 million, which was $3.7 million or 7.0% higher than the prior year. The increase in year-to-date net earnings reflects the effects of increased fares, higher usage of social programs, higher average customer spending, and lower financing costs, partially offset by reductions in fuel surcharges, operating cost increases, lower ferry transportation fees, and lower traffic levels.

In the third quarter of fiscal 2014, we experienced a 0.8% increase in vehicle traffic and a 1.0% increase in passenger traffic compared to the same period in the prior year. Both vehicle and passenger traffic increased on the Major and Northern Routes but decreased marginally on the Other Routes.

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



	2010	2011	2012	2013	2014
Vehicles	1,828	1,812	1,747	1,708	1,722
Passengers	4,444	4,463	4,330	4,226	4,267

Safety
Safety continues to be a key priority. The commitment of all our employees to safety improvement was recognized in November 2013 when we were presented with an International Inspiring Safety Award by Latitude Productions UK.

In the third quarter, we were audited for entry into the WorkSafe BC 'Certificate of Recognition' program. Final results of the audit will be available in February 2014. We continue to see a reduction in the number of employees injured at work. For the nine months ended December 31, 2014 compared to the same period in the prior year, time loss injuries are 17% lower and days lost are 25% lower. By the end of fiscal 2014, we expect time loss injuries to be down by 60% and days lost down by 56% since we initiated our SailSafe program.

The fifth annual SailSafe town hall sessions were completed in the third quarter of fiscal 2014. 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. The results of employee surveys from each of the 29 town halls show an improvement in all areas, including observed safety improvement at each worksite and awareness of the Sailsafe program.

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

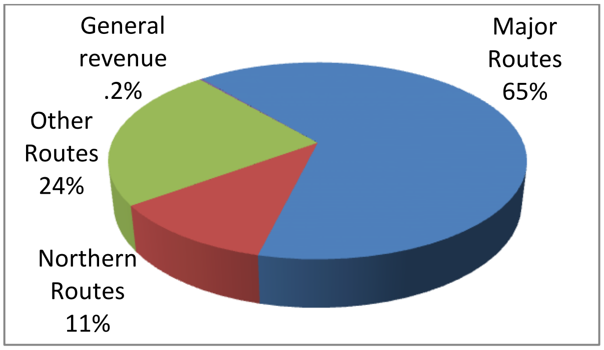
Training
As part of our Standardized Education and Assessment (SEA) program, we plan to roll out training for a total of 33 job categories, of which we've completed 16 to the end of December 2013 and expect to complete an additional 10 by the end of this fiscal year.

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 third quarter of fiscal 2014. As of December 31, 2013, 85% of deck officers in the fleet have received BOSS 1 training and 26% of deck officers in the fleet have received BOSS 2 training.

In the third quarter of fiscal 2014, two new one-day operational training programs were rolled out. The first was a workplace electrical safety program for our electricians and the second was a passenger safety management program for our employees at the terminals. We also completed a pilot training program for risk awareness which we plan to roll out this spring. This web-based training provides participants with a basic understanding of the principles of risk, how to identify hazards and control measures, and what action to take to reduce risk.

Collective agreement
On September 9, 2010, Mr. Vince Ready issued his arbitration award finding that certain shipboard positions were excluded from the bargaining unit by virtue of their managerial functions. The BC Ferry & Marine Workers' Union (the Union) applied for a review of this award; however, their application was rejected by the Labour Relations Board. The Union was unsuccessful in an application for judicial review and appealed to the British Columbia Court of Appeal. On November 20, 2013, the Court of Appeal dismissed the Union's appeal. The Union has now applied for leave to appeal to the Supreme Court of Canada.

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



In the nine months ended December 31, 2013, the greatest portion of our revenues (65%) was earned on our Major Routes. The revenue from the Northern Routes contributed 11% and Other Routes contributed 24%.

Selected operational statistics and total revenues for the three and nine months ended December 31, 2013 compared to the same periods in the prior year are shown in the tables below.

	Three months ended December 31		Nine months ended December 31	
Operational Statistics	**2013**	**2012**	**2013**	**2012**
Vehicle traffic	1,722,130	1,707,993	6,192,145	6,231,824
Passenger traffic	4,266,520	4,226,041	16,120,655	16,195,199
On-time performance	93.1%	92.7%	90.2%	90.7%
Number of round trips	20,746	20,808	63,703	63,899
Capacity provided (AEQs)	4,217,384	4,180,457	13,434,629	13,482,272
AEQs carried	1,953,270	1,937,416	7,011,145	7,038,055
Capacity utilization	46.3%	46.3%	52.2%	52.2%

In the three months ended December 31, 2013, vehicle traffic increased 0.8% (0.6% decrease year-to-date) and passenger traffic increased 1.0% (0.5% decrease year-to-date) compared to the same periods in the prior year. Both non-commercial and commercial traffic increased in the third quarter. 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.

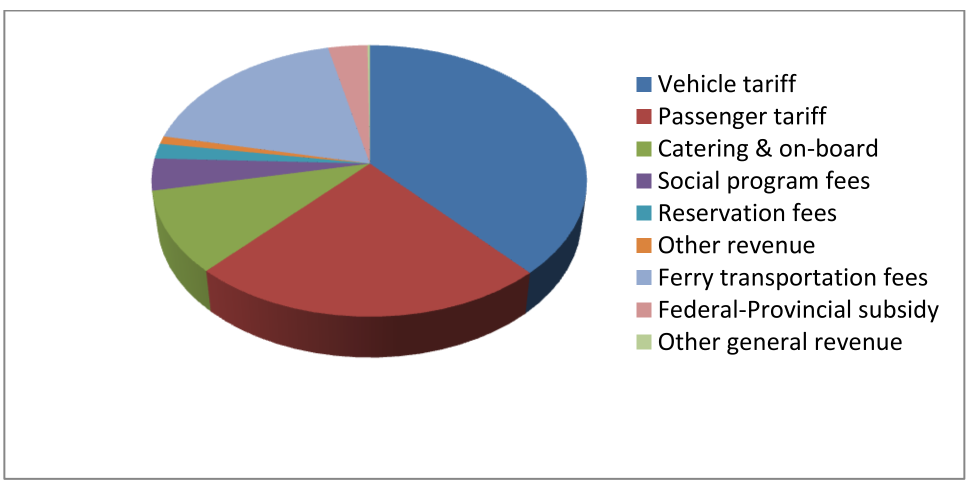
On-time performance on the Major and Other Routes is defined as the percentage of our sailings departing within 10 minutes of the scheduled time. On-time performance on the Northern Routes is defined as the percentage of our sailings arriving within 10 minutes of the scheduled time. On-time performance 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 in the three months ended December 31, 2013 remained at the same level as the same period in the prior year mainly as a result of the higher number of AEQs carried in the current quarter, which offset the higher capacity provided. Utilization year-to-date remained at the same level as a result of reduced capacity provided in the current year, which offset the lower number of AEQs carried.

Revenue ($ millions)	**Three months ended December 31**			**Nine months ended December 31**		
	2013	**2012**	**Increase (Decrease)**	**2013**	**2012**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	66.2	63.4	2.8	247.4	234.9	12.5
Passenger tariff	39.0	36.9	2.1	153.3	145.6	7.7
Fuel surcharges	-	1.4	(1.4)	-	11.5	(11.5)
Catering & on-board	16.8	16.0	0.8	63.5	61.2	2.3
Social program fees	7.3	6.9	0.4	24.5	22.6	1.9
Reservation fees	3.0	2.7	0.3	11.7	11.0	0.7
Other revenue	1.7	1.5	0.2	6.0	5.4	0.6
Total Direct Route Revenue	134.0	128.8	5.2	506.4	492.2	14.2
Indirect Route Revenue						
Ferry transportation fees	33.3	33.4	(0.1)	117.3	121.3	(4.0)
Federal-Provincial subsidy	7.1	7.1	-	21.3	21.1	0.2
Total Route Revenue	174.4	169.3	5.1	645.0	634.6	10.4
Other general revenue	0.4	0.3	0.1	1.3	1.2	0.1
Total Revenue	174.8	169.6	5.2	646.3	635.8	10.5



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 nine months ended December 31, 2013. From April 1, 2012 through November 30, 2012, fuel surcharges were in place. From April 1, 2012 through July 20, 2012, 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. As a result of declining fuel prices, all of these surcharges were reduced to 2.0% on July 20, 2012 and, on November 30, 2012, all surcharges were removed. No surcharges or rebates were in place on our Northern Routes. Due to the high cost of diesel fuel, on January 17, 2014 we implemented fuel surcharges of 3.5% on all of our routes with the exception of the Northern Routes. For the purpose of rate regulation, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

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 nine months ended December 31, 2013 and 2012 for the Major, Northern and Other Routes are discussed separately below.

Major Routes

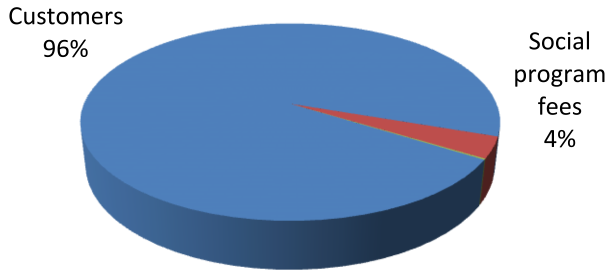
Our Major Routes consist of three regulated routes connecting Greater Vancouver with mid and southern Vancouver Island and our regulated route connecting Horseshoe Bay and Langdale. These are our four busiest routes, carrying 60% of our vehicle traffic and 65% of our passenger traffic during the nine months ended December 31, 2013 and 2012.

	Three months ended December 31		Nine months ended December 31	
Operational Statistics	**2013**	**2012**	**2013**	**2012**
Vehicle traffic	1,018,788	1,001,913	3,703,203	3,726,766
Passenger traffic	2,730,630	2,682,000	10,438,814	10,461,384
On-time performance	85.9%	82.4%	81.0%	83.7%
Number of round trips	2,963	2,931	9,746	9,792
Capacity provided (AEQs)	2,129,280	2,107,696	7,000,704	7,032,936
AEQs carried	1,203,248	1,184,265	4,355,214	4,365,727
Capacity utilization	56.5%	56.2%	62.2%	62.1%

In the three months ended December 31, 2013, vehicle traffic increased 1.7% (0.6% decrease year-to-date) and passenger traffic increased 1.8% (0.2% decrease year-to-date) compared to the same periods in the prior year. Both non-commercial and commercial traffic increased in the three months ended December 31, 2013. 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 30, 2012 included the entire Easter holiday weekend. In the three months ended December 31, 2013 we experienced a 15% (17% year-to-date) 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.

In the three months ended December 31, 2013 there were a higher number of round trips and on-time performance improved compared to the same period in the prior year mainly as a result of fewer cancellations and delays caused by adverse weather conditions. On-time performance year-to-date was adversely affected by significant maintenance activities in the first two quarters 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 months ended December 31, 2013 was marginally higher compared to the same period in the prior year as a result of a higher number of AEQs carried in the current year, mainly offset by increased capacity from additional round trips provided. Utilization year-to-date remained at a similar level mainly as a result of reduced total capacity in the current year, which offset the lower number of AEQs carried to the end of December 2013.



In the nine months ended December 31, 2013, revenue from our Major Routes consisted of 96% from customers and 4% from the Province.

Major Routes cont'd

Revenue ($ thousands)	Three months ended December 31			Nine months ended December 31		
	2013	**2012**	**Increase (Decrease)**	**2013**	**2012**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	56,145	53,477	2,668	205,795	194,425	11,370
Passenger tariff	32,411	30,481	1,930	123,527	116,120	7,407
Fuel surcharges	-	1,112	(1,112)	-	9,479	(9,479)
Catering & on-board	15,574	14,819	755	57,196	55,056	2,140
Social program fees	4,460	4,209	251	15,113	13,814	1,299
Reservation fees	2,930	2,678	252	11,442	10,799	643
Parking	961	884	77	3,318	2,992	326
Other revenue	691	667	24	2,396	2,238	158
Total Direct Route Revenue	113,172	108,327	4,845	418,787	404,923	13,864
Indirect Route Revenue						
Ferry transportation fees	261	867	(606)	784	2,620	(1,836)
Federal-Provincial subsidy	-	-	-	-	-	-
Total Route Revenue	113,433	109,194	4,239	419,571	407,543	12,028

In the three months ended December 31, 2013, average tariff revenue per vehicle increased $1.74 or 3.3% ($3.40 or 6.5% year-to-date) compared to the same periods in the prior year. Average tariff revenue per passenger increased $0.50 or 4.4% ($0.73 or 6.6% 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. In the quarter, both traffic and average fares were higher, resulting in a tariff revenue increase of $4.6 million. Year-to-date, higher average fares more than offset the traffic decline, resulting in an increase in tariff revenue of $18.8 million.

No fuel surcharges were collected in the nine months ended December 31, 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 our three other Major Routes connecting Greater Vancouver with mid and southern Vancouver Island until July 20, 2012. At that time, due to declining fuel prices, all surcharges were reduced to 2.0% and, on November 30, 2012, all surcharges were eliminated. On January 17, 2014, due to the high cost of diesel fuel, we implemented fuel surcharges of 3.5% on our Major Routes. 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 December 31, 2013, catering and on-board sales increased 5.1% compared to the same period in the prior year as a result of higher passenger traffic and higher average sales per passenger. Year-to-date, catering and on-board sales increased 3.9% compared to the same period in the prior year mainly as a result of higher average sales per passenger. Sales of quality apparel continue to grow, increasing a total of 13.6% in the three months ended December 31, 2013 (17.9% year-to-date) compared to the same periods in the prior year. Sales of books increased 16.0% in the quarter, however, year-to-date they are following industry trends and are declining, together with sales of magazines and comics.

Major Routes cont'd

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, a greater number of seniors travelling, and higher usage of other programs.

Reservation fees increased primarily as a result of higher usage and higher traffic in the quarter. Higher usage year-to-date was partially offset by lower traffic levels.

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

Other revenue increased 3.6% in the quarter (7.1% year-to-date). The increase is mainly as a result of an increase in hostling[1] fees from our drop trailer service and additional retail space rentals.

Ferry transportation fees decreased $0.6 million ($1.8 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. For the purpose of rate regulation, 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.

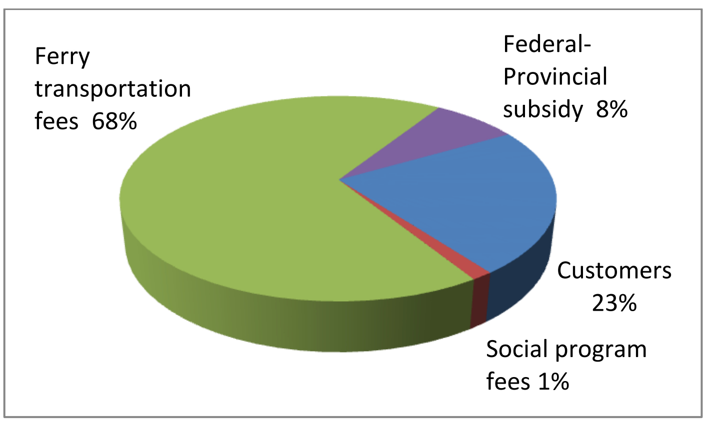
Northern Routes

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 December 31		Nine months ended December 31	
	2013	2012	2013	2012
Vehicle traffic	4,676	4,408	24,367	23,991
Passenger traffic	12,268	11,570	70,129	70,237
On-time performance	88.8%	89.8%	92.2%	94.0%
Number of round trips	59	56	292	288.5
Capacity provided (AEQs)	16,556	15,808	69,948	69,073
AEQs carried	5,744	5,485	29,216	28,895
Capacity utilization	34.7%	34.7%	41.8%	41.8%

In the three months ended December 31, 2013, vehicle traffic increased 6.1% (1.6% year-to-date) and passenger traffic increased 6.0% (0.2% decrease year-to-date) compared to the same periods in the prior year.

Utilization on these routes during the three and nine months ended December 31, 2013 is at the same level as the same periods in the prior year as a result of a higher number of AEQs carried in the current year, which offset the increased capacity from additional round trips provided.



In the nine months ended December 31, 2013, revenue from our Northern Routes consisted of 23% from customers and 77% from the Province (1% social program fees, 68% ferry transportation fees, and 8% from payments under the Federal-Provincial subsidy agreement).

Northern Routes cont'd

Revenue ($ thousands)	**Three months ended December 31**			**Nine months ended December 31**		
	2013	**2012**	**Increase (Decrease)**	**2013**	**2012**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	1,048	1,000	48	7,165	6,932	233
Passenger tariff	651	598	53	6,305	6,374	(69)
Catering & on-board	207	177	30	1,893	1,851	42
Social program fees	237	203	34	982	860	122
Stateroom rental	258	221	37	1,025	895	130
Hostling & other	51	57	(6)	193	170	23
Total Direct Route Revenue	2,452	2,256	196	17,563	17,082	481
Indirect Route Revenue						
Ferry transportation fees	10,051	9,518	533	48,895	48,764	131
Federal-Provincial subsidy	1,820	1,801	19	5,460	5,403	57
Total Route Revenue	14,323	13,575	748	71,918	71,249	669

In the three months ended December 31, 2013, average tariff revenue per vehicle decreased $2.74 or 1.2% ($5.10 or 1.8% increase year-to-date) compared to the same periods in the prior year. Average tariff revenue per passenger increased $1.38 or 2.7% ($0.84 or 0.9% decrease year-to-date). Average tariff revenues reflect the increases authorized by the Commissioner. The average tariff revenue also reflects changes in the proportionate amount of traffic on the shorter routes with lower fares versus the amount of traffic on the longer routes with higher fares. The changes in traffic levels and in average fares resulted in a total tariff revenue increase of $0.1 million ($0.2 million 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 increased 16.9% in the quarter compared to the same period in the prior year as a result of higher average sales per passenger and higher passenger traffic levels. Year-to-date, catering and on-board services increased 2.3% as a result of higher average sales per passenger, partially offset by lower passenger traffic levels.

Stateroom rental increased mainly due to higher usage.

Hostling and other revenues decreased marginally in the three months ended December 31, 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 $0.5 million in the quarter ($0.1 million year-to-date) due to (see "Outlook" below for more detail):

- $0.3 million ($0.6 million year-to-date) increase 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; and
- $0.5 million ($0.6 million year-to-date) increase 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); partially offset by:
- $0.3 million ($1.1 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

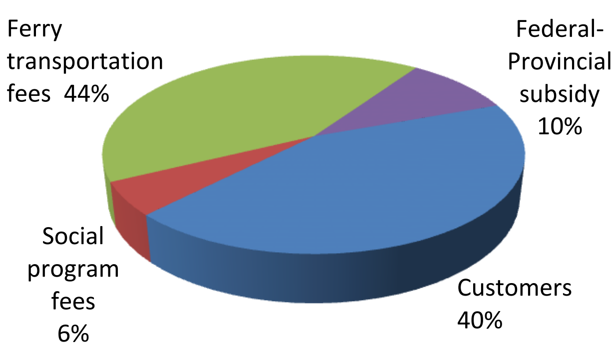
Our Other Routes consist of 18 regulated routes and eight small unregulated routes primarily serving the northern and southern Gulf Islands and the northern Sunshine Coast. One of the regulated routes and all of the unregulated routes are operated under contract by alternative service providers. We receive 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 December 31		Nine months ended December 31	
Operational Statistics[2]	**2013**	**2012**	**2013**	**2012**
Vehicle traffic	698,666	701,672	2,464,575	2,481,067
Passenger traffic	1,523,622	1,532,471	5,611,712	5,663,578
On-time performance	94.3%	94.3%	91.7%	91.8%
Number of round trips	17,724	17,821	53,665	53,818
Capacity provided (AEQs)	2,071,548	2,056,953	6,363,977	6,380,263
AEQs carried	744,278	747,666	2,626,715	2,643,433
Capacity utilization	35.9%	36.3%	41.3%	41.4%

In the three months ended December 31, 2013, vehicle traffic decreased 0.4% (0.7% year-to-date) and passenger traffic decreased 0.6% (0.9% year-to-date) compared to the same periods in the prior year. The year-to-date decreases in traffic reflect storm activity at the end of the second quarter and 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 30, 2012 included the entire Easter holiday weekend.

On-time performance during the three and nine months ended December 31, 2013 remained at a similar level as the same periods in the prior year. Year-to-date performance was impacted by significant upgrades at our Westview terminal, resulting in berth closures, and vessel substitution due to planned vessel maintenance, negatively impacting both arrivals and departures during the second quarter.

Utilization on these routes during the three months ended December 31, 2013 decreased compared to the same period in the prior year as a result of increased capacity provided in the current year, mainly due to vessel substitution, and the lower number of AEQs carried. Utilization year-to-date remained at a similar level as the same period in the prior year as a result of lower number of AEQs carried in the current year, mainly offset by reduced total capacity provided.



In the nine months ended December 31, 2013, revenue from our Other Routes consisted of 40% from customers and 60% from the Province (6% social program fees, 44% 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 December 31**			**Nine months ended December 31**		
	2013	**2012**	**Increase (Decrease)**	**2013**	**2012**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	8,989	8,881	108	34,443	33,537	906
Passenger tariff	5,963	5,837	126	23,516	23,132	384
Fuel surcharges	-	225	(225)	-	1,988	(1,988)
Social program fees	2,587	2,463	124	8,361	7,913	448
Catering & on-board	764	855	(91)	3,352	3,424	(72)
Reservation fees	42	37	5	186	178	8
Parking & other	19	28	(9)	82	82	-
Total Direct Route Revenue	18,364	18,326	38	69,940	70,254	(314)
Indirect Route Revenue						
Ferry transportation fees	23,047	22,956	91	67,688	69,874	(2,186)
Federal-Provincial subsidy	5,273	5,218	55	15,820	15,655	165
Total Route Revenue	46,684	46,500	184	153,448	155,783	(2,335)

In the three months ended December 31, 2013, average tariff revenue per vehicle increased $0.21 or 1.7% ($0.46 or 3.4% year-to-date) compared to the same periods in the prior year. Average tariff revenue per passenger increased $0.11 or 2.8% ($0.11 or 2.6% year-to-date). The increase in average fares, partially offset by the reduction in traffic, resulted in a total tariff revenue increase of $0.2 million ($1.3 million year-to-date).

No fuel surcharges were collected in the nine months ended December 31, 2013. In the prior year, surcharges of 5.0% were in place on most of our Other Routes until July 20, 2012. At that time, due to declining fuel prices, all surcharges were reduced to 2.0% and, on November 30, 2012, all surcharges were eliminated. On January 17, 2014, due to the high cost of diesel fuel, we implemented fuel surcharges of 3.5% on most of our Other Routes. For the purpose of rate regulation, 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, a greater number of seniors travelling and higher usage of MTAP and other programs.

Revenue from catering and on-board services decreased due to lower passenger traffic levels and lower average sales per passenger, largely as a result of vessel substitutions 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 in the quarter decreased mainly due to lower charter fees and lower retail sales allowances than the same period in the prior year. Year-to-date, higher charter fees and an increase in usage of our parking facilities are offset by lower retail sales allowances.

Ferry transportation fees increased $0.1 million in the quarter ($2.2 million decrease year-to-date) due to (see "Outlook" below for more detail):

- $2.0 million ($6.3 million year-to-date) reduction in ferry transportation fees received under the CFSC for the 18 regulated routes; mainly offset by:
- $2.1 million ($4.1 million year-to-date) increase 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 nine months ended December 31, 2013 and 2012 are summarized in the tables below:

Operating expenses ($ millions)	**Three months ended December 31**			**Nine months ended December 31**		
	2013	**2012**	**Increase (Decrease)**	**2013**	**2012**	**Increase (Decrease)**
Operations	106.2	101.4	4.8	345.1	333.7	11.4
Maintenance	17.4	20.8	(3.4)	45.2	49.6	(4.4)
Administration	7.4	7.2	0.2	21.9	21.5	0.4
Total operations, maintenance & administration	131.0	129.4	1.6	412.2	404.8	7.4
Cost of retail goods sold	6.9	6.5	0.4	25.3	24.1	1.2
Depreciation and amortization	33.2	33.5	(0.3)	101.6	101.9	(0.3)
Total operating expenses	171.1	169.4	1.7	539.1	530.8	8.3

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

The $4.8 million ($11.4 million year-to-date) increase in operations expenses consists mainly of increases in non-discretionary items as follows:

- $2.7 million increase in the quarter and year-to-date in fuel expense reflecting an increase of $2.5 million ($2.7 million year-to-date) primarily due to higher fuel prices. For purposes of rate regulation, $3.1 million in the quarter ($9.8 million year-to-date) of our fuel expense is recorded in deferred fuel cost accounts for future recovery. In fiscal 2013, $1.4 million ($8.3 million year-to-date) was recorded in deferred fuel cost accounts for future recovery (see "The Effect of Rate Regulation" above for detail);
- $2.0 million ($6.2 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; and
- $0.1 million ($2.5 million year-to-date) increase in several other operational areas, including credit card fees, data communications, materials & contracted services, and training related costs, other than wages.

The $3.4 million ($4.4 million year-to-date) decrease in maintenance costs reflects a $2.0 million ($1.7 million year-to-date) decrease in vessel maintenance as a result of variations in vessel refit scheduling and a $1.4 million ($2.7 million year-to-date) decrease in terminal maintenance.

The $0.2 million ($0.4 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 and 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 December 31**			**Nine months ended December 31**		
	2013	**2012**	**Increase (Decrease)**	**2013**	**2012**	**Increase (Decrease)**
Finance expenses						
Bond interest	15.5	15.9	(0.4)	48.0	47.7	0.3
KfW group (KfW) loans	1.9	2.1	(0.2)	5.8	6.3	(0.5)
Interest on finance lease	0.5	0.6	(0.1)	1.5	1.7	(0.2)
Short-term debt	0.1	0.1	-	0.5	0.3	0.2
Structured Financing Facility Program	-	-	-	-	(0.4)	0.4
Capitalized interest	(1.0)	(0.5)	(0.5)	(2.4)	(1.3)	(1.1)
Total finance expenses	17.0	18.2	(1.2)	53.4	54.3	(0.9)
Less: finance income	(1.1)	(0.8)	(0.3)	(2.6)	(2.0)	(0.6)
Net finance expenses	15.9	17.4	(1.5)	50.8	52.3	(1.5)
Loss on disposal of capital assets	0.1	-	0.1	0.1	0.1	-
Total net finance and other expenses	16.0	17.4	(1.4)	50.9	52.4	(1.5)

Net finance expenses decreased $1.5 million in the quarter and year-to-date due to:

- $0.5 million ($1.1 million year-to-date) increase in capitalized interest;
- $0.4 million decrease in bond interest in the quarter;
- $0.3 million ($0.6 million year-to-date) increase in finance income;
- $0.2 million ($0.5 million year-to-date) decrease in interest on KfW loans due to $9.0 million in principal repayments on the 2.95% per annum loan; and
- $0.1 million ($0.2 million year-to-date) decrease in interest on finance leases;

partially offset by:

- $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*;
- $0.3 million year-to-date increase in bond interest, reflecting the premium paid to redeem $140 million of Series 08-2 Bonds with an interest rate of 6.21% per annum, formerly due December 19, 2013, partially offset by interest savings. Due to this early redemption, we saved approximately $0.3 million in net interest costs in fiscal 2014 from what we would have incurred (see "Liquidity and Capital Resources" below for more detail); and
- $0.2 million year-to-date increase in short-term financing costs.

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 December 31, 2013, our unrestricted cash and cash equivalents and other short-term investments totalled $196 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 have saved approximately $0.3 million in net interest costs in fiscal 2014.

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% per annum, 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 December 31, 2013, 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 December 31, 2013, were “A” (DBRS) with a stable trend and “A+” (Standard & Poor’s) with a stable outlook. On January 24, 2014, Standard & Poor’s announced that, based on its decision to apply revised rating criteria, it expects to either raise or affirm the current rating within 90 days. Standard & Poor’s requested updated information related to financial projections and policy as well as management and governance.

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

Sources and uses of cash and cash equivalents for the nine months ended December 31, 2013 and 2012 are summarized in the table below:

	Nine months ended December 31		
($ millions)	**2013**	**2012**	**Increase (decrease)**
Cash and cash equivalents, beginning of period	36.6	7.7	28.9
Cash from operating activities:			
Net earnings	56.3	52.6	3.7
Items not affecting cash	151.6	158.1	(6.5)
Changes in non-cash operating working capital	(5.2)	(7.9)	2.7
Net interest paid	(53.0)	(56.3)	3.3
Cash generated by operating activities	149.7	146.5	3.2
Cash provided by financing activities	53.3	2.0	51.3
Cash used in investing activities	(139.8)	(123.8)	(16.0)
Net increase in cash and cash equivalents	63.2	24.7	38.5
Cash and cash equivalents, end of period	99.8	32.4	67.4

Cash generated by operating activities in the nine months ended December 31, 2013 was $3.2 million higher compared to the same period in the prior year mainly due to higher earnings, lower net interest paid and changes in non-cash operating working capital, partially offset by items not affecting cash.

Cash provided by financing activities in the nine months ended December 31, 2013 was $53.3 million due to proceeds of $200 million from our October 2013 bond issuance, partially offset by the redemption of our $140 million bond series, $4.5 million in other long-term debt repayments, $1.4 million in bond financing costs and $0.8 million in repayments of finance lease obligations. In the same period of the prior year, financing activities provided $2.0 million of cash as we received $25.0 million contributed surplus from the Province and repaid $17.7 million of short-term debt, $4.5 million of long-term debt and $0.7 million in finance lease obligations.

Cash used in investing activities in the nine months ended December 31, 2013 was $16.0 million higher than during the same period in the prior year mainly due to $14.0 million more cash used for capital expenditures and an increase of $1.7 million in purchases of short-term investments. (See "Investing in Our Capital Assets" below for detail of significant capital expenditures.)

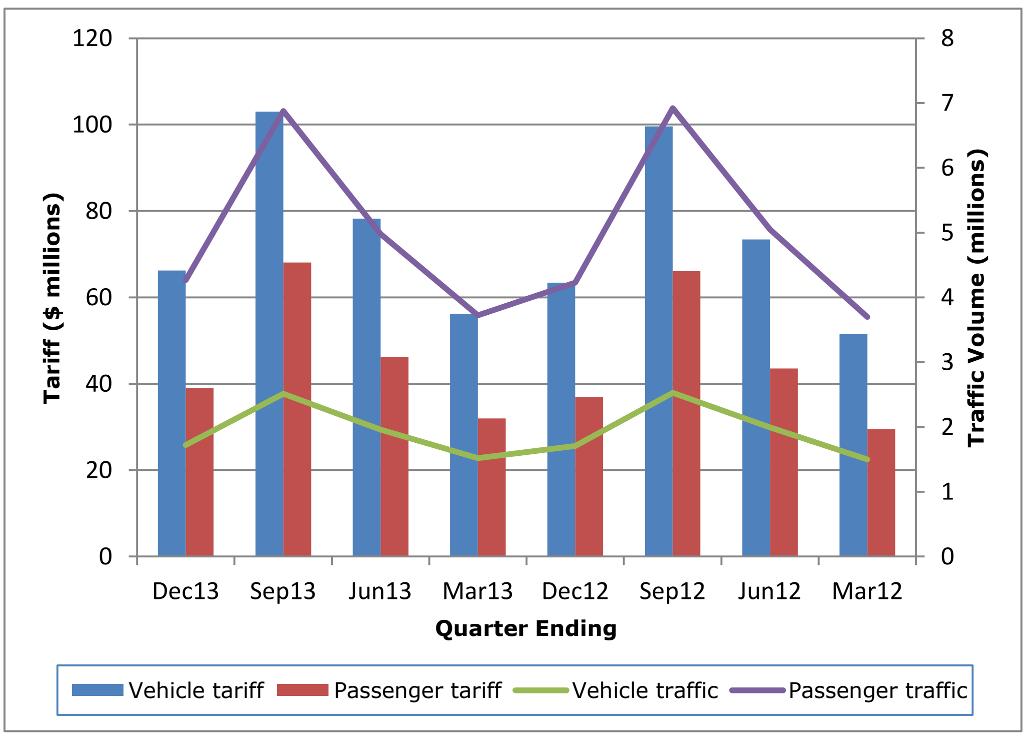
SUMMARY OF QUARTERLY RESULTS

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

	Quarter Ended (unaudited)							
($ millions)	**Dec 13**	**Sep 13**	**Jun 13**	**Mar 13**	**Dec 12**	**Sep 12**	**Jun 12**	**Mar 12**
Total revenue	174.8	271.5	200.0	150.5	169.6	268.6	197.7	145.0
Operating profit (loss)	3.7	82.3	21.3	(20.2)	0.2	84.1	20.7	(24.6)
Net (loss) earnings	(12.3)	64.3	4.3	(37.1)	(17.2)	66.5	3.3	(42.1)
Other comprehensive income	-	0.1	-	1.1	-	-	-	2.2
Total comprehensive (loss) income	(12.3)	64.4	4.3	(36.0)	(17.2)	66.5	3.3	(39.9)

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:



Capital Expenditures
Capital expenditures in the three and nine months ended December 31, 2013 totalled $42.4 million and $89.1 million, respectively.

($ millions)	December 31, 2013	
	3 Months	**9 Months**
Vessel upgrades and modifications	27.8	50.1
Terminal marine structures	9.7	26.7
Information technology	4.3	10.2
Terminal and building upgrades and equipment	0.6	2.1
Total capital expenditures	42.4	89.1

Vessel Upgrades and Modifications
Capital expenditures for vessel upgrades and vessel modifications in the three and nine months ended December 31, 2013 included the following:

($ millions)	December 31, 2013	
	3 Months	**9 Months**
Major overhauls and inspections	18.8	27.3
Tachek life extension	4.0	13.6
Kwuna three-quarter life upgrade	2.4	2.8
C-Class controllable pitch propeller and tail shaft rebuilds and monitoring system	0.5	1.2
Electrical and navigational equipment upgrades	0.2	1.1
Other projects	1.9	4.1
	27.8	50.1

Major overhauls and inspections completed in the nine months ended December 31, 2013 or currently underway include:

- $3.8 million on the *Queen of Cowichan*;
- $2.9 million on the *Northern Adventure*;
- $2.8 million on the *Queen of New Westminster*;
- $2.7 million on the *Island Sky;*
- $2.7 million on the *Kwuna*;
- $2.1 million on the *Coastal Celebration*;
- $1.9 million on the *Queen of Burnaby*;
- $1.8 million on the *Skeena Queen*;
- $1.6 million on the *Powell River Queen*;
- $1.4 million on the *Mayne Queen*;
- $1.1 million on the *Quinsam*;
- $1.1 million on the *Bowen Queen*;
- $0.7 million on the *Queen of Chilliwack;* and
- $0.7 million on several other vessels.

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 included new engines and shafting, new generators, and upgrades to lifesaving equipment and passenger facilities. The vessel returned to service in January 2014.

A $3 million project for a three-quarter life upgrade on the *Kwuna* is now complete and the vessel returned to service at the end of December 2013. The upgrade included 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.

Several projects impacting our C-Class vessels (the *Queen of Cowichan, Queen of Coquitlam, Queen of Alberni, Queen of Surrey*, and the *Queen of Oak Bay)* either completed in the third quarter of fiscal 2014 or are currently underway. A $2 million project to improve the C-Class vessel propulsion systems by installing two sets of controllable pitch propeller hub systems on the *Queen of Coquitlam* and the *Queen of Cowichan* is now complete. A project to install a vibration monitoring system of shaft bearings on all five C-Class vessels will reduce the operational risk of failures to the propulsion system and provide cost savings by removing the routine requirement to strip bearings for survey at refit. This project is expected to complete by the end of fiscal 2014. A project to rebuild two spare tail shafts in readiness for potential use in upcoming refits is expected to be complete by the end of the first quarter of fiscal 2015.

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 will take us further towards bridge standardization.

Other ongoing projects include early costs of the mid-life upgrades on the *Queen of Capilano* and the *Spirit of Vancouver Island* 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 nine months ending December 31, 2013 included the following:

($ millions)		December 31, 2013	
Terminal	**Description**	**3 Months**	**9 Months**
Westview	Replacement of trestle, ramp, apron and towers	2.9	9.6
Little River	Replacement of ramp, tower, wingwall and dolphin	2.2	5.8
McLoughlin Bay	Berth modifications	3.2	3.9
Alert Bay	Replacement of wingwalls, towers, ramp and aprons	-	2.5
Denman Island and Buckley Bay	Modifications to accommodate the new cable ferry	0.1	1.3
Horseshoe Bay	Transfer deck life-extension	-	0.8
Various	Install tie-up winches	0.1	0.6
Port McNeill	Replacement of trestle, ramp, apron and towers	0.3	0.5
Various	Other projects	0.9	1.8
		9.7	26.7

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; replacement of the ramp, ramp abutment, apron and towers with active lift hydraulics; and replacement of the waiting shelter. This project is expected to be complete by the end of fiscal 2014.

At Little River terminal, work continues on a $10 million project to replace the ramp, ramp abutment and towers with active lift hydraulics and replace the wingwalls and dolphin. This project is expected to be complete by the end of fiscal 2014.

At McLoughlin Bay, the $9 million project for berth modifications includes installation of three pontoon sections and modification of the berth to improve ship-to-shore tie-up. This project is expected to be complete by the end of the first quarter of fiscal 2015.

At Alert Bay terminal, an $8 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 continued during the third quarter on modifications at Denman Island and Buckley Bay terminals as part of the project for our new cable ferry service. On February 20, 2014, in response to our December 20, 2013 application, we received a decision from the Commissioner confirming that the expenditures required to implement the cable ferry system are reasonable and prudent. In conjunction with this decision, the Commissioner included reasonable conditions which we are confident we will be able to meet. 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 $2 million project to extend the life of the transfer deck to provide an additional seven years of useful life was completed in the third quarter of fiscal 2014.

The installation of tie-up winches at Langdale, Horseshoe Bay and Tsawwassen terminals has been completed and final test fitting of vessels at Tsawwassen terminal is scheduled to take place by the end of fiscal 2014. The project is expected to total $1.9 million, of which $1.8 million has been incurred to the end of December 2013.

At Port McNeill terminal, a $13 million project to replace the trestle, wingwalls, ramp, apron, towers, and dolphin and reposition the new ramp to accommodate all minor and intermediate vessels is underway. This project is expected to be complete by the end of the third quarter of fiscal 2015.

Other projects completed include a $0.6 million project to replace the double-sided floating lead at Village Bay terminal and a $0.4 million project at Crofton terminal to upgrade the ramp and life extend the starboard wingwall and trestle. Other projects in progress include a $1 million project for dredging at our Richmond maintenance facility which is expected to be complete by the end of fiscal 2014.

Information Technology
Capital expenditures for information technology in the three and nine months ending December 31, 2013 included the following:

($ millions)	**December 31, 2013**	
	3 Months	**9 Months**
Customer service program	2.4	6.0
Payroll system replacement	0.8	1.9
Computer hardware upgrades	0.5	1.1
Infrastructure relocation program	0.4	0.7
Other projects	0.2	0.5
	4.3	10.2

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. The main elements of this multi-year program will be implemented in stages starting in fiscal 2015, and are 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 $7 million in software and hardware is currently in service, including software to allow customers to book their travel on-line.

Our payroll system replacement initiative will replace both our payroll and labour distribution systems to provide added reliability and significant processing efficiencies and flexibility. It is expected to be complete before 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.

The 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 secondary 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.

Projects completed to the end of December 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 nine months ending December 31, 2013 included the following:

($ millions)	**December 31, 2013**	
	3 Months	**9 Months**
Vehicles and other equipment	0.2	0.8
Terminal seismic upgrades	0.3	0.5
Building improvements at several terminals	0.1	0.5
Other terminal projects	-	0.3
	0.6	2.1

Vehicles include eight 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, forklifts 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. Fiscal 2013 earnings included $11.5 million in fuel surcharges while in fiscal 2014, we expect fuel surcharges to be significantly lower. Excluding fuel surcharges, we expect our fiscal 2014 net earnings to be at a similar level to the prior fiscal year.

Traffic and tariff revenue
In the three months ended December 31, 2013, we experienced a 0.8% increase (0.6% decrease year-to-date) in vehicle traffic and a 1.0% increase (0.5% decrease year-to-date) in passenger traffic compared to the same periods in the prior year. Both non-commercial and commercial traffic increased in the third quarter. In the nine months ended December 31, 2013, our commercial traffic has increased while non-commercial traffic levels have declined somewhat. Traffic levels in the quarter and year-to-date are discussed above in "Financial and Operational Overview". We have terminal upgrades planned that are expected to cause a temporary reduction in traffic on some of our routes in the fourth quarter of this fiscal year. We expect both annual vehicle and passenger traffic to be at a similar level as the prior year. Tariff revenue is expected to be higher mainly as a result of the April 1, 2013 tariff increase.

Catering and on-board revenue
In the nine months ended December 31, 2013, compared to the same period in the prior year, catering and on-board revenues increased mainly 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.

Ferry transportation fees and service level adjustments
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. The plan includes the elimination of approximately 6,900 round trips over 15 routes, including a significant adjustment in how summer service is provided to mid-coast destinations. 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. The Province also announced a plan to reduce the current 100% passenger fare discount for BC seniors travelling Monday to Thursday to 50% on Major and Other Routes as of April 1, 2014. There is to be no change to the current 33% discount offered to seniors on the Northern Routes. The Province plans to redirect the annual savings of approximately $6 million to reduce the pressure for future fare and price cap increases. The Province also proposed 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 may also reduce the pressure for future fare and price cap increases.

The Province conducted another round of community engagement to allow public comment on these planned changes and on February 5, 2014, the Province released a summary report on the engagement and a final decision regarding service level reductions. The Province confirmed the implementation of service reductions of $14 million beginning this spring to better align service levels to demand on our Northern and Other Routes. We will be engaging with the affected communities regarding sailing schedule options so that finalized schedules can be implemented by April 28, 2014. The Province also confirmed that $4.9 million in savings through schedule optimization on the three Major Routes connecting Greater Vancouver with mid and southern Vancouver Island was to be achieved by April 2016. In addition, the Province confirmed its plan to reduce the current 100% passenger fare discount for BC seniors travelling Monday to Thursday to 50% on Major and Other Routes as of April 1, 2014 and proposed the implementation of a gaming pilot project on one of our Major Routes.

We will continue to explore strategies to create an affordable and sustainable ferry system beyond 2016, including standardized 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 reductions of discretionary expenditures and the return to PST and GST from HST. We continue to manage our costs prudently 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.

The new cable ferry, for service on our Buckley Bay to Denman Island route, 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 February 20, 2014, in response to our December 20, 2013 application, we received a decision from the Commissioner confirming that the expenditures required to implement the cable ferry system are reasonable and prudent. In conjunction with this decision, the Commissioner included reasonable conditions which we are confident we will be able to meet. For construction of the cable ferry, a Request for Proposal (RFP) was issued in September 2013 to three pre-qualified shipyards, two of which are Canadian. Proposals were evaluated and execution of a shipyard contract with the selected proponent is underway. For terminal construction, a RFP for concrete pontoons closed in January 2014 and a RFP for terminal upgrades and berth infrastructure closed in February 2014. Responses will be reviewed and construction contracts will be executed with the selected proponent(s). The new 50-car cable ferry is expected to be in service by the summer of 2015.

In December 2013, we issued an RFP to five pre-qualified shipyards, including one Canadian proponent, to participate further in our formal procurement process to design and build 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. The RFP stipulates that these three vessels be designed to operate as dual-fuel capable, so they can run on LNG or marine diesel fuel. We expect to award a contract for this project in the spring of 2014. The two 145 AEQ vessels are expected to enter service in 2016 and the third vessel is expected to join the fleet in 2017. These vessels will set a new standard of efficiency with standardized bridges, engine rooms and lifesaving equipment moving us to a higher safety standard and improving interoperability. We are pursuing funding under incentive programs to help offset any incremental capital costs associated with the use of LNG.

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 nine months ended December 31, 2013. Our 2013 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/investors/financial_reports.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 nine months ended December 31, 2013. Our 2013 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/investors/financial_reports.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 December 31, 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 nine months ended December 31, 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/investors/financial_reports.html.

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

International Accounting Standard (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 December 31, 2013 consolidated financial statements.

IFRS 14 *Regulatory Deferral Accounts* was issued January 30, 2014. As a result, first-time adopters of IFRS will be permitted to continue to recognize amounts related to rate regulation in accordance with their previous GAAP requirements. This standard is not applicable to those entities that have already transitioned to IFRS, as we have.

Future Accounting Changes
The following is a discussion of accounting changes that will be effective for us April 1, 2014:

International Financial Reporting Interpretations Committee (IFRIC) 21 *Levies* provides guidance on when to recognize a liability for a levy imposed by a government. The IFRIC is effective for us for annual periods commencing April 1, 2014 and is to be applied retrospectively. We do not expect the amendments to have a significant impact on our annual financial statements.

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

IFRS 9 *Financial Instruments* 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.

In November 2013, the International Accounting Standards Board issued amendments to IFRS 9. The amendments include changes which will align hedge accounting more closely with risk management. Although the amendments do not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness, more hedging strategies used for risk management will qualify for hedge accounting.

The amendments also remove the mandatory January 1, 2015 effective date for adoption of IFRS 9. The new mandatory effective date will be determined once the classification and measurement and impairment phases of IFRS 9 are finalized. The amended standard is available for early adoption.

We do not expect the application of IFRS 9 *Financial Instruments,* as amended, to have any impact on our consolidated financial statements and are considering the timing of its adoption.

FORWARD LOOKING STATEMENTS

This Management's Discussion and Analysis contains certain "forward looking statements". These statements relate to future events or future performance and reflect management's expectations regarding our growth, results of operations, performance, business prospects and opportunities and industry performance and trends. They reflect management's current internal projections, expectations or beliefs and are based on information currently available to management. Some of the market conditions and factors that have been considered in formulating the assumptions upon which forward looking statements are based include traffic, the Canadian Dollar relative to the US Dollar, fuel costs, construction costs, the state of the local economy, fluctuating financial markets, demographics, tax changes, and the requirements of the CFSC.

Forward looking statements included in this document include statements with respect to: economic conditions, traffic levels, tariff revenue, fuel surcharges, and fiscal 2014 net earnings; 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, our intention to refinance bonds maturing in May 2014, how the net proceeds from the October 25, 2013 bond issuance will be used, and our Standard and Poor's credit rating; the additional payments to be received from the Province over the following three fiscal years, the Province's service level reduction plan, and strategies to create an affordable and sustainable ferry system beyond 2016; and the impact of IFRIC 21 and IFRS 9 on our financial statements. 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.