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

For the fiscal year ended
March 31, 2014

Dated June 20, 2014

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BCFerries

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The following is our discussion and analysis of the financial condition and financial performance for British Columbia Ferry Services Inc. (BC Ferries) as of June 20, 2014. This discussion and analysis should be read in conjunction with our audited consolidated financial statements and related notes for the years ended March 31, 2014 (fiscal 2014) and March 31, 2013 (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. In fiscal 2014, we provided 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 services on other remote routes through contracts with independent operators.

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

We provide a wide range of ferry services for our customers. During the year ended March 31, 2014, we provided over 183,000 sailings, carrying 19.7 million passengers and 7.6 million vehicles. We experienced a 1.3% decline in vehicle traffic and a 1.1% decline in passenger traffic in fiscal 2014 compared to the prior year. However, we believe that after adjusting for the timing of the Easter holiday, fiscal 2014 traffic levels were generally flat compared to fiscal 2013. For a discussion of our traffic levels see "Financial and Operational Overview" and "Outlook – Traffic Levels" below.

Significant events during or subsequent to fiscal 2014 include the following:

- On July 24, 2013, we completed the redemption of all $140 million of our 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 from cash on hand and $88 million in draws on our credit facility. Due to this early redemption, we 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 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 were used to repay indebtedness under our credit facility, fund the debt service reserve related to these bonds, and will partially fund capital expenditures, and provide funding for general corporate purposes. These bonds were rated "A" (DBRS) and "A+" Standard & Poor's (S&P).

- 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 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 proposed expenditures to implement the cable ferry system on the route connecting Buckley Bay and Denman Island are reasonable and prudent. This decision included reasonable conditions which we are confident we will be able to meet. (See "Outlook – Asset Renewal Program" below for more detail.)

- On February 26, 2014, we awarded Seaspan's Vancouver Shipyards of North Vancouver a $15 million contract for the construction of a new cable ferry to service Buckley Bay – Denman Island and on March 19, 2014, we announced the award of contracts totalling $15 million for construction of the Buckley Bay and Denman West cable ferry berths. These contracts include an award to Vancouver Pile Driving Ltd for supply of two concrete floating pontoons and an award to Ruskin Construction Ltd. of Victoria for construction of two berths, expansion of Denman West holding compound and all associated upland development. (See "Outlook - Asset Renewal Program" below for more detail.)

- On April 1, 2014, we implemented average tariff increases in accordance with the Commissioner's Order 12-02 dated September 30, 2012. Tariff increases were 4.2% on average on our Major and regulated Other Routes. On the Northern Routes, we increased fares by less than 2% on average and eliminated the incremental tariff for over-height vehicles. These increases are directly associated with increased operating costs, notably fuel, capital replacement and labour.

- On April 28, 2014, 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 4.289% per annum, payable semi-annually. The net proceeds of this new issue, together with additional cash on hand, were used to repay our $250 million bond Series 04-1, which matured on May 27, 2014, and to fund the debt service reserve related to these bonds. These bonds were rated "A" (DBRS) and "AA-" (S&P). We secured a favourable interest rate by entering into interest rate hedges. The effective rate of this issue, net of hedging, is 4.5%, the lowest effective bond interest rate in the 11 year history of our company.

- On April 28, 2014, after six weeks of community consultation, feedback and further analysis of schedule refinement options, we implemented new schedules for the Northern and Other Routes to achieve a net savings of $14 million over the remainder of performance term three (PT3), which ends March 31, 2016. These new schedules relate to the service reductions outlined by the Province to better align service levels to demand, and to ensure the coastal ferry system is affordable, efficient and sustainable. In accordance with the Province's decision, we also implemented a reduction of the 100% passenger fare discount for BC seniors travelling Monday to Thursday to 50% on the Major and Other Routes effective April 1, 2014. (See "Corporate Structure – Economic Regulatory Environment" below for more detail.)

Coastal Ferry Services Contract

We operate ferry services under a regulatory regime established by the *Coastal Ferry Act* (the Act), and under the terms set out in the Coastal Ferry Services Contract (CFSC) between BC Ferries and the Province. This 60-year services contract with the Province, which commenced April 1, 2003, stipulates, among other things, the number of round trips that must be provided for each regulated ferry service route in exchange for specified fees (ferry transportation fees). The CFSC has been amended from time to time. (See discussion below).

Under the terms of the CFSC, we also receive an annual amount from the Province based on its agreement with the Government of Canada to fulfill the obligation of providing ferry services to coastal British Columbia. The amount of this payment is adjusted annually based on the Consumer Price Index (CPI) (Vancouver).

Economic Regulatory Environment

The office of the Commissioner was created under the Act, enacted by the Province on April 1, 2003. The Commissioner establishes price caps for designated ferry route groups for the purpose of regulating our tariffs. The Commissioner is also responsible for regulating the reduction of service, discontinuance of routes and certain other matters.

Bill 20

On June 24, 2010, the Province enacted *Miscellaneous Statutes Amendment Act (No. 3), 2010 (*Bill 20), amending several statutes including the Act. The amendments responded to the Comptroller General's Report on Review of Transportation Governance Models released November 6, 2009 and included changes to the governance and regulatory framework within which we operate.

Among other things, Bill 20 amendments to the Act changed the mandate of the B.C. Ferry Authority (the Authority) to include: responsibility for the compensation plans of our directors and certain executive officers, such compensation plans to be comparable to public sector organizations; a requirement that a director of the Authority cannot also be a director of BC Ferries; and the subjection of the records of the Authority and BC Ferries to the *Freedom of Information and Protection of Privacy Act*.

The amendments also expanded the regulatory responsibilities of the Commissioner to include: consideration of the interests of ferry users; regulation of our reservation fees; approval and public disclosure of our process for handling customer complaints; and review and public disclosure of our ten year capital plan, our plan for improving efficiency in the next performance term, and our methodology for allocating costs among the regulated routes. These amendments also broadened the Commissioner's role in regulating ferry transportation services where the Commissioner determines that we have an unfair competitive advantage. The amendments have also modified the process by which the Commissioner regulates our activities in seeking additional or alternative service providers on our regulated routes and require the Commissioner to issue an opinion on our performance and that of the Authority in carrying out our respective legislated responsibilities, as well as our performance in relation to the CFSC.

PT2 price cap increase

On April 1, 2011, during the final year of PT2, the price cap authorized by the Commissioner increased by 2.7% plus 0.49 times the latest reported annual change in the CPI (British Columbia) on the three Major Routes connecting Metro Vancouver with mid and southern Vancouver Island and 5.7% plus 0.73 times the change in the CPI (British Columbia) on all other regulated routes. This translated into a price cap increase of 3.38% on those three Major Routes and 6.71% on all other regulated routes. These price cap increases reflected a change in the CPI (British Columbia) of 1.39% applied April 1, 2011.

PT3 preliminary price cap increases

In March 2011, the Commissioner set preliminary price cap increases for each of the four years of PT3 of 4.15% on the three Major Routes and 8.23% on all other regulated routes, effective April 1, 2012. In making these determinations, the Commissioner excluded certain forecasted costs and incorporated a productivity challenge effectively further reducing our allowed costs.

Bill 14

On June 2, 2011, the *Coastal Ferry Amendment Act*, *2011* (Bill 14) was enacted. Effective April 1, 2012, for the first year of PT3, Bill 14 established a price cap increase for each route group of 4.15% from the weighted average of the tariffs in place at March 31, 2012 as established by the Commissioner. The Province agreed to compensate us for the reduction in the price cap set forth in the Commissioner's preliminary price cap order. The value of this price cap change was $11.5 million, which the Province agreed to provide as part of the $21.5 million increase in transportation fees for fiscal 2013 detailed below. In response to the price cap increases, we implemented tariff increases up to the new levels authorized. Bill 14 also provided that the Commissioner establish price caps for the balance of PT3.

Bill 14 also provided the Commissioner with the mandate to conduct a review of the Act before issuance of his final decision on price caps for the balance of PT3.

Commissioner's review of the Act

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

The report states:

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

The Commissioner's report made 24 substantive recommendations covering a wide range of ferry related issues and is available on the Commissioner's website at www.bcferrycommission.com.

Bill 47

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

- Allowing cross subsidization from the Major Routes to other routes;
- Changing the primary responsibility of the Commissioner from priority placed on the financial sustainability of the ferry operations to responsibility to protect the interests of ferry users, the interests of taxpayers, and the financial sustainability of the ferry operator;

- Expanding the Commissioner's authority and responsibilities, to include:
    - The authority to permanently reduce service in a manner and to a level consistent with the CFSC;
    - The authority to order a temporary or permanent service reduction and/or deferral of a planned capital expenditure in response to an extraordinary situation, in addition to or instead of an approval of extraordinary price cap increases;
    - The ability to require us to seek the Commissioner's approval in advance of making certain capital expenditures;
    - The responsibility to set price caps sufficient to enable us to meet our debt obligations and maintain access to borrowing rates that in the opinion of the Commissioner are reasonable;
    - Specific legislative authority to establish the deferred fuel cost accounts and the terms and conditions for their use, including fuel surcharges or rebates; and
    - The authority to conduct routine performance reviews and to require us to review our policies and undertake public consultation.

Ferry transportation fees

Together with the introduction of amendments to the Act contained in Bill 47, the Province announced additional payments totalling $79.5 million in order to reduce the pressure for future fare and price cap increases. The first payment of $25.0 million, approved on March 30, 2012, was received on April 20, 2012 as a contribution to our equity, leaving a balance of $54.5 million to be received throughout PT3. In fiscal 2013, we received $21.5 million (which included $11.5 million as compensation for price cap adjustments as detailed above) and in fiscal 2014, we received $10.5 million. A further $11.0 million will be received in fiscal 2015 and $11.5 million in fiscal 2016.

CFSC amendments

Amendments to the CFSC, agreed to with the Province and effective April 1, 2012, included:

- Grouping our route connecting Horseshoe Bay and Langdale with the three Major Routes connecting Metro Vancouver with mid and southern Vancouver Island;
- A reduction of up to 400 round trips in the minimum service requirement on our Major Routes as well as principles and targets for further service level reductions system wide.
- Implementation of principle-based service adjustments to achieve $30 million in net savings over PT3. These are detailed below and included:
    - Reductions in round trips already identified on three of our Major Routes reflecting a net savings of $4 million; and
    - Service adjustments to be determined on regulated routes to achieve an additional $26 million in net savings over PT3; and
- Ferry transportation fee enhancements of $54.5 million through PT3 as detailed above.

In response to the agreed reduction in the minimum service requirement on our Major Routes identified above, we implemented reductions in round trips on three of our Major Routes where the traffic levels no longer warranted extra service or where service was significantly under-utilized. Over PT3, these reductions are expected to result in $4 million in operating cost reductions from fuel savings and reduced requirements for casual employees during the off-season. There will be no reduction in our regular workforce. These identified reductions equate to 1% of our annual round trips on these routes. Further adjustments to service levels, as identified above, were required in order to attain the total objective of $30 million in net savings and these adjustments have resulted from the Province's consultation process discussed below.

Public consultation

In May 2012, the Province announced that it would conduct public consultation with ferry dependent communities about adjustments to service levels and trade-offs between service adjustments, fare increases and potential community contributions. The Province also announced that it would seek public input to develop strategies to support a long-term vision for connecting coastal communities. This process concluded on December 21, 2012 and on March 5, 2013, the Province released its report summarizing the input it received during this consultation and engagement process. The report can be found at www.coastalferriesengagement.ca. We provided technical assistance and subject matter support throughout this process.

On November 18, 2013, the Province announced its service level reduction plan to better align service levels with demand and on February 5, 2014, after further public consultation, the Province confirmed implementation of this plan, designed to achieve the remaining $18.9 million (see CFSC amendments below) in net savings over the remainder of PT3. The plan included 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 intention to reduce the 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.

Further CFSC amendments

On March 31, 2013, we reached an agreement with the Province to amend the CFSC to consolidate all regulated routes into a single group effective April 1, 2013. This revised grouping will be in effect until March 31, 2016. In the absence of any further amendments, on April 1, 2016, the route group structure in the CFSC will revert back to the structure at March 31, 2013.

On April 3, 2013, an amendment to the CFSC extended the deadline for identifying service level adjustments for the remainder of PT3 in order to provide sufficient time to complete its consultation process discussed above. As compensation for the delay in identifying service level adjustments, the Province also agreed to pay us $7.1 million in ferry transportation fees in 9 equal monthly instalments commencing July 2013. The balance of the $26 million in service reductions required over the remainder of the performance term ($18.9 million) was to be determined by March 31, 2014.

On March 31, 2014, an amendment to the CFSC removed the Northern Route that provided supplementary service to mid-coast destinations, resulting in a significant adjustment in how summer service is provided. The amendment also confirmed the net savings of $30 million over PT3 of which:

- $4.0 million were reductions in annual round trips on three of the Major Routes;
- $7.1 million received from the Province as a result of the extended deadline;
- $14.0 million in reductions in annual round trips on Northern and Other Routes; and
- $4.9 million in further reductions in annual round trips on three of the Major Routes.

The amendment confirmed the 100% discount for BC seniors travelling Monday to Thursday is reduced to 50% on the Major and Other Routes effective April 1, 2014. In respect of the corresponding reduction in social program funding and to reduce the magnitude of future tariff increases, the amendment also confirmed a maximum increase in ferry transportation fees of $18.0 million in fiscal 2015 and $19.3 million in fiscal 2016. The discount for BC seniors on the Northern Routes remains unchanged at 33% every day.

Commissioner's orders

On September 30, 2012, the Commissioner issued Order 12-02 which established the final price caps for the remaining three years of PT3. Increases for each route group were: 4.1% at April 1, 2013; 4.0% at April 1, 2014; and 3.9% at April 1, 2015, averaging 4.0% per annum.

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

In addition, the Commissioner reset the price caps for each route group to an index level of 100 as of April 1, 2012 based on the weighted average tariffs that existed as of March 31, 2012. The established price caps incorporate efficiency targets of $54.2 million, over and above the benefits associated with any service level adjustments, to be achieved by us over the four years of PT3.

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

On 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, to reflect the $7.1 million received from the Province. He also acknowledged the reduction of $4 million in service reductions already implemented with $18.9 million yet to be identified.

On September 30, 2012, the Commissioner issued Order 12-03 establishing the terms and conditions for the continued use of fuel price deferral accounts including the per litre cost of fuel included in the determination of price caps (the set price) for PT3. This was in response to our application filed in June 2012 seeking approval to establish a new fuel cost deferral mechanism under section 41.1 of the amended Act. On February 28, 2013, Order 12-03A was issued to extend the submission date for annual fuel reports to no later than 90 days after the end of the fiscal year.

On September 30, 2012, the Commissioner also issued Order 12-04 establishing the criteria for determining major capital expenditures which require advance approval from the Commissioner.

On July 19, 2013, the Commissioner approved our application to construct three new intermediate class vessels to replace the 49-year old *Queen of Burnaby* and the 50-year old *Queen of Nanaimo*. Both of these vessels are scheduled for retirement in 2016. (See "Outlook – Asset Renewal Program" below for more detail.)

On February 20, 2014, in response to our December 20, 2013 application, the Commissioner confirmed that the proposed expenditures to implement the cable ferry system on our route connecting Buckley Bay and Denman Island are reasonable and prudent. This decision included reasonable conditions which we are confident we will be able to meet. (See "Outlook – Asset Renewal Program" below for more detail.)

On March 20, 2014, the Commissioner approved a one-time transfer of the March 31, 2014 balance of tariffs in excess of price cap to reduce the deferred fuel cost account balance. (See "The Effect of Rate Regulation" below for more detail.)

The Commissioner's orders can be viewed at www.bcferrycommission.com.

The Effect of Rate Regulation

We are regulated by the Commissioner to ensure, among other things, that our tariffs are fair and reasonable. Under the terms of the Act, the tariffs we charge our customers over a performance term are subject to price caps set by the Commissioner. The Commissioner may, under certain circumstances, allow increases in price caps over the set levels. Certain decisions and orders of the Commissioner may give rise to assets or liabilities. Regulatory assets generally represent incurred costs that are probable of future recovery in tariffs or fuel surcharges. Regulatory liabilities represent obligations to customers which will be settled through future tariff reductions or fuel rebates.

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 included in revenue, and increases or decreases in fuel prices from those approved in price caps are included in operating expenses. These items are treated as assets and liabilities for regulatory purposes.

We continually assess whether our regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes. We believe the regulatory assets at March 31, 2014 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 20 to our audited consolidated financial statements.

If IFRS permitted us to report regulatory assets and liabilities in our financial statements, the effect on our Statements of Comprehensive (Loss) Income for the quarter and year ended March 31, 2014 and 2013 would be as follows:

($ millions)		**Three months ended March 31**		**Year ended March 31**	
		2014	**2013**	**2014**	**2013**
Total comprehensive (loss) income		(43.3)	(36.0)	13.1	16.6
Regulatory asset or liability	**Statement line item**				
Deferred fuel costs (a)					
Fuel costs incurred	Operations expense	4.7	3.0	14.5	11.3
Fuel surcharges collected	Fuel surcharge revenue	(2.7)	-	(2.7)	(11.5)
Payments from the Province	Ferry transportation fees	(0.8)	(0.9)	(3.0)	(2.5)
		1.2	2.1	8.8	(2.7)
Tariffs in excess of price cap (b)					
Obligation settled (incurred) during the period	Tariff revenue	0.5	-	(1.2)	2.5
Performance term submission costs (c)	Amortization expense	-	-	(0.1)	(0.1)
Increase (decrease) in total comprehensive income		1.7	2.1	7.5	(0.3)
Adjusted total comprehensive (loss) income		(41.6)	(33.9)	20.6	16.3

(a) Deferred fuel costs: As prescribed by regulatory order, we defer differences between actual fuel costs and approved fuel costs which were used to develop the regulated price caps. The difference between the approved fuel costs and the actual fuel costs (including fuel hedge gains and losses) is deferred for settlement in future tariffs. Also, 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 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 PT3. Our regulator has approved recovery of these costs over PT3.

On March 20, 2014, the Commissioner approved a one-time transfer of the March 31, 2014 balance of tariffs in excess of price cap to reduce the deferred fuel cost account balance.

FINANCIAL AND OPERATIONAL OVERVIEW

This section provides an overview of our financial and operational performance for the past three fiscal years.

($ millions)	Year ended March 31 2014	2013	2012
Total revenue	800.2	786.4	753.8
% increase	*1.8%*	*4.3%*	*n/a**
Operating expenses	714.3	701.6	693.0
Operating profit	85.9	84.8	60.8
Net finance and other	67.9	69.3	69.8
Net earnings (loss)	18.0	15.5	(9.0)
Other comprehensive (loss) income	(4.9)	1.1	2.2
Total comprehensive income (loss)	13.1	16.6	(6.8)
	As at March 31		
Total assets	1,885.2	1,824.3	1,836.7
Total long-term financial liabilities	1,127.3	1,199.8	1,349.6
Dividends on preferred shares	6.0	6.0	6.0

**We commenced reporting our financial position and financial performance under IFRS as of April 1, 2012 and comparable results are not available for fiscal 2011.*

Our total comprehensive income in fiscal 2014 was $3.5 million lower and net earnings were $2.5 million higher than in fiscal 2013. The increase in fiscal 2014 net earnings reflect the effects of increased fares and lower financing costs, partially offset by lower traffic levels and lower transportation fees, while maintaining our cost containing initiatives. The other comprehensive loss in fiscal 2014 reflects a $5.0 million unrealized hedge loss as at March 31, 2014 on interest rate forward contracts related to our April 28, 2014 issuance of $200 million of senior secured bonds. (See "Liquidity and Capital Resources – Long-Term Debt" below for more detail.)

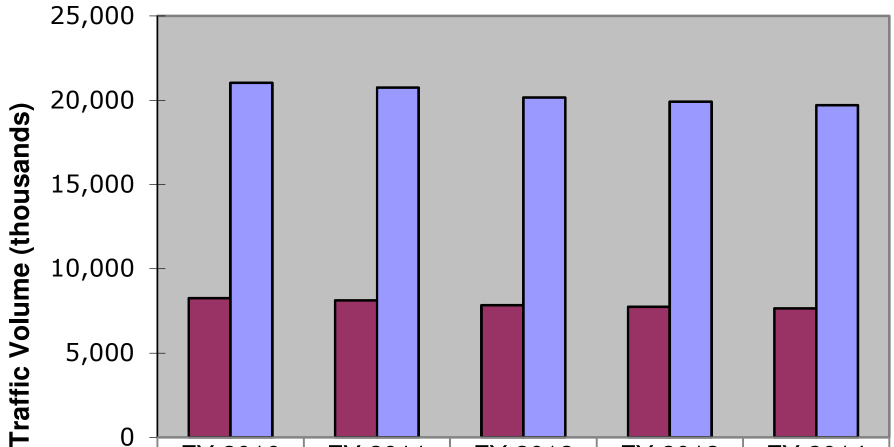
Our total comprehensive income in fiscal 2013 was $23.4 million higher and net earnings were $24.5 million higher than in fiscal 2012. The increase in fiscal 2013 net earnings reflect the effects of increased fares and higher ferry transportation fees, partially offset by lower traffic levels, while maintaining our cost containing initiatives.

Traffic

Prior to fiscal 2009, our traffic levels were relatively stable. However, the long-term traffic trend-line shifted significantly during fiscal 2009, when vehicle and passenger traffic were lower than the prior year by 5.2% and 4.9%, respectively. In fiscal 2009, the Canadian and world economies experienced turbulence in the financial markets, followed by a lengthy recessionary period. These economic conditions negatively impacted our commercial and discretionary travel markets. In fiscal years 2010 through 2013, we experienced an overall general decline in traffic due in part to these economic conditions.

In fiscal 2014, we experienced a 1.3% decline in vehicle traffic and a 1.1% decline in passenger traffic compared to fiscal 2013. We believe that fiscal 2014 traffic was negatively impacted by the timing of the Easter holiday. Fiscal 2014 included one day of the Easter holiday weekends (April 1, 2013), while fiscal 2013 included seven days of Easter holiday weekends (April 6 through 9, 2012 and March 29 through 31, 2013). We believe that, adjusting for the timing of the Easter holiday, fiscal 2014 traffic levels were generally flat compared to fiscal 2013.

The following graph illustrates our annual vehicle and passenger traffic levels from fiscal 2010 through fiscal 2014:

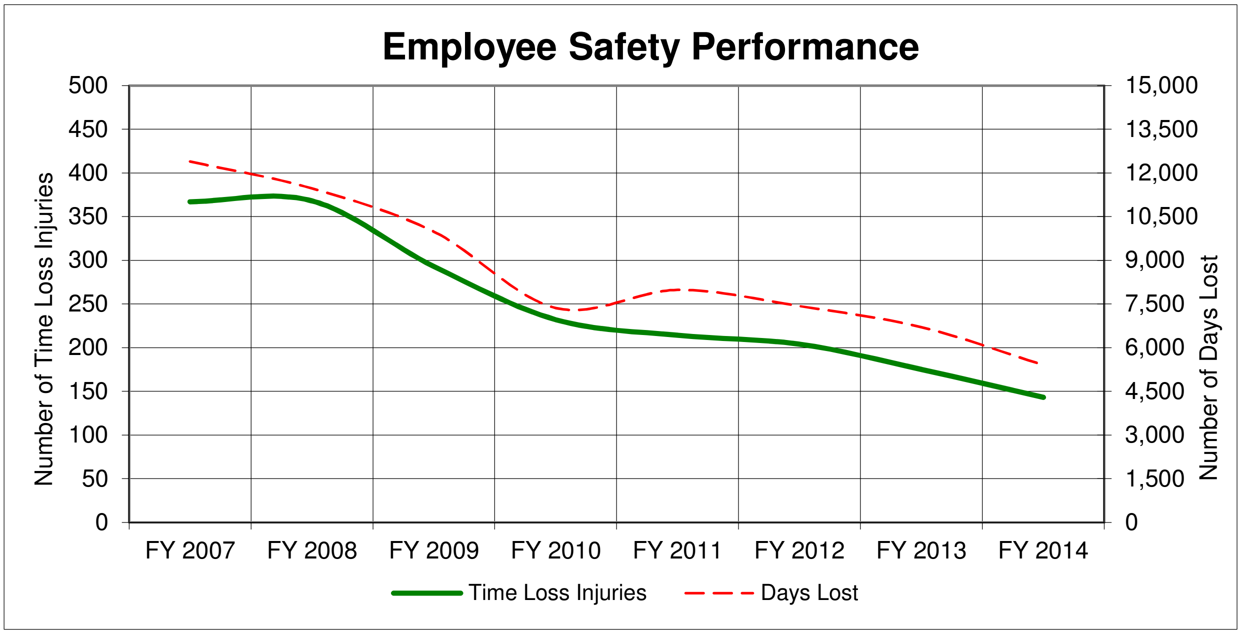


	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Vehicles	8,255	8,120	7,838	7,749	7,644
Passengers	21,036	20,746	20,170	19,919	19,697

Cost containment
In response to the decline in traffic levels and resulting revenues that began in fiscal 2009, we determined the need to restructure our business to align expenses with reduced revenues while continuing to ensure that safety remains our top priority. We carried out this restructuring in addition to deferral of filling staff vacancies and a hiring freeze for all non-essential positions, a two-year wage and salary freeze for exempt employees, reduced use of outside contractors and consultants, and reduction of discretionary expenditures. We have continued many of these cost containment measures, managing our costs as prudently as possible without compromising safe operations. Our operating expenses, excluding fuel costs, were $13.3 million below previously planned levels as published in our annual Business Plan for fiscal 2014.

To better align service levels to demand, the CFSC was amended in fiscal 2014 to reduce the number of annual round trips required on our Major Routes which, over PT3, is expected to result in $4 million in operating cost reductions from fuel savings and reduced requirements for casual employees during the off-season. Further amendments to sailing schedules on the Northern and Other Routes have been implemented in fiscal 2015 and additional amendments on the Major Routes are planned for fiscal 2016. In total, service level changes are expected to result in $22.9 million in cost reductions over PT3. In addition to these service level adjustments, our established price caps incorporate efficiency targets of $54.2 million over PT3. We are currently on pace to meet these targets. (See “Corporate Structure – Economic Regulatory Environment” above for more detail.)

Safety
Overall, injuries to employees and passengers continue to decline and we are experiencing the benefits of our investments in safety and security. In fiscal 2014, time loss injuries declined by 22% compared to fiscal 2013. Since 2007, the number of time loss injuries we experienced each year has dropped from over 360 to just over 140 and the number of days lost due to injury has declined from over 12,000 per year to under 5,500 per year. The results for fiscal years 2007 through 2014 are illustrated below:



In addition, this commitment has resulted in close to a 40% reduction in the number of passenger injuries in the past four years.

Our SailSafe program, which is designed to achieve world class safety performance, is in the sustainment phase. It transitioned at the beginning of fiscal 2013, from the implementation of a safety program to embodying safety as a normal part of all business activities and an integral part of our culture. The ultimate goal of SailSafe is for the program itself to no longer be necessary, as safety becomes completely ingrained in every activity undertaken, every day, throughout our business.

Specific areas of focus remain as:

- Reinforcing the role of safety committees;
- Continuous improvement in the process to report a potential hazard or situation which could cause injury or harm to a person, damage to equipment, or damage to the environment. These reports are referred to as ALERTs, which is an acronym for "All Learning Events Reported Today";
- Building and maintaining awareness of safety through communication;
- Developing strong safety teams; and
- Monitoring action plans previously implemented.

In fiscal 2014, we received the Certificate of Recognition (COR) from WorkSafe BC. A COR recognizes companies that go beyond the legal requirements of the Workers' Compensation Act and the Occupational Health & Safety Regulations by taking a best practices approach to implementing health, safety and return to work programs. Strengths and weaknesses in nine specific areas were audited, revealing a 90% score in Health and Safety and 91% in Injury Management. We were also provided with 31 recommendations which we are in the process of reviewing and implementing, with a view toward continual improvement. In June 2014, WorkSafe BC provided us with a $600,000 rebate on our 2013 assessed premiums. Besides confirming our workforce is safer and healthier, we expect this COR will result in on-going premium savings in the order of $500,000 annually.

In fiscal 2014, we also received other awards including the International Award for Inspiring Safety from Lattitude Productions in the United Kingdom and a Lloyd's List Safety Training award for our training programs (see below). In addition, we were also a finalist in the Lloyd's List Safety and Technical Innovation award categories.

Training

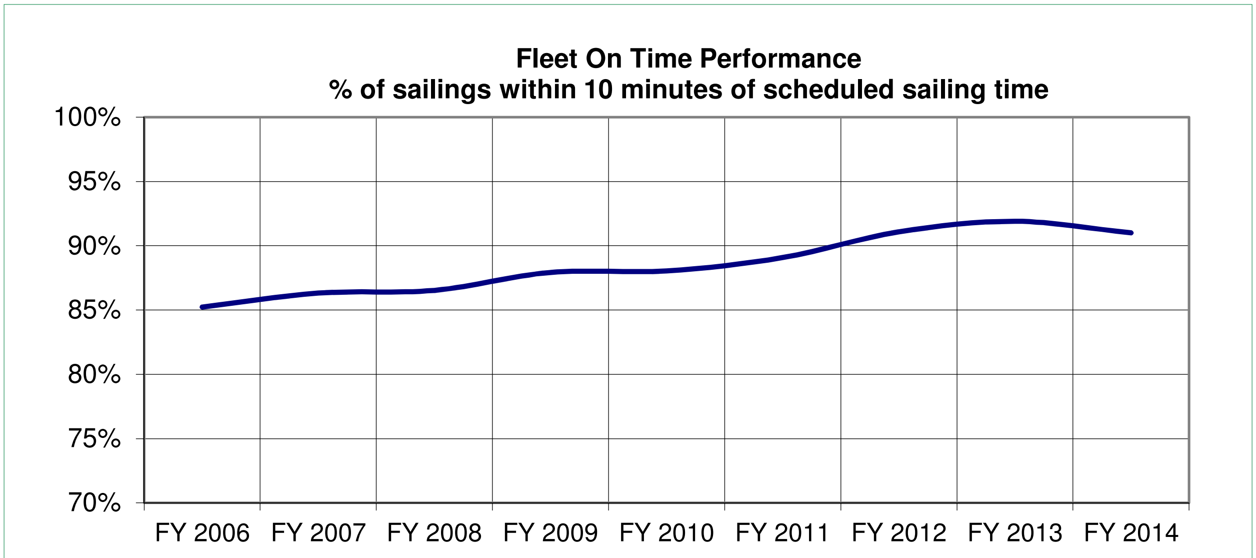
In fiscal 2014, 15,500 personal training days (PTDs) were conducted, inclusive of operational training, Bridge Team Simulation (BTS) training, and Standardized Education and Assessment (SEA) training. This is significantly higher than the 11,477 PTDs conducted in fiscal 2013, mainly due to the rollout of several new SEA programs. A portion of the increase in PTDs is also a result of the transition from on-the-job training to our formalized training programs.

Our SEA program replaces the traditional job-shadowing approach to vessel and terminal familiarization training with a blended learning approach being delivered by dedicated SEA trainers. The program leverages technology and e-learning to enhance hands-on training in a phased, auditable and sustainable manner. This program is an innovative, award-winning approach that is transforming training in the marine industry through the use of technology. Fiscal 2014 focused on enhancements to existing programs as well as the development and roll-out of several new programs. Since inception of the SEA project, programs have been developed and rolled out for 23 of the 32 operational positions identified for SEA training. Programs for the remaining nine positions will be implemented over the next two fiscal years. We also delivered 20 trainer workshops in fiscal 2014 to assist trainers preparing to deliver SEA training.

The operational training centre at our fleet maintenance unit is fully functioning and over the last year provided training facilities for over 300 days of requisite Rescue Boat and Survival Craft training, in addition to providing facilities for other training events and meetings. The more than 60 operational training programs continue to focus on preparing new and existing employees to be successful in their jobs, and to provide requisite skills and knowledge to our employees. In fiscal 2014, the specific areas of training which targeted the largest numbers of employees included first aid, ship safety, passenger safety and specialized training for the fleet's various evacuation systems. Safety education continues through various other programs including safe food handling and prevention of workplace violence. Our instructors are employees who lead courses in their area of expertise. To support these instructors, we provide education, including the first level of the Provincial Instructor's program, an on-line trainer forum, and other initiatives.

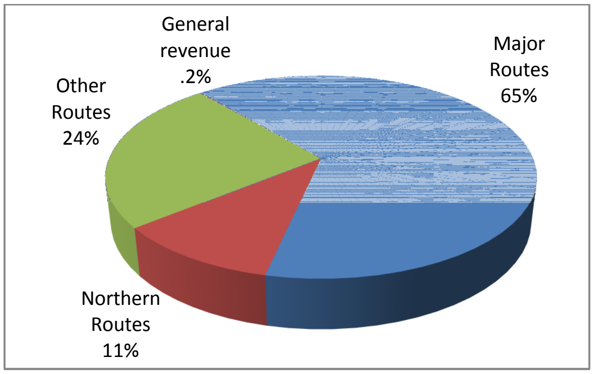
Our BTS program is delivering enhanced bridge team skills training and continues to receive praise from participants. We received international recognition of our signature course, Bridge Operations Skills and Systems (BOSS) 2, which received a Lloyd's List Safety Training award for outstanding commitment in training our employees ashore and at sea. Building on BOSS 1 principles, BOSS 2 focuses on gaining, maintaining and enhancing shared bridge team situational awareness. BOSS 2 includes a blended approach of simulation and classroom learning over three days and culminates in a team assessment to assist with students' learning transfer back to the fleet. As of March 31, 2014, 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. Post training support vessel visits by BTS instructors continue to assess the degree of learning transfer of BOSS principles into the workplace. In addition, seminars on communication and teamwork have been delivered to several departments.

Customer service
In fiscal 2014, our on-time performance rate was 91.5% with a fleet reliability score of 99.7%. This reliability score means that only 0.3% of sailings in fiscal 2014 were cancelled due to mechanical issues related to the vessels or terminals or crew availability. Improvements in on-time departure rates and reliability scores over the past few years were reflected in the results of our 2013 Customer Service Satisfaction Tracking Surveys which indicated that 87% of customers surveyed reported being satisfied with their overall trip experience. This rating has remained stable from the 2011 results and is several points higher than the 82% rating received in 2003. Ratings remain high in all areas except for those relating to customer satisfaction with value received relative to the associated cost. A copy of the full report for each year is available at http://www.bcferries.com/about/cst_archive.html.



Revenue
The following discussions of revenue are based on IFRS results with reference to the impacts of rate regulation. Results throughout reflect the amended CFSC which, effective April 1, 2012, includes the route connecting Horseshoe Bay and Langdale with the Major Routes and, as a consequence, this route has been removed from Other Routes and included in Major Routes in our discussions below for all years shown.

Total revenues and selected operational statistics over the past three fiscal years are shown in the tables below.



In fiscal 2014, 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%.

Operational Statistics	**2014**	**2013**	**2012**
Vehicle traffic	7,644,344	7,748,743	7,837,919
% increase(decrease)	(1.3%)	(1.1%)	(3.5%)
Passenger traffic	19,696,710	19,919,098	20,169,977
% increase(decrease)	(1.1%)	(1.2%)	(2.8%)
On-time performance	91.5%	92.3%	91.6%
Number of round trips	83,972	84,114	83,790
Capacity provided (AEQ's)	17,394,237	17,607,012	17,588,540
AEQ's carried	8,675,549	8,769,217	8,861,795
Capacity utilization	49.9%	49.8%	50.4%

In fiscal 2014, vehicle and passenger traffic decreased 1.3% and 1.1%, respectively, compared to fiscal 2013. The decline was experienced in both the Major and Other Routes while the Northern Routes experienced a modest increase. Our non-commercial traffic decreased 1.3% while commercial traffic increased marginally. When compared to the prior year, fiscal 2014 traffic was negatively impacted by the timing of the Easter holiday. Fiscal 2014 included one day of the Easter holiday weekends (April 1, 2013), while fiscal 2013 included seven days of Easter holiday weekends (April 6 through 9, 2012 and March 29 through 31, 2013). We believe that, adjusting for this timing of Easter holiday weekends, fiscal 2014 traffic levels were generally flat compared to fiscal 2013. 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.

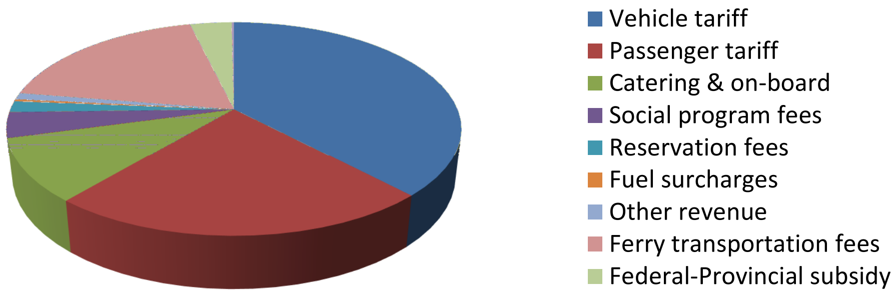
On-time performance on the Major and Other Routes is defined as the percentage of our sailings departing within 10 minutes of the scheduled time. On-time performance on the Northern Routes is defined as the percentage of our sailings arriving within 10 minutes of the scheduled time. On-time performance 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.

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 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 remained at the same level as the prior year as a result of reduced capacity provided in the current year, which offset the lower number of AEQs carried.

Revenue ($ millions)	Year ended March 31		
	2014	**2013**	**2012**
Direct Route Revenue			
Vehicle tariff	303.7	291.1	283.7
Passenger tariff	185.6	177.7	174.7
Fuel surcharges	2.7	11.5	13.1
Catering & on-board	76.8	74.5	74.3
Social program fees	30.7	28.6	26.6
Reservation fees	13.4	12.8	13.8
Other revenue	7.9	7.1	6.9
Total Direct Route Revenue	620.8	603.3	593.1
Indirect Route Revenue			
Ferry transportation fees	149.4	153.5	131.7
Federal-Provincial subsidy	28.4	28.1	27.5
Total Route Revenue	798.6	784.9	752.3
Other general revenue	1.6	1.5	1.5
Total Revenue	800.2	786.4	753.8



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 for each route group of 4.1% effective April 1, 2013 and, in response, we implemented average tariff increases up to the new level authorized. These fares are directly associated with increased operating costs, notably fuel, capital replacement and labour.

Surcharges and/or rebates are implemented as a direct result of rising and declining fuel prices. 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. A history of fuel surcharges in effect for fiscal 2012 through fiscal 2014 is below:

Date range	% surcharge	Applicable routes
April 1, 2012 – July 19, 2012	2.5%	Horseshoe Bay-Langdale Route
	5.0%	All other regulated routes*
July 20, 2012 – November 29, 2012	2.0%	All regulated routes*
November 30, 2012 – January 16, 2014	0.0%	All regulated routes
January 17, 2014 – March 31, 2014	3.5%	All regulated routes*

**with the exception of the Northern Routes*

For the purpose of rate regulation, surcharges and/or rebates 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 and the effects of being over or under the price cap may cause the average vehicle and passenger tariff rate to be under or over the allowed increase in any one period.

Year to year changes for the past two fiscal years for the Major, Northern and Other Routes are discussed separately below.

Year to Year Comparison of Revenues and Operational Statistics 2014 – 2013

Major Routes

Our Major Routes consist of three regulated routes connecting Metro Vancouver with mid and southern Vancouver Island and our regulated route connecting Horseshoe Bay and Langdale. These are our four busiest routes, carrying approximately 60% of our vehicle traffic and 64% of our passenger traffic during each of fiscal 2012 through 2014.

Operational Statistics	2014	2013	2012*
Vehicle traffic	4,556,839	4,600,647	4,637,931
% increase(decrease)	(1.0%)	(0.8%)	(3.6%)
Passenger traffic	12,708,731	12,777,222	12,920,807
% increase(decrease)	(0.5%)	(1.1%)	(2.9%)
On-time performance	82.7%	84.5%	86.5%
Number of round trips	12,543	12,621	12,705
Capacity provided (AEQ's)	8,999,280	9,053,830	9,106,524
AEQ's carried	5,380,708	5,411,460	5,444,580
Capacity utilization	59.8%	59.8%	59.8%

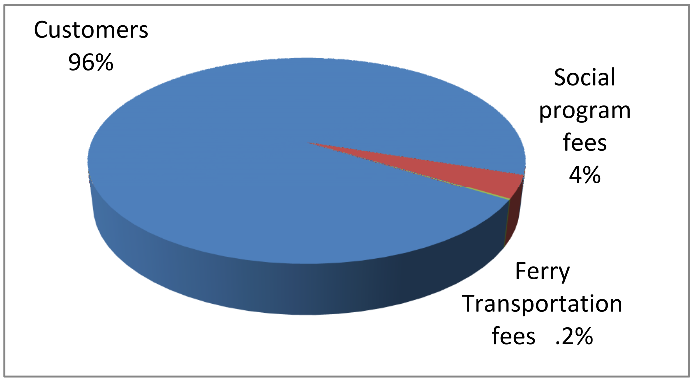
**Restated to include our route connecting Horseshoe Bay and Langdale.*

Vehicle traffic decreased 1.0% and passenger traffic decreased 0.5% in fiscal 2014 compared to fiscal 2013. Traffic in both fiscal 2014 and fiscal 2013 were negatively affected by periods of stormy weather. When compared to the prior year, fiscal 2014 traffic was also negatively impacted by the timing of the Easter holiday. Fiscal 2014 included one day of the Easter holiday weekends (April 1, 2013), while fiscal 2013 included seven days of the Easter holiday weekends (April 6 through 9, 2012 and March 29 through 31, 2013). We believe that, after adjusting for this timing of Easter holiday weekend days, fiscal 2014 traffic levels were generally flat compared to fiscal 2013. A decline in non-commercial vehicle traffic was partially offset by a 1.7% increase in total commercial traffic, including a 14.8% increase in drop trailer traffic. Our drop trailer service is available on two of our Major Routes, where commercial customers can drop their trailers off at one terminal and pick them up at another.

In fiscal 2014, there were a lower number of round trips compared to fiscal 2013, mainly as a result of service reductions on the Major Routes expected to result in $4 million in operating cost reductions in PT3. On-time performance 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.

Capacity utilization remained the same as the prior year mainly as a result of reduced total capacity in the current year from fewer round trips, which offset the lower number of AEQs carried.

Major Routes cont'd



Fiscal 2014 revenue from our Major Routes consisted of 96% from customers and 4% in social program fees from the Province.

Direct Route Revenue ($ thousands)	**Years ended March 31**			
	2014	**2013**	**Increase (Decrease)**	
Vehicle tariff	253,707	241,893	11,814	4.9%
Passenger tariff	150,351	142,363	7,988	5.6%
Fuel surcharges	2,268	9,481	(7,213)	(76.1%)
Catering & on-board	69,500	67,240	2,260	3.4%
Social program fees	18,954	17,381	1,573	9.1%
Reservation fees	13,196	12,600	596	4.7%
Parking	4,217	3,714	503	13.5%
Other revenue	3,403	3,086	317	10.3%
Total Direct Route Revenue	515,596	497,758	17,838	3.6%
Indirect Route Revenue				
Ferry transportation fees	1,045	3,391	(2,346)	(69.2%)
Total Route Revenue	516,641	501,149	15,492	3.1%

Average tariff revenue per vehicle increased $3.10 or 5.9% in fiscal 2014 compared to the prior year. Average tariff revenue per passenger increased $0.69 or 6.2%. The increase in average tariff revenues in fiscal 2014 reflects the increases authorized by the Commissioner and 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 $19.8 million.

Fuel surcharges collected in fiscal 2014 were $7.2 million lower than in the prior year. No surcharges were in place during fiscal 2014 until January 17, 2014, when due to the continuing high cost of fuel, we implemented a fuel surcharge of 3.5% on average on our Major Routes. In fiscal 2013, 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 Metro Vancouver with mid and southern Vancouver Island through July 19, 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. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

Major Routes cont'd

All vessels that provide service on our Major Routes have a gift shop and options for food service. Catering and on-board sales increased 3.4% in fiscal 2014 compared to the prior fiscal year reflecting higher average sales per passenger partially offset by lower passenger traffic levels. Areas of growth include sales of quality apparel which increased 14.7%; and sales of children's products which increased 9.3%. Sales of books, magazines and newspapers have declined 5.4%, 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 in fiscal 2014 as a result of higher fares and higher usage of all programs. The most significant increases are a $0.9 million or 8.3% increase in the number of seniors travelling and a $0.5 million or 1.3% increase in the number of individuals travelling with vehicles under the MTAP program.

Reservation fees increased 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 increased mainly as a result of an increase in hostling fees from our drop trailer service and additional retail space rentals.

Ferry transportation fees decreased $2.3 million in fiscal 2014 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, the funds related to the import duty remission are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

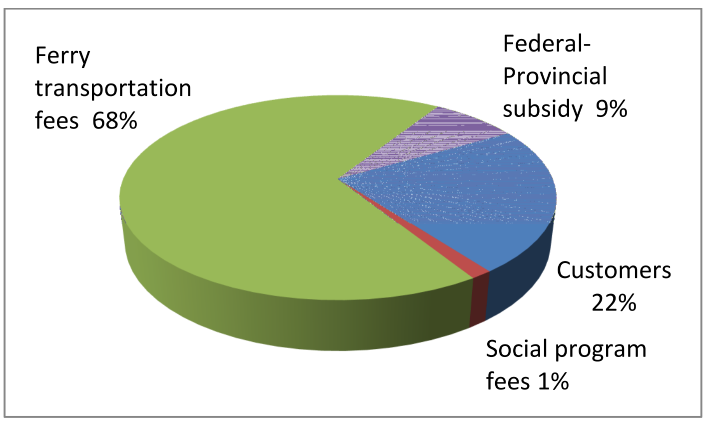
Northern Routes

Our Northern Routes consist of three regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island. Effective April 1, 2014, the shortest of these routes, which only operated during the summer months, was eliminated and service to the mid-coast destinations has been significantly adjusted.

Operational Statistics	**2014**	**2013**	**2012**
Vehicle traffic	28,366	27,811	27,573
% increase(decrease)	2.0%	0.9%	(6.1%)
Passenger traffic	81,100	80,848	80,642
% increase(decrease)	0.3%	0.3%	(6.2%)
On-time performance	91.6%	91.9%	90.6%
Number of round trips	348	347	345
Capacity provided (AEQ's)	83,450	84,677	85,100
AEQ's carried	34,238	33,623	33,677
Capacity utilization	41.0%	39.7%	39.6%

In fiscal 2014, the Northern Routes experienced a modest increase in traffic. Vehicle traffic increased 2.0% and passenger traffic increased 0.3%, compared to the previous year.

Utilization on these routes is higher than the prior year as a result of a higher number of AEQs carried in the current year, and the decreased capacity provided. The decreased capacity reflects variations in vessels servicing the routes.



Fiscal 2014 revenue from our Northern Routes consisted of 22% from customers and 78% from the Province (1% social program fees, 68% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

Northern Routes cont'd

Direct Route Revenue ($ thousands)	**Years ended March 31**			
	2014	**2013**	**Increase (Decrease)**	
Vehicle tariff	8,126	7,785	341	4.4%
Passenger tariff	6,859	6,917	(58)	(0.8%)
Social program fees	1,181	1,042	139	13.3%
Catering & on-board	2,064	2,007	57	2.8%
Stateroom rental	1,259	1,092	167	15.3%
Hostling & other	227	201	26	12.9%
Total Direct Route Revenue	19,716	19,044	672	3.5%
Indirect Route Revenue				
Ferry transportation fees	58,039	58,439	(400)	(0.7%)
Federal-Provincial subsidy	7,280	7,204	76	1.1%
Total Route Revenue	85,035	84,687	348	0.4%

Average tariff revenue per vehicle increased $6.55 or 2.3% in fiscal 2014 compared to the prior fiscal year. Average tariff revenue per passenger decreased $0.98 or 1.2%. The increase in average tariff revenues reflect the increases authorized by the Commissioner and changes year over year 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 $0.3 million.

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 mainly as a result of higher average sales per passenger.

Stateroom rental increased due to higher usage, partly a result of the marginal increase in passenger traffic.

Hostling and other revenues increased as a result of increased use of parking facilities and hostling services, partially offset by lower use of reservations.

Ferry transportation fees in fiscal 2014 were $0.4 million lower than the prior year, reflecting:

- $1.0 million 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 by the Province to the Northern Routes; partially offset by:
- $0.6 million increase for fees received from the Province related to the price of fuel. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail).

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

Other Routes

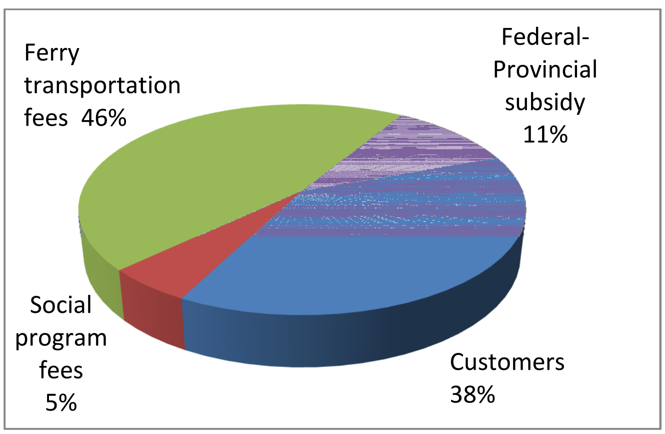
Our Other Routes consist of 18 regulated routes and eight small unregulated routes primarily serving the northern and southern Gulf Islands and the Sunshine Coast. One of the regulated routes and all of the unregulated routes are operated under contract by alternative service providers. We receive fees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

Operational Statistics	**2014**	**2013**	**2012***
Vehicle traffic	3,059,139	3,120,285	3,172,415
% increase(decrease)	(2.0%)	(1.6%)	(3.3%)
Passenger traffic	6,906,879	7,061,028	7,168,528
% increase(decrease)	(2.2%)	(1.5%)	(2.5%)
On-time performance	92.9%	93.6%	92.4%
Number of round trips	71,081	71,146	70,741
Capacity provided (AEQ's)	8,311,507	8,468,505	8,396,916
AEQ's carried	3,260,603	3,324,134	3,383,538
Capacity utilization	39.2%	39.3%	40.3%

**Restated to exclude our route connecting Horseshoe Bay and Langdale.*

Vehicle traffic decreased 2.0% and passenger traffic decreased 2.2%, compared to the prior year. We believe this decrease was partially due to the timing of the Easter holiday weekends and service alterations to accommodate upgrades at some of our terminals.

Capacity utilization on these routes was marginally lower in fiscal 2014 compared to the prior year mainly as a result of lower AEQs carried in the current year, partially offset by lower capacity provided.



Fiscal 2014 revenue from our Other Routes consisted of 38% from customers and 62% from the Province (5% social program fees, 46% ferry transportation fees, and 11% from payments under the Federal-Provincial subsidy agreement).

Other Routes cont'd

Direct Route Revenue ($ thousands)	Years ended March 31			
	2014	2013	Increase (Decrease)	
Vehicle tariff	41,879	41,418	461	1.1%
Passenger tariff	28,382	28,404	(22)	(0.1%)
Fuel surcharges	422	1,988	(1,566)	(78.8%)
Social program fees	10,559	10,180	379	3.7%
Catering & on-board	3,941	4,153	(212)	(5.1%)
Reservation fees	228	208	20	9.6%
Parking & other	100	114	(14)	(12.3%)
Total Direct Route Revenue	85,511	86,465	(954)	(1.1%)
Indirect Route Revenue				
Ferry transportation fees	90,298	91,667	(1,369)	(1.5%)
Federal-Provincial subsidy	21,093	20,873	220	1.1%
Total Route Revenue	196,902	199,005	(2,103)	(1.1%)

The average tariff revenue per vehicle increased $0.42 or 3.1% in fiscal 2014 compared to the prior year, while the average tariff revenue per passenger increased $0.09 or 2.2%. The increase in average fares, partially offset by the reduction in traffic, resulted in a total tariff revenue increase of $0.4 million.

Fuel surcharges collected in fiscal 2014 were $1.6 million lower than in the prior year. No surcharges were in place during fiscal 2014 until January 17, 2014, when, due to the rising cost of fuel, we implemented a fuel surcharge of 3.5% on average on our Other Routes. In fiscal 2013, surcharges of 5% of tariffs on average were in place until July 20, 2012. At that time, due to declining fuel prices, all surcharges were reduced to 2% and, on November 30, 2012, all surcharges were eliminated. 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 in fiscal 2014 as a result of higher program usage and higher fares. The most significant increase was a $0.3 million or 7.7% increase in the number of seniors travelling.

Decreases in revenue from catering and on-board services reflect the lower traffic levels on the routes where those services are offered and lower average spending per passenger.

Fees for reservations increased as a result of higher usage, partially offset by lower traffic levels.

Parking and other revenues were lower in fiscal 2014 than in the prior year, mainly due to a reduction in usage of our parking facilities.

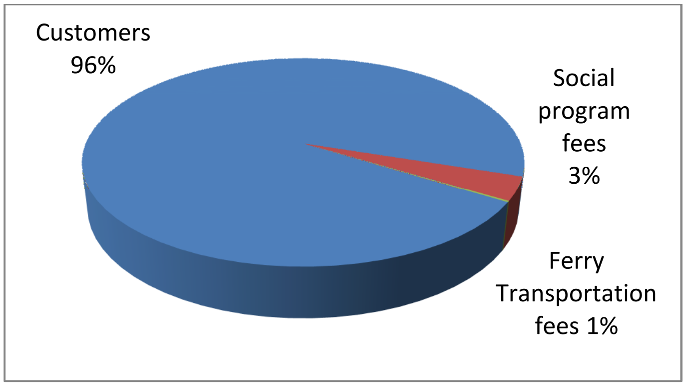
Ferry transportation fees decreased $1.4 million reflecting the reduction in fees received under the CFSC for the 18 regulated routes. Funds received from the Province related to the import duty remission on one of our foreign-built vessels remained at a similar level, as did fees from the Province for the provision of contracted services.

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

Year to Year Comparison of Revenues and Operational Statistics 2013 – 2012

Major Routes

Vehicle traffic decreased 0.8% and passenger traffic decreased 1.1% in fiscal 2013 compared to fiscal 2012. Traffic was negatively impacted by a period of stormy weather with high winds that resulted in numerous sailing cancellations in and around the December 2012 holiday season. The general decline in vehicle traffic was partially offset by a 33.5% 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.



Fiscal 2013 revenue from our Major Routes consisted of 96% from customers and 4% from the Province (3% social program fees and 1% ferry transportation fees in support of our route connecting Horseshoe Bay and Langdale).

Direct Route Revenue ($ thousands)	**Years ended March 31**			
	2013	**2012***	**Increase (Decrease)**	
Vehicle tariff	241,893	234,483	7,410	3.2%
Passenger tariff	142,363	139,666	2,697	1.9%
Fuel surcharges	9,481	9,768	(287)	(2.9%)
Catering & on-board	67,240	66,957	283	0.4%
Social program fees	17,381	16,124	1,257	7.8%
Reservation fees	12,600	13,499	(899)	(6.7%)
Parking	3,714	3,750	(36)	(1.0%)
Other revenue	3,086	2,943	143	4.9%
Total Direct Route Revenue	497,758	487,190	10,568	2.2%
Indirect Route Revenue				
Ferry transportation fees	3,391	3,965	(574)	(14.5%)
Federal-Provincial subsidy	-	986	(986)	(100.0%)
Total Route Revenue	501,149	492,141	9,008	1.8%

** Restated to include our route connecting Horseshoe Bay and Langdale.*

Average tariff revenue per vehicle in fiscal 2013 increased $2.02 or 4.0% compared to the prior year. Average tariff revenue per passenger increased $0.33 or 3.1%. Higher average fares more than offset the traffic decline, resulting in an increase in tariff revenue of $10.1 million.

Fuel surcharges collected in fiscal 2013 were $0.3 million lower than the prior year. Surcharges were eliminated on November 30, 2012 as a result of declining fuel prices. Surcharges of 2.0% of tariffs on average had been in place since July 20, 2012. These surcharges had been decreased from 2.5% on our Horseshoe Bay – Langdale route and 5.0% on our three other Major Routes connecting Metro Vancouver with mid and southern Vancouver Island. These surcharges had been in place since December 12, 2011.

Major Routes cont'd

Revenue from catering and on-board sales increased marginally in fiscal 2013 compared to the prior year, reflecting higher average sales per passenger mainly offset by lower passenger traffic levels. Sales of quality apparel continued to grow in fiscal 2013, increasing by 14.4% compared to the prior year. Sales of magazines, comics and newspapers continued to decline following industry trend.

Social program fees increased as a result of higher program usage and higher fares. The most significant increases were a $1.0 million or 5.6% increase in the number of seniors travelling and a $0.3 million or 2.7% increase in the number of individuals travelling with vehicles under the MTAP program.

Reservation fees decreased as a result of the lower traffic levels and lower usage. Revenue from parking remained at a similar level as the prior year.

Other revenue increased mainly as a result of an increase in hostling fees from our drop trailer service. This service has been well received in the commercial market place.

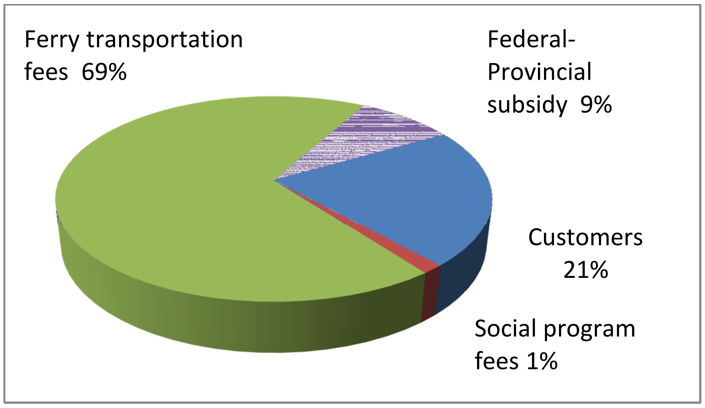
Ferry transportation fees decreased $0.6 million. The fees received in fiscal 2013 included:

- Ferry transportation fees received in support of services provided on our Horseshoe Bay – Langdale route, resulting in a decrease of $1.4 million from the prior year. While total ferry transportation fees from the Province increased, a lower portion of the total fees has been allocated by the Province to support the Horseshoe Bay – Langdale route this fiscal year.
- A re-allocation of funds received from the Province related to the import duty remission on one of our foreign-built vessels, resulting in an increase of $0.8 million.

The allocation of the Federal-Provincial subsidy to the Horseshoe Bay – Langdale route was eliminated effective April 1, 2012, the beginning of the PT3. These funds were reallocated to the Northern and Other Routes.

Northern Routes

In fiscal 2013, the Northern Routes experienced a modest increase in traffic. Vehicle traffic increased 0.9% and passenger traffic increased 0.3%, compared to the previous year.



Fiscal 2013 revenue from our Northern Routes consisted of 21% from customers and 79% from the Province (1% social program fees, 69% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

Direct Route Revenue ($ thousands)	**Years ended March 31**			
	2013	**2012**	**Increase (Decrease)**	
Vehicle tariff	7,785	7,878	(93)	(1.2%)
Passenger tariff	6,917	7,075	(158)	(2.2%)
Social program fees	1,042	961	81	8.4%
Catering & on-board	2,007	2,108	(101)	(4.8%)
Stateroom rental	1,092	1,060	32	3.0%
Hostling & other	201	212	(11)	(5.2%)
Total Direct Route Revenue	19,044	19,294	(250)	(1.3%)
Indirect Route Revenue				
Ferry transportation fees	58,439	50,377	8,062	16.0%
Federal-Provincial subsidy	7,204	6,800	404	5.9%
Total Route Revenue	84,687	76,471	8,216	10.7%

The average tariff revenue per vehicle decreased $5.79 or 2.0% while the average tariff revenue per passenger decreased $2.18 or 2.5%, compared to the prior year, mainly as a result of a greater proportionate number of vehicles and passengers on the shorter routes with lower fares. These lower average tariff rates, partially offset by higher traffic levels, resulted in a total tariff revenue decrease of $0.3 million.

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 higher fares, partially offset by lower usage of other programs.

Revenue from catering and on-board services decreased as a result of a lower average spending per passenger, partially offset by a marginal increase in passenger traffic.

Stateroom rental increased due to higher usage and a marginal increase in passenger traffic.

Hostling and other revenues decreased overall. Reservation revenue decreased while hostling and parking revenue increased marginally.

Northern Routes cont'd

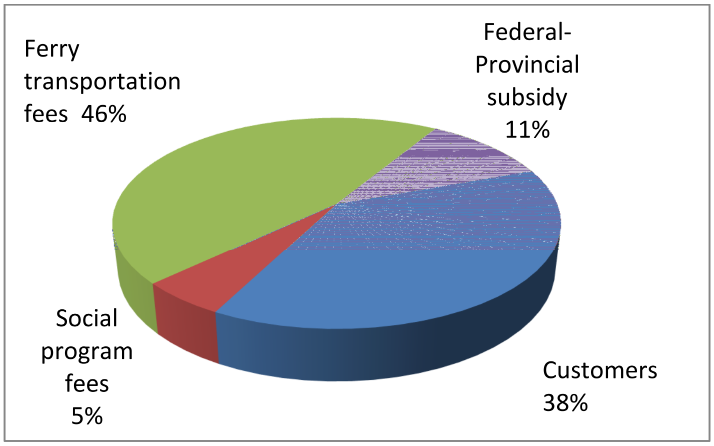
Ferry transportation fees increased $8.0 million. The fees received in fiscal 2013 included:

- Ferry transportation fees for these routes received under the CFSC. These fees increased $8.8 million as a result of additional funding from the Province as well as a larger portion of the total fees allocated by the Province to these routes.
- Ferry transportation fees received from the Province related to the price of fuel. As a result of changes in fuel prices, these amounts were $0.8 million lower year over year.

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

Other Routes

Vehicle traffic decreased 1.6% and passenger traffic decreased 1.5%, compared to the prior year.



Fiscal 2013 revenue from our Other Routes consisted of 38% from customers and 62% from the Province (5% social program fees, 46% ferry transportation fees, and 11% from payments under the Federal-Provincial subsidy agreement).

Direct Route Revenue ($ thousands)	**Years ended March 31**			
	2013	**2012***	**Increase (Decrease)**	
Vehicle tariff	41,418	41,323	95	0.2%
Passenger tariff	28,404	27,967	437	1.6%
Fuel surcharges	1,988	3,330	(1,342)	(40.3%)
Social program fees	10,180	9,522	658	6.9%
Catering & on-board	4,153	4,205	(52)	(1.2%)
Reservation fees	208	227	(19)	(8.4%)
Parking & other	114	92	22	23.9%
Total Direct Route Revenue	86,465	86,666	(201)	(0.2%)
Indirect Route Revenue				
Ferry transportation fees	91,667	77,311	14,356	18.6%
Federal-Provincial subsidy	20,873	19,702	1,171	5.9%
Total Route Revenue	199,005	183,679	15,326	8.3%

**Restated to exclude our route connecting Horseshoe Bay and Langdale.*

The average tariff revenue per vehicle in fiscal 2013 increased $0.25 or 1.9%, compared to the prior year, while the average tariff revenue per passenger increased $0.12 or 3.1%. The increase in average fares, partially offset by the reduction in traffic, resulted in a total tariff revenue increase of $0.5 million.

Fuel surcharges collected were $1.3 million lower in fiscal 2013 than in the prior year. Surcharges were eliminated on November 30, 2012 as a result of declining fuel prices. Fuel surcharges on our regulated Other Routes were 2% of tariffs on average since July 20, 2012. Prior to July 20, 2012, fuel charges of 5% had been in place since June 1, 2011.

Other Routes cont'd

Reimbursements from the Province for social program fees increased in fiscal 2013 as a result of higher program usage and higher fares. The most significant increases were a $0.4 million or 7.4% increase in the number of seniors and a $0.2 million or 3.3% increase in the number of individuals travelling with vehicles under the MTAP program.

Decreases in revenue from catering and on-board services reflect the lower traffic levels on the routes where those services are offered and lower average spending per passenger.

Fees for reservations decreased as a result of lower usage and lower traffic levels.

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

Ferry transportation fees increased $14.4 million. The fees received in fiscal 2013 included:

- Ferry transportation fees for the 18 regulated routes which increased $14.5 million as a result of additional funding from the Province as well as a larger portion of the total fees allocated by the Province to these routes;
- Fees from the Province for the provision of contracted service on unregulated routes which increased $0.7 million; and
- Funds from the Province related to the import duty remission on one of our foreign-built vessels which were $0.8 million lower as a result of the reallocation among the routes.

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

Expenses
Expenses for the past three fiscal years are summarized in the tables below:

Operating expenses ($ millions)	Year ended March 31		
	2014	2013	2012
Operations	451.7	436.8	433.2
Maintenance	63.2	70.0	65.9
Administration	31.6	29.6	31.2
Total operations, maintenance & administration	546.5	536.4	530.3
% Increase	*1.9%*	*1.2%*	*n/a**
Cost of retail goods sold	30.9	29.5	29.1
Depreciation and amortization	136.9	135.7	133.6
Total operating expenses	714.3	701.6	693.0

**We commenced reporting our financial position and financial performance under IFRS as of April 1, 2012 and comparable results are not available for fiscal 2011.*

We continue to take proactive measures to contain and reduce expenses while continuing to ensure that safety has remained our top priority. In fiscal 2013, our operating expenses, excluding fuel costs, were $14.2 million or 2.5% below previously planned levels as published in our annual Business Plan for fiscal 2014.

Net finance and other ($ millions)	Year ended March 31		
	2014	2013	2012
Interest expense			
Bond interest	64.0	63.3	63.4
KfW bank group (KfW) loans	7.5	8.3	9.4
Interest on finance lease	2.0	2.3	2.4
Short-term debt	0.7	0.4	0.2
Structured Financing Facility (SFF) program	-	(0.4)	(1.5)
Capitalized interest	(3.2)	(1.8)	(2.0)
Total interest expense	71.0	72.1	71.9
Less: finance income	(3.7)	(2.9)	(2.4)
Net finance expense	67.3	69.2	69.5
Loss on disposal and revaluation of property, plant and equipment and intangible assets	0.6	0.1	0.3
Total net finance and other expenses	67.9	69.3	69.8

Year to Year Comparison of Expenses 2014 – 2013

The $14.9 million increase in operations expenses for fiscal 2013 to fiscal 2014 consists of:

- $6.4 million increase in wage and benefits costs, mainly due to wage rate increases, higher benefit costs, increased training costs and a 7% increase in overtime partially due to service alterations to accommodate upgrades at some of our terminals;
- $4.5 million increase in fuel expense, reflecting an increase of $4.8 million or 1.1% due to higher fuel prices, partially offset by a $0.3 million or 1.7% decrease in fuel consumption. While IFRS does not permit accounting for rate-regulated entities, we are in fact rate-regulated. For purposes of rate regulation, $14.5 million of our fuel expense for fiscal 2014 ($11.3 million for fiscal 2013) is recorded in deferred fuel cost accounts for future recovery. (See "The Effect of Rate Regulation" above for more detail.);
- $0.9 million increase in travel expenses, mainly related to the service alterations to accommodate upgrades at some of our terminals;
- $0.8 million increase in telecommunications costs, software license fees and computer leases;
- $0.6 million increase in insurance claims costs, mainly due to a $0.7 million claim recovery in fiscal 2013;
- $0.5 million increase in credit card processing fees;
- $0.5 million increase in materials and supplies; and
- $1.4 million increase in various other operating costs

partially offset by:

- $0.7 million decrease in contracted services.

The $6.8 million decrease in maintenance costs results from a decrease in vessel maintenance costs, reflecting the variations in vessel refit scheduling, while terminal maintenance costs remained at a similar level to the prior year.

The $2.0 million increase in administration costs is mainly due to a $1.3 million increase in computer software fees, licenses and leases and a $0.6 million increase in wages and benefits.

The $1.4 million increase in cost of retail goods sold reflects the increase in overall sales and the higher cost of food and select retail items.

Depreciation and amortization increased $1.2 million, reflecting higher amortization resulting from the new capital assets entering service during fiscal 2014. (See "Investing in our Capital Assets" below for details of capital asset expenditures in fiscal 2014.)

Net finance and other expenses decreased by $1.4 million from fiscal 2013 to fiscal 2014 due to:

- $1.4 million increase in interest capitalized;
- $0.8 million increase in finance income;
- $0.8 million decrease in interest on KfW loans, reflecting $9.0 million in principal repayments on the 2.95% KfW loan and lower interest rates on the Tranche B than on the Tranche A components of the 12-year KfW loans (See "Liquidity and Capital Resources – Long-Term Debt" below for more detail.); and
- $0.3 million decrease in interest on finance leases;

partially offset by:

- $0.4 million year-to-date decrease in interest rate support received through the SFF Program offered by the Government of Canada, reflecting the completion of the funding related to the life extension of the *Quinsam*;
- $0.7 million increase in bond interest, reflecting $60 million increase in outstanding bonds ($200 million issued and $140 million redeemed in October 2013);
- $0.5 million loss on disposal and revaluation of property, plant and equipment and intangible assets; and
- $0.3 million increase in short-term interest.

Year to Year Comparison of Expenses 2013 – 2012

The $3.6 million increase in operations expenses from fiscal 2012 to fiscal 2013 consists of:

- $5.0 million increase in wage and benefits costs, mainly due to wage rate increases and higher benefit costs;
- $1.3 million increase in fuel expense, reflecting an increase of $3.3 million or 1.1% due to higher fuel prices, partially offset by a $2.0 million or 1.7% decrease in fuel consumption. While IFRS does not permit accounting for rate-regulated entities, we are in fact rate-regulated. For purposes of rate regulation, $11.3 million of our fuel expense for fiscal 2013 ($19.4 million for fiscal 2012) is recorded in deferred fuel cost accounts for future recovery. (See "The Effect of Rate Regulation" above for more detail.);

partially offset by:

- $1.2 million decrease in materials, supplies and contracted services;
- $0.9 million decrease in insurance premiums and claims, mainly due to a $0.7 million claim recovery in fiscal 2013; and
- $0.6 million decrease in several other operational areas including rental and lease expenses, telecommunications costs, and advertising and public relations costs.

The $4.1 million increase in maintenance costs results from an increase in vessel maintenance, reflecting the variations in vessel refit scheduling and an increase in terminal maintenance.

The $1.6 million decrease in administration expenses is mainly due to lower wages and benefits, including lower executive compensation which is due to a reduced number of senior executive positions and a lower average compensation per executive position.

The $0.4 million increase in cost of retail goods sold reflects the increase in overall sales and a change in sales mix with a decrease in food sales with a lower cost and an increase in gift shop sales with a higher cost.

Depreciation and amortization increased $2.1 million reflecting higher amortization resulting from the new capital assets entering service during fiscal 2013.

Net finance and other expenses decreased by $0.5 million from fiscal 2012 to fiscal 2013 primarily due to:

- $1.1 million reduction in interest due to lower interest rates on the Tranche B than on the Tranche A components of the 12-year KfW loans and $9.0 million of principal repayments on the 2.95% KfW loan;
- $0.5 million increase in finance income; and
- $0.2 million reduction in losses on disposal and revaluation of property, plant and equipment;

partially offset by;

- $1.1 million in lower interest rate support through the SFF program offered by the Government of Canada, reflecting the completion of the funding related to the life extension of the *Quinsam*; and
- $0.2 million less interest capitalized.

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.

Over the last five years, our capital expenditures averaged $112 million annually. Over the next five years, we expect the average to increase to approximately $275 million annually as we proceed with the replacement of our aged minor and intermediate-sized vessels and make significant improvements at our terminals serving our Major Routes. Over the next few years, we expect our cash requirements will be met through operating cash flows and by accessing our credit facility from time to time. At March 31, 2014, our unrestricted cash and cash equivalents and other short-term investments totalled $71 million and $81 million, respectively.

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 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 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 repaid our credit facility, funded the debt service reserve related to these funds and will partially fund capital expenditures and provide funding for general corporate purposes. These bonds were rated “A” (DBRS) and “A+” (S&P).

On April 28, 2014, 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 4.289% per annum, payable semi-annually. The net proceeds of this new issue, together with additional cash on hand, was used to repay our $250 million bond Series 04-1, which matured on May 27, 2014 and to fund the debt service reserve related to these bonds. These bonds were rated “A” (DBRS) and “AA-” (S&P). We managed our interest rate risk and secured a favourable interest rate by entering into interest rate hedges. The effective rate of this issue, net of hedging, is 4.5%, the lowest effective bond interest rate in the 11 year history of our company.
Our $155 million credit facility was amended on March 12, 2014 to extend the maturity date of the facility from April 2018 to April 2019 as well as to add a new pricing grid category of “>A+”. The facility is available to fund capital expenditures and other general corporate purposes. At March 31, 2014, there were no draws on this credit facility.

We target maintaining a strong investment-grade credit rating to allow capital market access at reasonable interest rates. On March 17, 2014, S&P announced that, based on its decision to apply revised rating criteria, it raised our rating from “A+” to “AA-“. Our credit ratings at March 31, 2014, were “A” (DBRS) with a stable trend and “AA-” (S&P) with a stable outlook.

On September 30, 2012, the Commissioner issued Order 12-02, which established price cap increases for the balance of PT3. These price cap increases are sufficient to enable us to meet our debt obligations and maintain access to borrowing rates that, in the opinion of the Commissioner, are reasonable. The order indicated that the Commissioner had established the price caps with the intention of allowing us to achieve, by the end of PT3, equity not less than 17.5% of total capitalization and a DSCR of 2.5 or greater.

Long-Term Debt
Our long-term debt at March 31 of the last three years is summarized below:

($millions)	Effective interest rate	Amount outstanding as at March 31		
		2014	2013	2012
Senior Secured Bonds				
5.74%, Due May 2014	5.92%	250	250	250
6.25%, Due October 2034	6.41%	250	250	250
5.02%, Due March 2037	5.06%	250	250	250
5.58%, Due January 2038	5.62%	200	200	200
6.21%, Due December 2013	6.33%	-	140	140
4.70%, Due October 2043	4.75%	200	-	-
12 Year Loans				
Tranche A, Due March 2020	5.17%	45	53	60
Tranche B, Due March 2020	1.52%*	21	13	6
Tranche A, Due June 2020	5.18%	47	54	62
Tranche B, Due June 2020	1.52%*	20	13	5
2.95% Loan, Due January 2021	3.08%	63	72	81
		1,346	1,295	1,304

* Floating rate as at March 31, 2014

In 2004, we entered into the Master Trust Indenture (May 2004) (the MTI), a copy of which is available at www.SEDAR.com. The MTI established common security and a set of common covenants for the benefit of our lenders. Our financing plan encompasses an ongoing program capable of accommodating a variety of corporate debt instruments and borrowings ranking *pari passu*. We do not currently view common share equity as a potential source of capital and have no intention of offering common shares to the public or other investors.

We are also party to a credit agreement with a syndicate of Canadian banks that is secured under the MTI. Under this agreement, we have available a revolving facility in the amount of $155 million, maturing April 2019. The facility is available to fund capital expenditures and other general corporate purposes. At March 31, 2014 and March 31, 2013, there were no draws on this credit facility ($17.7 million at March 31, 2012).

Of the five senior secured bond offerings outstanding to date, all have interest payable semi-annually. The bonds are redeemable in whole or in part, at our option.

We have entered into three 12-year amortizing loan agreements with KfW, each of which is secured under the MTI. Two of these loans are at a fixed interest rate of 4.98%, payable quarterly. These agreements defer the principal payments for three years to a second tranche (Tranche B) on which interest is payable at a floating rate and the principal is due at maturity (March 2020 and June 2020). The third loan is at a fixed interest rate of 2.95%, payable semi-annually.

Terminal Leases

We entered into a master agreement with the BC Transportation Financing Authority (BCTFA) effective March 31, 2003, as part of the restructuring of our company. In return for the transfer of ownership interest in all ferry terminals from the former British Columbia Ferry Corporation to the BCTFA at the time of the corporate restructuring, we received recognition of prepayment of rent under terminal leases.

The leases grant us exclusive access and use of ferry terminal properties for a period of 60 years commencing April 1, 2003. The leases are renewable for an additional period of 20 years at a total cost of $20 per lease provided the CFSC is renewed. We must manage, maintain and develop the terminals at our own cost.

Since the original transfer, a total of $11.7 million of additional lands at Horseshoe Bay, Swartz Bay and Departure Bay have been added to the existing terminal leases in exchange for highway improvements.

If we fail to meet our obligations under the terminal leases or default under the CFSC, the BCTFA may at its option re-enter and take possession of the ferry terminal properties and at its option terminate the leases. The BCTFA has entered into an acknowledgement agreement with the Trustee under the MTI, which sets out certain limitations on the use of this option.

Finance Lease

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

The initial term of the lease was 15 years, with four renewal options of five years each. In November, 2010, we advanced $24.2 million to the developer of the property for a term of 15 years, secured by a second mortgage on the property. The loan agreement provides for interest equal to one-half of the net cash flow from the property, subject to minimum and maximum percentage rates of interest. Over the term of the loan, interest is expected to approximate the market rate when the loan was made. Incidental to the loan, we were granted an option to purchase up to 50% of the owner’s equity interest in the new building at a price of $24.2 million. Final adjustments were made on April 15, 2011, bringing the total amount of the loan and the purchase option to $24.5 million. The purchase option expires at the end of the loan term.

Other Long-Term Liabilities

Other long-term liabilities consist primarily of accrued post-retirement and post-employment benefits.

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 fiscal 2014 and 2013 are summarized in the table below:

	Year ended March 31		
($ millions)	**2014**	**2013**	**Increase (decrease)**
Cash and cash equivalents, beginning of year	36.6	7.7	28.9
Cash from operating activities:			
Net earnings	18.0	15.5	3.0
Items not affecting cash	205.2	208.0	(3.3)
Changes in non-cash operating working capital	(1.1)	1.6	(2.7)
Net interest paid	(66.8)	(70.5)	3.7
Cash generated by operating activities	155.3	154.6	0.7
Cash generated by (used in) financing activities	42.5	(8.8)	51.3
Cash used in investing activities	(163.0)	(116.9)	(46.1)
Net increase in cash and cash equivalents	34.8	28.9	5.9
Cash and cash equivalents, end of year	71.4	36.6	34.8

For the year ended March 31, 2014, cash generated by operating activities increased by $0.7 million compared to the prior year, due to an increase in net earnings and a decrease in interest paid, mainly offset by items not affecting cash and changes in non-cash operating working capital.

Cash generated by financing activities in fiscal 2014 was $42.5 million. This amount consisted of proceeds of $200 million from our October 2013 bond issuance, partially offset by: the redemption of our $140 million bond series; $9.0 million in other long-term debt repayments; $6.0 million in dividends paid on preferred shares; $1.4 million in bond financing costs; and $1.1 million repayment of finance lease obligations.

Cash used in financing activities in fiscal 2013 was $8.8 million. This amount consisted of $9.0 million in debt repayments on KfW loans; $17.7 million in repayments of short-term debt; $6.0 million in dividends paid on preferred shares; and $1.0 million in repayment of finance lease obligations; partially offset by the receipt of $25.0 million contributed surplus from the Province.

Cash used in investing activities in fiscal 2014 increased by $46.1 million compared to the prior year, mainly due to a $24.7 million increase in cash used for capital expenditures; a $21.1 million increase in cash used for short-term investing; and a $0.3 million change in debt service reserves. Cash used to purchase property, plant, equipment and intangible assets in fiscal 2014 totalled $125.3 million, compared to $100.6 million in the prior year. (See “Investing in Our Capital Assets” below for detail of significant capital expenditures.)

FOURTH QUARTER RESULTS

The following provides an overview of our financial performance and selected operational statistics for the three months ended March 31 for each of the past three fiscal years.

The fourth quarter reflects a seasonal reduction in traffic levels which we utilize to perform upgrades and major maintenance and refit programs as well as to undertake mandatory inspections on the majority of our vessels.

Operational Statistics	**2014**	**2013**	**2012**
Vehicle traffic	1,452,199	1,516,919	1,502,231
% (decrease)increase	(4.3%)	1.0%	(3.4%)
Passenger traffic	3,576,055	3,723,899	3,666,163
% (decrease)increase	(4.0%)	1.6%	(2.1%)
On-time performance	95.5%	95.4%	94.4%
Number of round trips	20,269	20,215	20,273
Capacity provided (AEQ's)	3,959,608	4,124,740	4,080,430
AEQ's carried	1,664,418	1,731,162	1,716,673
Capacity utilization	42.0%	42.0%	42.1%

Vehicle traffic decreased 4.3% and passenger traffic decreased 4.0% in the fourth quarter, compared to the same quarter in fiscal 2013. Vehicle traffic decreased in both the Major and Other Routes while the Northern Routes experienced a small increase. We believe that this decrease was partially due the timing of the Easter holiday. The fourth quarter of fiscal 2014 did not include the Easter holiday weekend while the fourth quarter of fiscal 2013 included three days of the Easter holiday weekend. Traffic in the fourth quarter of fiscal 2014 was also negatively impacted by service alterations to accommodate upgrades at some of our terminals, and adverse weather conditions as compared to the same period of the prior year.

Utilization in the three months ended March 31, 2014 remained at the same level as the same period in the prior year as a result of reduced capacity resulting from a decrease in the number of round trips on the Major Routes, which offset the lower number of AEQs carried.

	Three months ended March 31			
			Variance	
($ millions)	**2014**	**2013**	**$**	**%**
Total revenue	153.9	150.5	3.4	2.3%
Operating expenses	175.2	170.7	(4.5)	(2.6%)
Operating loss	(21.3)	(20.2)	(1.1)	(5.4%)
Net finance and other	17.0	16.9	(0.1)	(0.6%)
Net loss	(38.3)	(37.1)	(1.2)	(3.2%)
Other comprehensive (loss) income	(5.0)	1.1	(6.1)	(554.5%)
Total comprehensive loss	(43.3)	(36.0)	(7.3)	(20.3%)

Our total comprehensive loss in the three months ended March 31, 2014 was $7.3 million higher and the net loss was $1.2 million higher than in the same quarter of fiscal 2013. The other comprehensive loss in fiscal 2014 reflects the $5.0 million unrealized hedge loss at March 31, 2014, on interest rate forward contracts related to our April 28, 2014 issuance of $200 million of senior secured bonds. Fiscal 2014 net loss reflects an increase in net operating expenses, lower traffic levels and lower ferry transportation fees, partially offset by increased fares and fuel surcharges.

Revenue

Our total revenues for the fourth quarter of fiscal 2014 increased slightly compared to the same quarter in the prior year, as shown in the following table:

	Three months ended March 31			
($ millions)			Increase (Decrease)	
	2014	**2013**	**$**	**%**
Direct Route Revenue				
Vehicle tariff	56.3	56.2	0.1	0.2%
Passenger tariff	32.2	32.0	0.2	0.6%
Fuel surcharges	2.7	-	2.7	100.0%
Catering & on-board	13.3	13.3	-	-
Social program fees	6.2	6.0	0.2	3.3%
Reservation fees	1.8	1.8	-	-
Other revenue	2.0	1.7	0.3	17.6%
Total Direct Route Revenue	114.5	111.0	3.5	3.2%
Indirect Route Revenue				
Ferry transportation fees	32.0	32.2	(0.2)	(0.6%)
Federal-Provincial subsidy	7.1	7.0	0.1	1.4%
Total Route Revenue	153.6	150.2	3.4	2.3%
Other general revenue	0.3	0.3	-	-
Total Revenue	153.9	150.5	3.4	2.3%

Average tariff revenue per vehicle increased $1.72 or 4.6% in the quarter compared to the same period in the prior year and average tariff revenue per passenger increased $0.41 or 4.8%. The higher average fares, largely offset by the decrease in traffic, resulted in a $0.3 million increase in tariff revenue.

On January 17, 2014, due to the high 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 implemented on our unregulated or Northern Routes. There were no fuel surcharges in place in the fourth quarter of fiscal 2013.

Catering and on-board revenues were at the same level as the fourth quarter of the prior year, due to an increase in average spending per passenger offset by a decrease in passenger traffic on routes where these services are offered.

Social program fees increased by 3.3% as a result of a 1.9% increase in the number of seniors travelling and higher usage of the MTAP program on our Major Routes, as well as an increase in fares. These increases were partially offset by lower usage of all programs on the Other Routes.

The increase in other revenue is mainly due to increases in parking revenue and stateroom rental.

Ferry transportation fees were lower primarily as a result changes in funding from the Province as described above.

Expenses
Our operating and net finance and other expenses for the fourth quarter of fiscal 2014 and fiscal 2013 are shown in the following tables:

Operating expenses ($ millions)	**Three months ended March 31**			
			(Increase) Decrease	
	2014	**2013**	**$**	**%**
Operations	106.6	103.1	(3.5)	(3.4%)
Maintenance	18.0	20.4	2.4	11.8%
Administration	9.7	8.1	(1.6)	(19.8%)
Total operations, maintenance & administration	134.3	131.6	(2.7)	(2.1%)
Cost of retail goods sold	5.6	5.4	(0.2)	(3.7%)
Depreciation and amortization	35.3	33.7	(1.6)	(4.7%)
Total operating expenses	175.2	170.7	(4.5)	(2.6%)

The increase in operations costs for the three months ended March 31, 2014, compared to the same period in the prior year, is due to a $1.9 million increase in fuel costs as a result of higher fuel prices, a $0.7 million insurance claim recovery in the last quarter of fiscal 2013, $0.2 million in travel costs mainly related to service alterations and various other increases, partially offset by reductions in contracted services. For purposes of rate regulation, $4.7 million of our fuel expense for the quarter that resulted from higher prices is recorded in deferred fuel cost accounts for future recovery.

The decrease in maintenance costs reflects both decreases in terminal maintenance costs and variations in vessel refit scheduling.

The increase in administration costs is mainly due to a $0.7 million increase in computer software fees and licenses, a $0.6 million increase in wages and benefits and increases in several other areas including materials and services and contracted charges.

Depreciation and amortization was $1.6 million higher in the quarter compared to the same period in the prior year as a result of the new capital assets entering service.

Net finance and other ($ millions)	**Three months ended March 31**			
			(Increase) Decrease	
	2014	**2013**	**$**	**%**
Interest expense				
Bond interest	16.0	15.6	(0.4)	(2.6%)
KfW loans	1.7	2.0	0.3	15.0%
Interest on finance lease	0.5	0.6	0.1	16.7%
Short-term debt	0.2	0.1	(0.1)	(100.0%)
Capitalized interest	(0.8)	(0.5)	0.3	60.0%
Total interest expense	17.6	17.8	0.2	1.1%
Less: finance income	(1.1)	(0.9)	0.2	22.2%
Net finance expense	16.5	16.9	0.4	2.4%
Loss on disposal and revaluation of property, plant and equipment and intangible assets	0.5	-	(0.5)	-
Total net finance and other expenses	17.0	16.9	(0.1)	(0.6%)

Net finance and other expenses in the quarter were $0.1 million higher compared to the same period in the prior year, primarily due to $0.5 million in losses on disposal and revaluation of property, plant and equipment and intangible assets, mainly offset by $0.2 million decrease in net interest expense and $0.2 million increase in finance income.

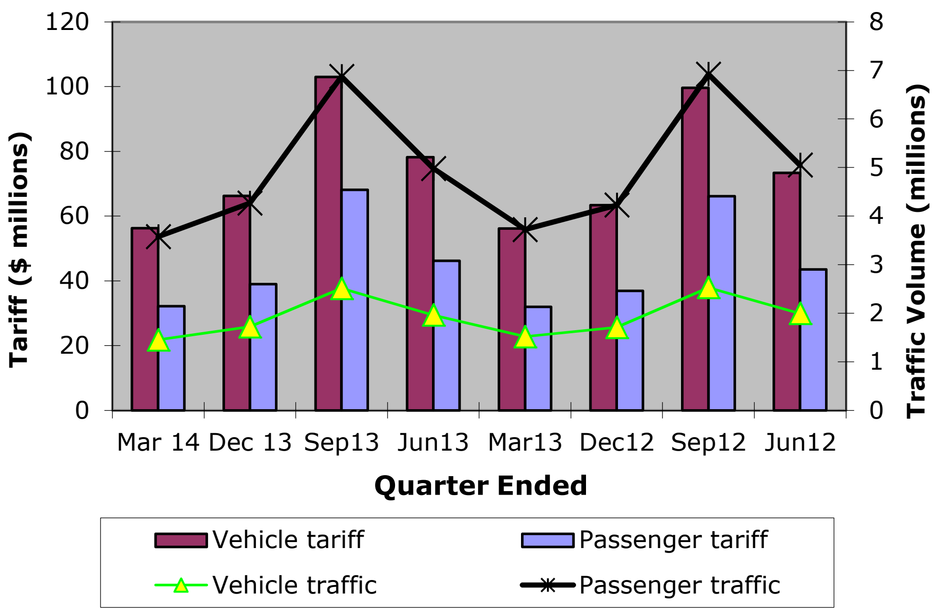
SUMMARY OF QUARTERLY RESULTS

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

	Quarter Ended (unaudited)							
($ millions)	**Mar 14**	**Dec 13**	**Sep 13**	**Jun 13**	**Mar 13**	**Dec 12**	**Sep 12**	**Jun 12**
Total revenue	153.9	174.8	271.5	200.0	150.5	169.6	268.6	197.7
Operating (loss) profit	(21.3)	3.7	82.3	21.2	(20.2)	0.2	84.1	20.7
Net (loss) earnings	(38.3)	(12.3)	64.3	4.3	(37.1)	(17.2)	66.5	3.3
Other comprehensive (loss) income	(5.0)	-	0.1	-	1.1	-	-	-
Total comprehensive (loss) income	(43.3)	(12.3)	64.4	4.3	(36.0)	(17.2)	66.5	3.3

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

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



Capital Expenditures

Capital expenditures in the three and twelve months ended March 31, 2014 totalled $40.8 million and $129.9 million, respectively.

($ millions)	March 31, 2014	
	3 Months	**12 Months**
Vessel upgrades and modifications	18.6	68.9
Terminal marine structures	13.7	40.2
Information technology	6.7	16.9
Terminal and building upgrades and equipment	1.8	3.9
Total capital expenditures	40.8	129.9

Vessel Upgrades and Modifications

Capital expenditures for vessel upgrades and vessel modifications in the three and twelve months ended March 31, 2014 included the following:

($ millions)	March 31, 2014	
	3 Months	**12 Months**
Major overhauls and inspections (see below)	11.5	38.8
Tachek life extension	0.6	14.2
Cable ferry	3.2	3.4
Kwuna three-quarter life upgrade	0.2	3.0
Electrical and navigational equipment upgrades	0.3	1.4
C-Class controllable pitch propeller and tail shaft rebuilds and monitoring system	0.1	1.3
New rescue boats and davits	0.6	1.1
Replacement of fuel and oil purifiers	0.6	0.7
Queen of Oak Bay three-quarter life upgrade	0.3	0.6
New intermediate vessels	0.2	0.6
Other projects	1.0	3.8
	18.6	68.9

The $38.8 million in major overhauls and inspections completed in the year ended March 31, 2014 or currently underway include:

- $3.7 million for the *Queen of Cowichan*;
- $3.4 million for the *Northern Adventure*;
- $3.3 million for the *Queen of Surrey*;
- $3.2 million for the *Spirit of Vancouver Island*;
- $3.0 million for the *Queen of New Westminster*;
- $2.7 million for the *Island Sky;*
- $2.6 million for the *Kwuna*;
- $2.5 million for the *Queen of Burnaby*;
- $2.1 million for the *Coastal Celebration*;
- $2.0 million for the *Quinsam*;
- $1.8 million for the *Queen of Nanaimo*;
- $1.8 million for the *Skeena Queen*;
- $1.6 million for the *Powell River Queen*;
- $1.4 million for the *Mayne Queen*;
- $1.2 million for the *Queen of Cumberland*;
- $1.1 million for the *Bowen Queen*;
- $0.9 million for the *Queen of Chilliwack;* and
- $0.5 million for several other vessels.

A $20 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.

On February 27, 2014, we announced the award of a $15 million contract to Seaspan's Vancouver Shipyards of North Vancouver for the construction of the new cable ferry. The new 50-car vessel is expected to be in service in the summer of 2015. (See "Outlook – Asset Renewal Program" below for more detail.)

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

A $1.4 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 complete. This will take us further towards bridge standardization.

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 fiscal 2014 or are currently underway. Completed projects include improving vessel propulsion systems by installing new controllable pitch propeller hub systems on the *Queen of Coquitlam* and the *Queen of Cowichan* and installing a vibration monitoring system of shaft bearings on all five C-Class vessels that 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. A project to rebuild two spare tail shafts for potential use in upcoming overhauls is expected to be complete by the end of the first quarter of fiscal 2015.

A $1.1 million project for new rescue boats and davits on the *Northern Adventure* and *Spirit of Vancouver Island* was completed in the fourth quarter.

A $0.7 million project to replace the original fuel and oil purifiers on the *Spirit of Vancouver Island* and the *Spirit of British Columbia* was substantially completed in fiscal 2014.

A $16 million project for a three-quarter life upgrade of the *Queen of Oak Bay* will include significant pipe and steel renewal, upgrades to the electrical system, replacement of the steering gear system, upgrades to the fire protection system, standardization of the bridge and replacing the emergency generator. The upgrade is expected to be complete by the end of fiscal 2015.

A project to construct three new intermediate class vessels is underway. We are currently reviewing the responses to the Request for Proposals (RFP) we issued in December 2013. The new vessels are expected to enter service in late 2016 through mid-2017 and will replace the 49-year old *Queen of Burnaby* and the 50-year old *Queen of Nanaimo*. The new vessels will be designed to operate as dual-fuel capable, so they can run on LNG or marine diesel fuel. (See "Outlook – Asset Renewal Program" below for more detail.)

Other ongoing projects include early costs for the mid-life upgrades of the *Queen of Capilano,* the *Spirit of Vancouver Island* and the *Queen of Cumberland*.

Terminal Marine Structures
Capital expenditures for terminal marine structures in the three and twelve months ended March 31, 2014 included the following:

($ millions)		March 31, 2014	
Terminal	**Description**	**3 Months**	**12 Months**
Westview	Replacement of trestle, ramp, apron and towers	6.2	15.8
Little River	Replacement of ramp, tower, wingwall and dolphin	2.3	8.1
McLoughlin Bay	Berth modifications	3.3	7.2
Denman Island and Buckley Bay	Modifications to accommodate the new cable ferry	0.2	1.3
Alert Bay	Replacement of wingwalls, towers, ramp and aprons	-	2.5
Fleet maintenance facility	Dredging at Deas basin	0.6	0.8
Horseshoe Bay	Transfer deck life-extension	-	0.8
Various	Install tie-up winches	-	0.6
Port McNeill	Replacement of trestle, ramp, apron and towers	0.6	1.1
Various	Other projects	0.5	2.0
		13.7	40.2

At Westview terminal, an $18 million project to replace the existing trestle with one with an improved approach radius, capacity to carry heavier vehicles, two traffic lanes and a pedestrian sidewalk was completed in the fourth quarter of fiscal 2014. The project also included replacement of the ramp, ramp abutment, apron and towers with active lift hydraulics and replacement of the waiting shelter.

At Little River terminal, a $9 million project to replace the ramp, ramp abutment and towers with active lift hydraulics and replace the wingwalls and dolphin was also completed in the fourth quarter.

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.

Modifications at Denman Island and Buckley Bay terminals, as part of the project for our new cable ferry service, include two contracts totalling $15 million awarded for supply of two concrete floating pontoons, construction of two berths, expansion of Denman West holding compound and all associated upland development. These modifications are expected to be complete by the end of the third quarter of fiscal 2015. (See "Outlook – Asset Renewal Program" below for more detail.)

At Alert Bay terminal, an $8 million project to upgrade wingwalls, towers, aprons and ramp was substantially completed in the first quarter of fiscal 2014, in time for the busy summer season.

At our maintenance facility in Richmond, we completed a $1 million project for dredging Deas basin. This is done, as needed, every five to six years to maintain the depth necessary to accommodate our vessels in the basin.

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.

A $1.8 million project for the installation of tie-up winches at Langdale, Horseshoe Bay and Tsawwassen terminals was completed, including final test fitting of vessels, in the fourth quarter of fiscal 2014.

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, a $0.4 million project at Crofton terminal to upgrade the ramp and life extend the starboard wingwall and trestle and a $0.3 million project to upgrade a ramp at Horseshoe Bay terminal.

Information Technology
Capital expenditures for information technology in the three and twelve months ended March 31, 2014 included the following:

($ millions)	March 31, 2014	
	3 Months	**12 Months**
Customer service program	3.1	9.1
Payroll system replacement	1.2	3.1
Computer hardware upgrades	1.4	2.5
Infrastructure relocation program	0.8	1.5
Other projects	0.2	0.7
	6.7	16.9

Our 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. The main elements of this multi-year program will be implemented in stages starting in 2015, and are expected to be completed in 2017. We believe this program will significantly improve our ability to efficiently respond to the changing needs of our customers. A total of $8 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 in fiscal 2014 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 twelve months ended March 31, 2014 included the following:

($ millions)	**March 31, 2014**	
	3 Months	**12 Months**
Vehicles and other equipment	0.5	1.3
Building improvements at several terminals	0.4	0.9
Signage at terminals serving our Major Routes	0.2	0.5
Terminal seismic upgrades	-	0.5
Other terminal projects	0.7	0.7
	1.8	3.9

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 construction of a new training facility for training on life saving equipment; updating signage at our terminals serving our Major Routes; seismic upgrades at certain of our maintenance facilities; and a new pedestrian walkway at Skidegate terminal.

OUTLOOK

Traffic Levels

Ferry traffic levels are affected by a number of factors, such as the economy, weather, transportation costs (including vehicle gasoline prices and ferry fares), the value of the Canadian dollar, global security, tourism levels, disposable personal income, demographics, and population growth. We are uncertain as to the individual or cumulative impact these items may have on our traffic levels. We are also uncertain as to the cumulative impact that tariff rate increases and the implementation and removal of fuel surcharges or rebates may have.

A summary of vehicle and passenger traffic over the last six years is shown below and a discussion of the changes over the years is discussed above in the "Financial and Operational Overview".

Vehicle Traffic by fiscal year

(thousands)	**2014**	**2013**	**2012**	**2011**	**2010**	**2009**
Major routes	4,556.8	4,600.6	4,637.9	4,811.0	4,859.0	4 796.1
Other routes	3,059.1	3,120.3	3,172.4	3,279.2	3,365.3	3,302.6
Northern routes	28.4	27.8	27.6	29.3	31.1	31.7
Total	7,644.3	7,748.7	7,837.9	8,119.5	8,255.4	8,130.4
(Decrease) increase	*(1.3%)*	*(1.1%)*	*(3.5%)*	*(1.6%)*	*1.5%*	*(5.2%)*

Passenger Traffic by fiscal year

(thousands)	**2014**	**2013**	**2012**	**2011**	**2010**	**2009**
Major routes	12,708.7	12,777.2	12,920.8	13,309.7	13,388.3	13,191.8
Other routes	6,906.9	7,061.0	7,168.5	7,350.5	7,559.1	7,441.7
Northern routes	81.1	80.9	80.7	86.0	88.2	94.0
Total	19,696.7	19,919.1	20,170.0	20,746.2	21,035.6	20,727.5
(Decrease) increase	*(1.1%)*	*(1.2%)*	*(2.8%)*	*(1.4%)*	*1.5%*	*(4.9%)*

Fiscal 2014 traffic was negatively impacted by the timing of the Easter holiday. Fiscal 2014 included one day of the Easter holiday weekends (April 1, 2013), while fiscal 2013 included seven days of Easter holiday weekends (April 6 through 9, 2012 and March 29 through 31, 2013). We believe that, after adjusting for this timing of Easter holiday weekend, fiscal 2014 traffic levels were generally flat compared to fiscal 2013. Fiscal 2014 traffic was also negatively impacted as a result of service alterations to accommodate upgrades at some of our terminals.

We believe the outlook for the travel industry and the US economy has improved, though not significantly. We also see signs of modestly improving consumer confidence and spending which are especially positive for the leisure travel segment. We expect these improvements will result in a limited recovery in discretionary traffic levels. In the near term, we anticipate no significant increase or decrease in overall traffic volume on all our routes.

Market Opportunities
We are constantly looking for innovative ways to serve our customers and actively pursue opportunities for growth.

Our drop trailer service, launched in March 2009, operates on two of our Major Routes. Our commercial customers on these routes can drop their trailers off at one terminal and pick them up at another. This drop trailer service is the fastest growing segment of our market with increases in revenue over the past three years of 15%, 34%, and 54%, respectively. The service also improves our overall productivity by utilizing otherwise unused capacity. We expect to see modest growth in drop-trailer traffic over the next few years as general economic conditions improve and our overall commercial market share remains relatively stable.

In May 2010, we opened our vacations centre, which is conveniently located in the tourist sector of downtown Vancouver. Through the use of our travel centre and an integrated marketing approach, we are able to leverage our core business to drive incremental ferry traffic as well as generate commissions from the related services. Using a 37-foot long interactive media wall display, customers are able to view route maps, vessel schematics, and destination images to help them choose from a variety of travel package options. In fiscal 2014, the number of vacation packages sold generated over $3.3 million in revenue, an increase of 12.6% over the prior year. As the economy strengthens, we expect to see continuing growth, leading to increased traffic volumes as well as incremental non-tariff revenue.

We also have opportunities for continued growth with our onboard retail gift shops. Over 40% of our gift shop sales are clothing. Sales of our quality clothing have grown over the past three years with increases of 14.6%, 13.8%, and 14.8%, respectively.

Asset Renewal Program
We have one of the largest fleets in the world. The average age of our assets was among the oldest of major ferry operators worldwide. To address this, we instituted a multi-year major fleet and asset renewal program which involved upgrading and replacing a large share of our major vessels and terminal assets.

Over a number of years, this program saw seven new vessels being added to our fleet, many other vessels significantly upgraded and numerous improvements to our terminal assets. The entry of the new vessels into service and asset revitalization reduced the average age of our major vessels from 33 years to 19 years and has assisted in maintaining operational reliability. The most significant portion of this asset renewal program was completed during fiscal 2008 and 2009.

Capital expenditures by fiscal year

($ millions)	2014	2013	2012	2011	2010	2009	2008
Vessel upgrades & modifications	64.9	39.9	47.6	43.8	21.5	75.7	53.7
Terminal marine structures	43.6	27.5	44.0	41.6	22.5	31.0	26.6
Information technology	16.9	20.6	18.6	17.2	15.5	14.2	15.2
Terminal & building upgrades & equipment	3.9	7.2	11.1	24.5	15.1	24.3	27.9
Total (without new vessels)	129.3	95.2	121.3	127.1	74.6	145.0	123.4
New vessels	0.6	1.4	0.9	1.6	6.8	348.7	329.1
Total (including new vessels)	129.9	96.6	122.2	128.7	81.4	493.9	452.5

In fiscal 2010, the costs for the new major vessels were finalized and design costs for new minor and intermediate sized vessels, including the cable ferry, began. The typical life span of vessels is 40 to 45 years and our minor and intermediate sized vessels currently have an average age of 37 years. As the identified replacement dates approach, we are reviewing these vessels to determine potential candidates for life extension rather than replacement. Our expectation is that we will need to replace or life extend 11 of these vessels over the next 10 years and 42% of the total capital expenditures we forecast incurring over this period are for new vessel projects.

The first of the new vessels will be a cable ferry as detailed below. When the cable ferry comes into service, it will allow us the option to retire the 50 year-old *Tenaka.*

Our strategy for new vessels includes design optimization, interoperability, and standardization of vessels across the fleet, to the extent possible, to provide more flexibility to respond to changes in the market demand and traffic forecasts. We also plan to adopt LNG as a fuel source where economic.

In December 2013, we issued an RFP to five pre-qualified shipyards, including one Canadian proponent, to participate further in our 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; each with the capacity to carry 145 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 are currently reviewing the responses to the RFP. Two of the 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.

Besides new vessel projects, our 10-year capital plan includes many vessel betterment projects, including mid-life upgrades of the *Spirit of Vancouver Island* and *Spirit of British Columbia* and terminal upgrades, including at our Langdale and Horseshoe Bay terminals.

Cable Ferry

After many years of studying the feasibility of a cable ferry, performing extensive design and analysis and obtaining regulatory approvals, the cable ferry project for service on one of our shortest routes between Buckley Bay on Vancouver Island and Denman Island is now underway. This 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.

Compared to the current service, it is projected that, over 40 years, the cable ferry will provide over $80 million in cost savings as well as significant environmental benefits, including: reduced fuel consumption; lower air emissions; reduced wake; no propeller turbulence; low anti-fouling discharge; low propeller scour; and zero discharge to the marine environment.

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 on the route connecting Buckley Bay and Denman Island are reasonable and prudent. This decision included reasonable conditions which we are confident we will be able to meet.

On February 27, 2014, we announced the award of a $15 million contract to Seaspan's Vancouver Shipyards of North Vancouver for the construction of the new cable ferry. On March 19, 2014, we announced the award of two contracts totalling $15.2 million for construction of Buckley Bay and Denman Island West cable ferry berths. The berth contracts include an award to Vancouver Pile Driving Ltd for supply of two concrete floating pontoons and another award to Ruskin Construction Ltd. of Victoria for construction of two berths, expansion of Denman West holding compound and all associated upland development. Terminal construction is expected to be complete by the end of the third quarter of fiscal 2015 and the new 50-car vessel is expected to be in service in the summer of 2015.

Fuel Conversion

On October 29, 2012, we submitted a fuel strategies report to the Commissioner which included our plan for transition to alternate fuels. Both LNG and the marine diesel we currently use meet all current domestic and international emissions regulations as well as the new regulations which will be effective January 1, 2015. We have studied the feasibility of using LNG and believe that a move to this fuel source would reduce costs and emissions. At this time, LNG is over 50% less expensive than the ultra-low sulphur diesel we currently use and has significantly less emissions. We believe that LNG is a viable option for future new vessels and, as noted above, our three new intermediate vessels will have the capability to run on it. We are also analyzing LNG as an option for existing vessels undergoing major retrofits and intend to pursue the option where it is economically and technically feasible. We have several existing vessels scheduled for mid-life upgrades beginning in fiscal 2015.

Alternative Service Providers

In an effort to reduce costs on our regulated routes, and consistent with section 69 of the Act, from time to time we test the market to determine if another operator, under contract to us, could provide safe, reliable and high quality service that is more cost-effective.

Regulation

On January 1, 2013, the requirement to maintain a Shipboard Energy Efficiency Management Plan (SEEMP) came into force for all vessels governed by International Maritime Organization (IMO) standards. Our only vessel under IMO standards is the *Northern Adventure.* The *Canada Shipping Act, 2001* has adopted this IMO standard for vessels of over 400 gross tonnage and now a SEEMP is required for the majority of our vessels. We have completed an initial implementation on one of our vessels and expect to have implementation complete on each vessel prior to renewal of their annual Air Pollution Prevention Certificates. We do not expect any significant impact as a result of the new requirement and view this as an opportunity to implement, evaluate and share local initiatives for improving vessel operating efficiency.

New regulations are now in force to address air emissions from vessels over 400 gross tonnage. The *Regulations Amending the Vessel Pollution and Dangerous Chemicals Regulations*, promulgated under the *Canada Shipping Act, 2001* were published on May 8, 2013. Among other things, the amendments implement standards for the North American Emission Control Area (ECA). Vessels operating inside the ECA are required to meet certain sulphur dioxide, nitrogen dioxide and particulate levels. We are currently well below the 2015 requirements regarding sulphur dioxide, and requirements for nitrogen dioxide levels for new vessels can be met through the use of LNG or the installation of exhaust scrubber technology.

We expect composting bylaws banning landfill disposal of organics to be implemented in Metro Vancouver in fiscal 2015. We are well positioned for these new bylaws as we currently have a composting program which we are expanding in early fiscal 2015 to a third Major Route.

The designation of marine protected areas and use of integrated marine management is gaining momentum within the coastal waters of British Columbia. There are currently a number of marine area planning processes underway that will decide who has access to marine resources and how these resources are managed. We are paying close attention to these processes to ensure there is no impact on our operations.

Financial Outlook

We do not anticipate that economic conditions will materially change although we estimate that service reductions (See "Corporate Structure – Economic Regulatory Environment") may result in a small reduction in our traffic levels in the near term. We are continuing our program of cost containment and deferrals, while maintaining safe, reliable service. However, we have no plans to reduce our planned refit and maintenance programs, training and safety programs or capital programs.

We expect positive net earnings in fiscal 2015, reflecting adjustments to service levels, a modest increase in fares, and continued cost management, coupled with a gradual improvement in the overall economy.

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.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment. Where the market prices are not available, fair values are estimated using discounted cash flow analysis based on our current borrowing rate for similar borrowing arrangements.

Credit Risk

Our exposure to credit risk is limited to the carrying value on our statements of financial position for cash, short-term investments, derivative assets and trade and other receivables. There is a risk that a third party may fail to meet its obligations under the terms of a financial instrument, however, we do not believe that it is a significant risk.

Risk mitigation: We limit our exposure to credit risk on cash and investments by investing in liquid securities with high credit quality counterparties, and placing limits on the tenor of investment instruments and maximum investments per counterparty. We manage credit exposure related to financial instruments by dealing with high credit quality institutions, in accordance with established policy and parameters and by an ongoing review of our exposure to counterparties. Counterparty credit rating and exposures are subject to approved credit limits and are monitored by us on an ongoing basis. Counterparties with which we have significant derivative transactions must be rated “A” or higher. We do not expect any counterparties to default on their obligations.

Our credit risk from trade customers is limited by having a large and diversified customer base and is managed through the review of third-party credit reports, utilizing pre-authorized payment plans, monitoring of aging of receivables, and collecting deposits and adjusting credit terms for higher risk customers. Amounts due from the Province and the Government of Canada are considered low credit risk. At March 31, 2014, 52% of our trade and other receivables were comprised of amounts due from the Province and the Government of Canada and 100% of our trade and other receivables are current.

Liquidity Risk

We target a strong investment grade credit rating to maintain capital market access at reasonable interest rates. Our financial position could be adversely affected if we fail to arrange sufficient and cost effective financing to fund, among other things, capital expenditures and the repayment of maturing debt. This is subject to numerous factors, including the results of our operations, our financial position, conditions in the capital and bank credit markets, ratings assigned by rating agencies and general economic conditions.

We deem liquidity risk to be low at this time as we do not foresee the need to access the capital markets in the near term.

Risk mitigation: We manage liquidity risk through daily monitoring of cash balances, the use of long-term forecasting models and the maintenance of a credit facility and debt service reserves. Our credit ratings at March 31, 2014, were “A” (DBRS) with a stable trend and “AA-” (S&P) with a stable outlook.

Market Risk
Interest Rate
Our exposure to interest rate risk is limited to interest expenses associated with our short-term borrowings, floating rate debt and any new long-term issues and to earnings associated with interest rate movement beyond the term of the maturity of fixed rate short-term investments.

Risk mitigation: To manage this risk, we maintain between 70% and 100% of our debt portfolio in fixed rate debt, in aggregate. In addition, we may enter into interest rate agreements to manage our exposure on debt instruments. At March 31, 2014 we had entered into interest rate forward contracts to reduce such exposure on our April 28, 2014 bond issue. (See "Liquidity and Capital Resources" above for more detail.) A 50 basis point change in interest rates would not have had a significant effect on our fiscal 2014 earnings.

Foreign Currency
We are also exposed to risk from foreign currency prices on financial instruments, such as accounts payable denominated in currencies other than the Canadian dollar.

Risk mitigation: To manage exposure on future purchase commitments, we review our foreign currency denominated commitments and hedge through derivative instruments as necessary. With the possible exception of fuel prices (see discussion below), a 10% change in the US dollar or Euro foreign exchange rates would not have had a significant effect on our fiscal 2014 earnings.

Fuel Price
Our exposure to fuel price risk is associated with the changes in the Canadian market price of marine diesel fuel. Fuel costs have fluctuated significantly over the past few years and there is uncertainty of the cost of fuel in the future.

High levels of fuel pricing could translate into significant fuel surcharges and result in unprecedented total tariff levels. There is uncertainty of the impact on future ferry traffic levels if fuel surcharges and therefore total tariff levels rise significantly. There is a risk of a decline in ferry traffic levels as a result of increasing customer costs resulting from the implementation of fuel surcharges.

Risk mitigation: To mitigate the effect of volatility in fuel oil prices on our earnings, we use deferred fuel cost accounts together with fuel surcharges or rebates as required. (See "The Effect of Rate Regulation" above for more detail.)

We may enter into hedging instruments in order to reduce fuel price volatility and add a fixed component to the inherent floating nature of fuel prices. Fuel price hedging instruments are used solely for the purpose of reducing fuel price risk, not for generating trading profits. Pursuant to our Financial Risk Management Policy, the term of the contracts is not to extend beyond three years. This policy limits hedging to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period, 90% of anticipated monthly fuel consumption for the 12 month period thereafter, and to 85% of anticipated monthly fuel consumption for the remaining 12 month period. Fuel forward contracts are only entered into when there is a reasonable likelihood that the hedge will result in a net procurement cost per litre less than or equal to the set price per litre established by the Commissioner. At March 31, 2014, we did not have any outstanding fuel forward contracts. Gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs.

Derivatives
We hedge our exposure to fluctuations in fuel prices, foreign currency exchange rates and interest rates from time to time through the use of derivative instruments. At March 31, 2014 we held four foreign exchange forward contracts with a carrying and fair value liability of $7 thousand while at March 31, 2013 we held three such contracts with a carrying and fair value liability of $12 thousand. Also, at March 31, 2014 we held four interest rate forward contracts with a carrying and fair value liability of $5.3 million. There were no commodity derivatives in place at March 31, 2014 and no interest rate forward contracts or commodity derivatives in place at March 31, 2013.

At March 31, 2014, with the application of hedge accounting, the $5.1 million effective portion of the unrealized loss of $5.3 million was recognized in other comprehensive income and the $0.2 million ineffective portion was recognized in net earnings. The realized hedge gains/losses related to these forward contracts will be included in the initial carrying amount of the bonds and will be reclassified from accumulated other comprehensive income and recognized in net earnings over the 30-year life of the debt instruments hedged.

The fair value of commodity derivatives would reflect only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel. The fair values would reflect the estimated amounts that we would receive or pay should the derivative contracts be terminated at the stated dates. For regulatory purposes, any gains or losses related to fuel commodity swaps would be charged to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

Non-Derivative Financial Instruments
The carrying and fair values of non-derivative financial instruments at March 31, 2014, and 2013 are as follows:

($ millions)	2014 Carrying Value	2014 Fair Value	2013 Carrying Value	2013 Fair Value
Financial Assets				
Cash and cash equivalents	71.4	71.4	36.7	36.7
Restricted short-term investments	35.8	35.8	35.6	35.6
Other short-term investments	81.0	81.0	43.4	43.4
Trade and other receivables	16.6	16.6	18.1	18.1
Long-term loan receivable	24.5	24.5	24.5	24.5
	229.3	229.3	158.3	158.3
Financial Liabilities				
Accounts payable and accrued liabilities	48.1	48.1	51.8	51.8
Interest payable on long-term debt	19.6	19.6	18.1	18.1
Provisions	51.3	51.3	50.8	50.8
Long-term debt, including current portion	1,336.8	1,515.1	1,286.2	1,486.7
	1,455.8	1,634.1	1,406.9	1,607.4

The fair value of all financial instruments included above, with the exception of long-term debt, approximate their carrying amounts due to the nature of the item and/or the short time to maturity.

The carrying value of long-term debt is measured at amortized cost using the effective interest rate method. Fair value is calculated by discounting the future cash flow of each debt issue at the estimated yield to maturity for the same or similar issues, or by using available quoted market prices.

We continue to employ a variety of commonly accepted methodologies to identify, assess and mitigate risks. We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business. We have an integrated approach to managing risk, involving our Board of Directors through to our employees.

Our Board of Directors is responsible for ensuring that we have the appropriate policies, procedures and systems in place to identify and manage the principal risks of our business. Management keeps the Board and its Committees apprised of changing risks and the processes and systems used to mitigate them. The individual Committees of the Board regularly consider and review internal processes for managing those risks that are specific to the areas of our business for which they have oversight responsibility, and obtain assurance from management and internal audit, as appropriate, regarding the adequacy of the associated risk management processes.

Individual business units are responsible for considering risk exposures at all levels within their unit and also for considering the possible impact such risks may have on other areas. To ensure we focus on safety as our first priority, all operational meetings are expected to start with safety as the first item on the agenda. This helps ensure that safety and risk are always front and center for all employees.

A culture that promotes the management of risk as part of each employee's daily activities is integral to our program. One way we promote this culture is through our SailSafe program. Employees are provided with a risk-based ALERT tool that can facilitate change in the specific task or process or within other areas of the company if the risk is applicable to other aspects of operations. We have also introduced an on-line operational risk register.

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 stagnant economic environment and ensure a viable, profitable future.

The following is a list of our business risks.

Customer Demand
Our vehicle and passenger traffic levels in fiscal 2014, as compared to the prior year, declined 1.3% and 1.1%, respectively. The decline was experienced in both the Major and Other Routes while the Northern Routes experienced a modest increase. We believe that, after adjusting for the timing of the Easter holiday weekend, fiscal 2014 traffic levels were generally flat compared to fiscal 2013.

Effective April 1, 2014, the Province reduced the passenger fare discount for BC seniors travelling Monday to Thursday to 50% from 100% on the Major and Other Routes. We believe that this will have a negative impact on our traffic levels.

Many factors affect customer demand, including current economic conditions, the value of the Canadian dollar, levels of tourism, demographics and population growth. The cost of transportation, including the price of fuel at the pump and ferry fares (including the implementation and removal of fuel surcharges or rebates), disposable personal income, heightened global security and weather conditions may have a negative effect on discretionary travel and levels of tourism.

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

Risk mitigation: We are constrained by the CFSC, which stipulates, among other things, the number of round trips that must be provided for each regulated ferry route. Within these constraints, we actively manage our capacity in an efficient and effective manner to ensure we can react quickly to changing levels of demand within the restrictions of the CFSC.

In fiscal 2013, the CFSC was amended to allow a reduction in the service requirement on three of our Major Routes and set targets for further service level reductions system wide. We implemented reductions in round trips on those Major Routes, where the traffic levels no longer warranted extra service or where service was significantly under-utilized. In fiscal 2014, the CFSC was again amended to allow for further reductions in the service requirement and effective April 28, 2014, we implemented reductions in round trips on our Northern and Other Routes. On April 1, 2015, further reductions will be made on three of our Major Routes.

Vessel planning strategies are in place with the goal of standardization so we can better respond to changes in customer demand. We also regularly review and update our short and long-term financial and operating plans to ensure appropriate alignment of expenses with revenue.

Security

Deliberate, malicious acts could cause death, injury or property damage. The occurrence of a major incident or mishap could negatively affect the propensity for the public to travel, reducing our ferry traffic levels. It could also lead to a substantial increase in insurance and security costs. Any resulting reduction in tariff revenues and/or increases in costs could have a material adverse effect on our business prospects, financial condition and results of operations.

Risk mitigation: Security initiatives are in place to counter intentional attacks. Our 24-hour operations and security centre provides enhanced situational awareness and assessments, increased security monitoring, and a coordinated response during any incidents.

We have completed our multi-year project to upgrade security at our terminals and maintenance facilities. The project primarily involved fencing, gating, lighting, access controls, and closed circuit television, as well as upgrades to foot passenger ticketing areas, baggage screening, and the use of canine patrols. Although this major project is complete, we continue to make improvements in the security on our vessels and at our terminals and maintenance facilities.

We are also in the process of relocating 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.

We also have a sound conventional insurance program designed to mitigate the financial impact of a major incident. However, there can be no guarantee that the insurance coverage will be sufficient to cover all such incidents.

Safety
The safety of the public and our employees is our highest priority. However, there is a risk to passenger and employee safety and/or property damage as a result of the ineffectiveness of policy and procedures, equipment, maintenance, training, supervision, facility design and security measures.

We also have significant food and beverage sales, both on our vessels and at our terminals, and there is a risk of a foodborne illness contracted from contaminated products purchased from our food services.

A significant damage, injury or illness event could have an adverse effect on the lives of our employees and customers, our ability to meet operational service requirements, the environment, staff morale, our reputation and our financial position and results of operations.

Risk mitigation: Our safety program, SailSafe, launched in fiscal 2008, is a joint initiative with the Union and involves all employees. It has been successful in changing our culture of safety awareness. The objective of the SailSafe program is to ensure that safety is kept as the primary concern in the minds of our employees each and every day. As part of the SailSafe program, we have upgraded our safety management system including the introduction of an operational risk assessment and management process.

Our food storage, handling, preparation and cooking procedures are aligned with the hazard analysis critical control point (HACCP) methodology which is a preventive approach to food safety. HACCP is an industry-wide effort approved by the scientific community, as well as by regulatory and industry practitioners.

We adhere to a program of internal and external safety audits designed to verify our compliance with our safety management system. In fiscal 2014, we participated in the BC Maritime Employers Association's Certificate of Recognition Program which takes participating companies beyond basic safety compliance and sets an industry standard for developing a safety management system. The results of the audit concluded that we should receive a 90% score on the health and safety section and a 91% score on the injury management section, qualifying us for our first ever Certificate of Recognition. As a result of the audit, 31 recommendations were submitted to us that we are currently reviewing, with a view toward continual improvement.

We also have a sound conventional insurance program designed to mitigate the financial impact of a major incident. However, there can be no guarantee that the insurance coverage will be sufficient to cover all such incidents.

Security of Information
Deliberate or inadvertent release of confidential or sensitive information, whether in paper or electronic format, could have an adverse effect on the lives of our employees and customers as well as negatively impact our reputation. A significant loss of confidential management information could also negatively impact our financial position and results of operations.

Risk mitigation: Governance is in place for ensuring information privacy.
Our information security policy has been developed and implemented. Standard procedures for access and use of private data have been implemented. Multiple levels of technology controls are in place and networks, websites and databases are monitored by dedicated information technology security staff to detect potential issues. Information technology projects are delivered using the 'security by design' principle. Regular security scans by trusted and qualified vendors are conducted on a quarterly basis.

Communication to employees of their responsibility to protect private information is ongoing and a formal awareness and training program is in place.

Regulations – Other
Our operations are subject to a wide variety of national and local laws and regulations, all of which may change at any time.

There is the potential that the introduction of new safety or other regulations, including new taxes, or the interpretation of existing regulations, may impose a new, unexpected and significant cost burden and/or result in major disruptions to our operations.

Risk mitigation: We foster positive relationships with local officials and treat recommendations and advisories with respect and due consideration. Appeals are made to higher authorities as required.

We continue to seek reasonable and cost effective solutions for compliance with new regulations through our planning processes and asset renewal initiatives.

We also have the opportunity to apply to the Commissioner under section 42 of the Act for an extraordinary price cap increase or other relief if the introduction of new safety or other regulations impose a new, unexpected and significant cost burden.

Economic Regulatory Environment
We cannot predict what changes the Province may make to the Act or to other legislation, nor can we predict how the Commissioner's interpretation and administration of the Act may change over time. Such changes may impact our profitability. (See "Corporate Structure – Economic Regulatory Environment" above for more detail.)

The Commissioner has released the final price caps for the remaining two years of performance term three, April 1, 2014 to March 31, 2016. These price caps represent increases of 4.0% at April 1, 2014 and 3.9% at April 1, 2015. The order indicated the Commissioner has the intention of allowing us to achieve, by the end of the third performance term, equity not lower than 17.5% of total capitalization and a DSCR of 2.5 or higher. There remains uncertainty in the Commissioner's future price cap rulings.

Risk mitigation: We strive to maintain regular and open communications and positive relationships with the Province, the Commissioner, the Deputy Commissioner and local Ferry Advisory Committees that represent the interests of the communities we serve.

Access to Capital Markets
Our ability to arrange sufficient, cost-effective and timely debt financing could be materially adversely affected by numerous factors: our economic regulatory environment, our results of operations and financial position, market conditions, our credit ratings and general economic conditions.

Any failure or inability to borrow on satisfactory terms when required could impair our ability to repay maturing debt, fund necessary capital expenditures and meet other obligations and requirements and, as a result, could have a material adverse effect on our ongoing operations.

Risk mitigation: The results of our last two bond placements have been very positive. Our October 2013 bonds were rated "A" (DBRS) and "A+" (S&P) and our April 2014 bonds were rated "A" (DBRS) and "AA-" (S&P). We continue to strive to communicate to our stakeholders the importance of our financial viability within our economic regulatory framework and our commitment to maintaining financial strength, in order to access these important markets.

Regulations – Environmental
Our operations are subject to Federal, Provincial and local environmental laws and regulations dealing with various operations, including solid and liquid waste management, air quality and oil spill response.

The provincial government has made a commitment to reduce greenhouse gas emissions (GHG) by 33% by the year 2020, based on emissions in 2007. While the reduction targets have not yet been set, the transportation industry has been identified as a sector that will have emission limits.

If we were to be involved in an environmental accident or be found in material violation of applicable law and regulations, we could be responsible for material clean-up costs, repair of property damage, and fines or other penalties.

Risk mitigation: We will continue to comply with environmental laws and regulations and actively search for ways to improve our environmental performance to help us become an industry leader in environmental management. We have training programs in place that include training our staff in first response to an oil spill and we conduct regularly scheduled oil spill drills on our vessels and at our terminals.

We constantly look for ways to reduce fuel consumption and emissions on our vessels. We continue to use ultra-low sulphur diesel with a 5% biodiesel component on all of our vessels across the fleet and we currently meet the North American Emission Control Area standards for sulphur content that have been set for 2015. We have implemented a wide variety of fuel saving measures ranging from operating our vessels more efficiently to installing new, more fuel-efficient engines on some of our vessels and fuel monitoring systems on others and designing and building our new vessels to meet or exceed current environmental standards.

We are also actively pursuing LNG options for new vessels and vessels undergoing major retrofits because we believe that a move to this fuel source would reduce emissions as well as costs. Both LNG and the marine diesel we currently use meet all current domestic and international emissions regulations as well as regulations that will be effective January 1, 2015.

We have programs in place to protect the environment and reduce GHG. Besides using biodegradable hydraulic oils, we recycle beverage containers, cardboard, newsprint, plastics, wood, metal, spent fluorescent tubes, batteries, aerosol spray cans, old upholstery foam and used cooking oil. We also have a composting program which we are in the process of expanding. We are currently in the process of transitioning from Styrofoam cups to paper cups which can be recycled or composted. In fiscal 2014, we diverted approximately 200 tonnes of compostable material on two of our Major Routes, doubling the amount diverted in the prior year. We continue to replace chemical products with more environmentally friendly solutions and have replaced gasoline powered terminal vehicles with electric vehicles and gasoline powered baggage vans with propane powered tugger units. We also reduce GHG levels by transferring vessels to shore-power while berthed overnight at several of our terminals, promoting anti-idling and increasing waste diversion. We are currently expanding our shore-power program to additional terminals by upgrading the current shore power installations and adding new shore power installations where necessary to provide sufficient capacity to provide power to the vessels.

We have also introduced other initiatives to further mitigate our environmental impact. We have a sewage and waste water treatment system that, wherever possible, the vessels convey sewage to a terminal through pump-ashore infrastructure. Where terminal facilities are not available, small vessels were fitted with holding tanks, with truck pump-off. In all other cases, the vessels have been fitted with federally compliant marine sanitation devices. We have a treatment plant at one of our terminals while at the remaining seven; sewage is collected and transferred to treatment plants operated by local governments. (See "Investing in our Capital Assets" above for more detail.)

We believe that we maintain adequate environmental insurance; however, there can be no guarantee that the insurance coverage will be sufficient to cover all such losses.

Performance Risk

The occurrence of a major incident or mishap could result in default under the CFSC unless such accident or mishap qualified as an event of force majeure.

The occurrence of a default under the CFSC could have consequences, including an adjustment to ferry transportation fees from the Province or the forced sale of our vessels to the Province for net book value and termination of the Terminal Leases.

Risk mitigation: We have an asset renewal program for our vessels and terminals. This program is revitalizing our fleet and upgrading our terminals to support our ongoing operations and maintain service reliability.

We regularly update our vessel maintenance schedules to ensure that we provide the core service levels required under the CFSC.

We continuously monitor our operations from our 24-hour operations and security centre. This provides enhanced situational awareness and assessments to identify and prevent potential incidents and provides a coordinated response to any incident that may occur.

Taxes

We received an advance income tax ruling from the Canada Revenue Agency (CRA) that, provided the facts and other statements set out therein are accurate, we are a "Tax Exempt Corporation" described in paragraph 149(1)(d.1) of the *Income Tax Act*. This ruling was subject to a proposed amendment to subsection 149(1.3) of the *Income Tax Act* announced by the Department of Finance on December 20, 2002. The essential elements of this amendment have now been enacted. We have received a non-binding opinion from the CRA that amended subsection 149(1.3) will not cause us to cease to be a Tax Exempt Corporation.

There can be no assurance that we are and will continue to be a Tax Exempt Corporation.

Risk mitigation: We have the opportunity to apply to the Commissioner under section 42 of the Act for an extraordinary price cap increase or other relief if the introduction of new regulations imposes a new, unexpected and significant cost burden.

Treaty Negotiations

Much of British Columbia, including areas where we have operations and real property interests, is subject to claims of aboriginal rights or title. Canadian courts have recognized that aboriginal peoples may enjoy constitutionally protected rights, whether or not recognized in a treaty, in respect of lands that were used or occupied by their ancestors. These rights vary from the right to use lands and waters to carry out traditional activities (for example, an aboriginal right to fish) to the right to exclusively occupy lands that are subject to aboriginal title. What kind of right might exist depends primarily upon the nature and extent of the prior aboriginal use and occupation at specific dates in British Columbia's history.

At present, many aboriginal groups, who claim that they have un-extinguished Aboriginal rights and title, are seeking recognition of those claimed rights in modern treaties, or in government decision-making that may affect their traditional territories. Canadian courts have confirmed that provincial and federal governments have a duty to consult with and, if appropriate, accommodate aboriginal groups when they are proposing to make a decision that could potentially infringe asserted Aboriginal rights and title. Government approvals and licences, such as those required to operate existing terminal facilities or develop new ones, may trigger the government's duty to consult with any aboriginal groups whose claims of Aboriginal rights and title might be adversely affected by the granting of the licence or approval in question. Recent court decisions have clarified that the Crown, when making decisions, does not have to accommodate Aboriginal groups for historic infringements, though historic infringements may be taken into consideration in addressing proposed new infringements.

Aboriginal groups that have entered into treaties may have a right to be consulted with respect to government actions that could adversely affect their treaty rights. Modern treaties may also require the Crown to consult with an Aboriginal group with respect to certain kinds of government action in certain geographic areas, depending on the terms of the treaty.

Risk mitigation: Under the master agreement, the Province retains its liability, to the extent any exists, for the acts and omissions of the Province that occurred prior to our possession of the ferry terminal properties leased under the Terminal Leases and will reimburse us for any damages we suffer as a result. The Province will reimburse us for damages suffered if there is a final court decision or a treaty settlement that recognizes or confers upon an aboriginal group a proprietary or other interest in the ferry terminal properties should that right or interest interfere with our quiet enjoyment of the ferry terminal properties as set out in the Terminal Leases.

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 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.

We believe the following are the most critical accounting policies, estimates, and judgements that we have used in the preparation of our financial statements:

Workers' Compensation Claims Liability
Our financial statements include an estimate of residual liability for workers' compensation claims arising from the Workers' Compensation Board deposit class coverage system, in which our predecessor entity participated on or prior to March 31, 2003.

An actuarial valuation of the unfinalized claims remaining to be paid at March 31, 2013 that relate to incidents on or prior to March 31, 2003 was received in fiscal 2014 and the accrued benefit obligation estimated at $1.8 million. The residual liability balance ($1.9 million at March 31, 2013) was decreased during fiscal 2014 by $0.1 million and this actuarial gain recorded in other comprehensive income. This residual liability is drawn down as claims are paid. The balance at March 31, 2014 of $1.4 million ($1.9 million at March 31, 2013) is included in accrued employee future benefits in our financial statements.

Public Service Pension Plan
Our employees are members of the Public Service Pension Plan (the Plan), a defined benefit and multiemployer pension plan. The Plan is exempt from the requirements under the provincial *Pension Benefits Standards Act* to use the "solvency" method in conjunction with the "going concern" method for valuation purposes. As such, the Plan is currently valued solely by the going concern method. The most recent valuation, as at March 31, 2011, indicated an unfunded liability of $275 million across the total Plan.

Effective April 1, 2012, the Public Service Pension Board of Trustees increased contribution rates to the basic account for plan members and employers from 7.78% to 8.18% of pensionable earnings each, primarily due to the change in the investment return and demographic assumptions. The contribution rates to the inflation adjustment account for members and employers changed from 1.50% and 2.50% to 1.25% and 2.75%, respectively.

Retirement Bonus Liability
We sponsor a plan that provides a post-retirement benefit for eligible long service employees. The valuation of this plan is estimated based on complex actuarial calculations using several assumptions. These assumptions are determined by management with significant input from our actuary. The valuation of the obligation depends on such assumptions as discount rate, projected salary increases, retirement age and termination rates. An actuarial valuation of the plan at March 31, 2011, was obtained and the accrued benefit obligation estimated at $13.8 million. The liability included in accrued employee future benefits in our financial statements at March 31, 2014, was $14.2 million ($13.9 million at March 31, 2013). With our adoption on April 1, 2013 of the amended IAS 19 *Employee Benefits*, actuarial gains and losses resulting from valuations of obligations under this plan are immediately recognized in other comprehensive income. (See "Adoption of New Accounting Standards" below.)

Depreciation and Amortization Expense
Our capital assets, including assets under finance leases, are depreciated or amortized on a straight-line basis at varying rates. Depreciation and amortization rates require the use of estimates of the useful lives of the assets and of salvage value to be realized upon asset retirement.

We annually review asset lives in conjunction with our longer term asset deployment, replacement and upgrade strategies. When we determine that asset lives do not reflect the expected remaining period of benefit, we make prospective changes to the remaining period over which they are depreciated or amortized. There are a number of uncertainties inherent in estimating our asset lives and changes in these assumptions could result in material adjustments to our financial statements.

As disclosed in note 1 to our financial statements, we review and evaluate our long-lived assets for impairment when events or changes in circumstances indicate that the related amounts may not be recoverable.

Hedging Relationships
We utilize derivative financial instruments to manage market risk against the volatility in foreign currency, interest rate, and fuel price exposures. We do not utilize derivative financial instruments for trading or speculative purposes. At the inception of each hedge, we determine whether or not to apply hedge accounting.

When applying hedge accounting, we document all relationships between hedging instruments and hedged items, as well as our risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. We also assess, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. Realized and unrealized gains or losses associated with derivative instruments which have been terminated or cease to be effective prior to maturity are recognized in net earnings in the period in which they have been terminated or cease to be effective.

Asset Retirement Obligations
When it can be reasonably determined, we recognize the fair value of a liability for any legal obligations associated with the retirement of long-lived assets when those obligations result from the acquisition, construction, development or normal operation of the assets. A corresponding asset retirement cost is added to the carrying amount of the related asset and depreciated or amortized to expense on a systematic and rational basis.

Certain of our vessels contain undetermined amounts of asbestos. Under certain circumstances, we may be required to handle and dispose of the asbestos in a manner required by regulations. It is our intention to sell decommissioned vessels into world markets to buyers who will keep them in active service. Under these circumstances asbestos remediation would become the responsibility of the new owner.

No amount has been recorded for asset retirement obligations relating to these assets as it is not possible to make a reasonable estimate of the fair value of any such liability due to the indeterminate magnitude, likelihood, or financial impact, if any, of this issue. In addition, as our operations are regulated, there is a reasonable expectation that any significant asset retirement costs would be recoverable through future tariffs.

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, and, 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. During fiscal 2014, we recognized actuarial gains of $0.1 million in other comprehensive income.

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 our consolidated financial statements for the year ended March 31, 2014.

IFRS 14 *Regulatory Deferral Accounts*

- was issued January 30, 2014 and, 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 in accounting periods after March 31, 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.

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 removed the mandatory January 1, 2015 effective date for adoption of IFRS 9. This IFRS will be effective for us for annual periods commencing April 1, 2018, however early adoption is permitted.

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

CORPORATE STRUCTURE AND GOVERNANCE

National Instrument 58-101 *Disclosure of Corporate Governance Practices* (the "Instrument") and a related National Policy 58-201 *Corporate Governance Guidelines* (the "Guidelines") issued by the Canadian Securities Administrators require reporting issuers to disclose annually their approach to corporate governance with reference to specific matters. See Schedule A for the disclosure in accordance with this Instrument.

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, and fuel prices; tariff revenue, fuel surcharges, and fiscal 2015 net earnings; our expectations of the impact of our cost containment program and the annual premium savings we expect as a result of receiving the Certificate of Recognition from WorkSafe BC; 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, LNG plans, and safety and training projects; our expectations regarding vacation package sales, and growth in drop trailer traffic and onboard retail gift shop sales; our expectations regarding our lack of need to access capital markets in the near term; how our operational cash requirements will be met over the next few years; the additional payments to be received from the Province over the following two fiscal years, and the amount of savings to be achieved through service level adjustments; our expectations regarding the impact of new legislation; and our expectations regarding 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, 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, customer satisfaction ratings, vehicle and passenger traffic, on-time performance, fleet reliability score, 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.

Schedule A

Corporate Structure and Governance
Board of Directors

British Columbia Ferry Services Inc. (BC Ferries or the Company) is subject to the *Business Corporations Act – British Columbia* and the *Coastal Ferry Act – British Columbia* (CFA). The board of directors (board) of BC Ferries is appointed by the Company's sole voting shareholder, B.C. Ferry Authority (BCFA or the Authority).

During the fiscal year ended March 31, 2014 the board was composed of the following directors:

Chair: Donald P. Hayes
Members: Jane M. Bird, Holly A. Haston-Grant, John A. Horning, Guy D. Johnson, Brian G. Kenning, Gordon R. Larkin, Maureen V. Macarenko, P. Geoffrey Plant (vice chair), Wayne H. Stoilen and Graham M. Wilson

Holly A. Haston-Grant and Wayne H. Stoilen ceased to be directors effective June 27, 2013, and Guy D. Johnson ceased to be a director effective November 22, 2013.

The directors are stewards of BC Ferries and set the strategic direction of the Company. The board exercises its stewardship responsibilities by overseeing the conduct of the business, supervising management, which is responsible for the day-to-day conduct of the business, and endeavouring to ensure that all major issues affecting the business and affairs of the Company are given proper consideration.

The board governance manual articulates the governance framework under which the board fulfills its stewardship responsibilities. The manual assembles in one document the essential elements for providing an appropriate level of governance for the organization. It includes, among other things, terms of reference for the board, chair, directors, committees and committee chairs, and serves as a practical guide for the board and management in fulfilling their respective duties and responsibilities. The governance manual is a product and responsibility of the board.

The board is committed to the principles of independence and accountability. The board has adopted policies and practices that ensure it has the capacity, independent of management, to fulfill the board's responsibilities, make objective assessments of management, and assess the merits of management initiatives. The Governance & Nominating Committee has an ongoing responsibility to ensure that the governance structures and processes continue to enable the board to function independently.

The board and management recognize that there is a regular need for the board to meet without management in attendance. It is general practice to conduct a portion of every board and committee meeting with no members of management in attendance.

The board and its committees each have the authority to retain any outside advisor, at the Company's expense, that it determines to be necessary to permit it to carry out its duties.

The recruitment of directors is undertaken with the objective of ensuring the board is composed of a majority of strong, qualified, independent directors. The board supports the concept that the board chair should be an independent director.

The board has adopted a definition of an independent director for members of the Audit & Finance Committee consistent with the definition of independence in Multilateral Instrument 52-110. This definition, with some modification that is consistent with Multilateral Instrument 52-110, also applies to determining the independence of other members of the board.

The board is responsible for determining whether directors are independent pursuant to the definition of independence adopted by the board. To do this, the board requires members to disclose their relationships with the Company and its subsidiaries. These disclosures are reviewed by the corporate secretary, the chair of the Governance & Nominating Committee, and the chair of the board. Any director who is deemed independent, and whose circumstances change such that he or she might be considered to no longer be an independent director, is required to promptly advise the board of the change in circumstances. Directors are required annually to attest to their independence in writing.

All of the directors of the Company in the fiscal year were determined by the board to be independent pursuant to the definition of independence adopted by the board.

Directorships
The following are directors of a reporting issuer (or the equivalent) in Canada or a foreign jurisdiction, other than BC Ferries:

Jane M. Bird:	Director, IBI Group Inc.
Brian G. Kenning:	Director, MacDonald Dettwiler & Associates Inc.
Graham M. Wilson:	Director, ITRON Inc.
	Director, Hardwoods Distribution Inc.
	Director, Naikun Wind Energy Group Inc.

Orientation and Continuing Education
The Company has a variety of orientation and education programs in place for directors. These programs are aimed at increasing the directors' familiarity with the operation of the Company and its governance practices.

All new directors are provided with the opportunity to participate in an orientation program. The orientation program is tailored to the individual director's needs and areas of interest. The program generally involves a half to full day session, usually held prior to a new director attending his/her first board meeting, during which the new director is briefed by members of senior management and receives written information about the business and operations of BC Ferries and board governance practices, including the duties and obligations of directors. The board governance manual is made available to all directors. This manual provides a comprehensive overview of the roles and responsibilities of the board, its committees, and the contributions expected by each director.

The board recognizes the importance of ongoing director education and the need for each director to take personal responsibility for this process. To facilitate ongoing education, presentations are made to directors from time to time on matters of particular importance or emerging significance to the Company. As well, attendance by directors at seminars, courses or conferences of relevance to their position as directors of the Company may be arranged. Directors are expected to maintain ongoing familiarization with the operations of BC Ferries through regular system-wide ferry travel. This, together with visits to other facilities and operations of BC Ferries, serves to enhance the directors' ongoing knowledge and understanding of the Company.

Responsibility for ensuring that orientation and ongoing education are provided to directors rests with the chair of the board. The Governance & Nominating Committee has responsibility for reviewing the orientation and education programs to ensure they are effective and meet the needs of directors.

Ethical Business Conduct
The board approved and adopted a Code of Business Conduct and Ethics (code) in November 2004; the code was subsequently reviewed and amended by the board in November 2009. Notice of adoption, and subsequent amendment of the code as Company policy, was communicated to the Company's personnel by intra-Company information bulletin and BC Ferries' newsletter for personnel. In addition, the code has been posted on the Company's intranet website for Company personnel, and on the Company's internet site. The code was filed on SEDAR on March 1, 2006; the amended code was filed on November 24, 2009. The board has also adopted a Corporate Disclosure and Securities Trading Policy and a Corporate Communications Policy, both of which are also posted on the Company's intranet and internet sites.

As part of the Company's disclosure controls process, in conjunction with quarter-end financial reporting, appropriate managers are required to make representations regarding compliance with the code, the Corporate Disclosure and Securities Trading Policy and the Corporate Communications Policy.

As part of the communication process for the reporting of questionable accounting and auditing matters, a secure telephone line and a secure e-mail address, each monitored by the executive director of internal audit, as well as a secure e-mail address monitored by the chair of the Audit & Finance Committee of the board, have been established. This has been communicated to Company personnel by intra-Company information bulletin and BC Ferries' newsletter for personnel. The contact particulars are also posted with the code on the Company's intranet site.

The board, through the Audit & Finance Committee, monitors compliance with the code through review of compliance reports received quarterly from management, the external auditors, and the internal auditor.

Directors and officers review the code, and acknowledge their support and understanding of the policy by signing an annual disclosure statement.

The code requires that directors and officers disclose potential conflicts of interest at the time of their appointment and immediately upon a situation of a conflict of interest or potential conflict of interest arising. Such disclosures are communicated to and reviewed by the corporate secretary, the chair of the Governance & Nominating Committee, and the chair of the board.

Nomination of Directors
The CFA requires that when electing directors to the board of BC Ferries, the Authority must select individuals in such a way as to ensure that, as a group, the directors of BC Ferries are qualified candidates, who hold all of the skills and all of the experience needed to oversee the operation of the Company in an efficient and cost effective manner. On the recommendation of the BC Ferries board, the board of the Authority approves a profile setting out the skills, experience and expertise that should be represented on the BC Ferries board (skills profile). The board of BC Ferries nominates qualified candidates for election as directors and recommends to the Authority the size of the BC Ferries board.

The Governance & Nominating Committee has responsibility for the director nomination process. The committee is composed entirely of directors who are independent, pursuant to the definition of independence adopted by the board of BC Ferries, and operates under terms of reference adopted by the board.

The skills, experience, and expertise of the incumbents and any retiring directors of BC Ferries are reviewed by the Governance & Nominating Committee in the context of the skills profile approved by the board of the Authority, and the ongoing governance needs of BC Ferries. Any gaps are identified. Potential conflicts of interest and other extenuating circumstances are also identified.

The Governance & Nominating Committee makes recommendations to the BC Ferries board on suitable candidates for appointment to the board. These recommendations take into consideration the talents of the existing members of the BC Ferries board and those of the nominees, taking the skills profile established for the board, including knowledge of or presence in the communities served by BC Ferries, into account.

The BC Ferries board makes its decision on prospective directors and forwards its recommendations to the board of the Authority. The Authority board then determines the directors of BC Ferries and causes the Authority, as the sole holder of the single issued voting share of BC Ferries, to elect such individuals to the board of BC Ferries.

Executive Compensation

The Human Resources & Compensation Committee is responsible for reviewing and making recommendations to the BC Ferries board on executive compensation.

Executive Compensation Plan

The CFA requires that the compensation of certain executive officers of BC Ferries be set and administered within a remuneration limit prescribed by an executive compensation plan. The Authority is responsible under the CFA for approving an executive compensation plan and any amendments to such plan.

In the fiscal year ended March 31, 2012, upon the recommendation of the BC Ferries board, the Authority approved an executive compensation plan with an effective date of October 1, 2011. The plan describes the philosophy for executive compensation and the maximum remuneration that individuals whose compensation is governed by such plan can receive in any fiscal year. The remuneration limits set out in the executive compensation plan were established with the assistance of an independent third-party compensation expert and with reference to the CFA, which requires that the remuneration under an executive compensation plan be consistent with the remuneration provided to individuals who, in organizations in Canada that are of a similar size and scope to BC Ferries, perform similar services or hold similar positions to that member of executive of BC Ferries, and not be greater than the remuneration that provincial public sector employers in British Columbia provide to individuals who, in those organizations, perform similar services or hold similar positions to that member of executive of BC Ferries.

Consistent with the CFA and *Miscellaneous Statutes Amendment Act No. 3 - 2010* (Bill 20), the executive compensation plan approved by the Authority presently governs the remuneration the Company may provide to its President & CEO, but not the remuneration of any other current executive officer so long as that individual remains in his current position. The plan is available for public view on the Authority's website (www.bcferryauthority.com).

In the fiscal year ended March 31, 2014, the BC Ferries board amended the compensation framework for its executive officers, discontinuing the short term incentive plan and implementing a salary holdback compensation plan for these individuals effective April 1, 2013. No amendment of the executive compensation plan was required to effect this change in the compensation framework, and the plan remained unchanged in the fiscal year.

Executive Compensation Process

The salary holdback compensation plan, in which the executive officers are participants, is designed to link the compensation of participants with the achievement of specific annual operating objectives that are important to supporting the overall business strategy. By its nature, the plan responds to the Company's pay-for-performance philosophy. Under the plan, a maximum salary is established for each participant, a portion of which is held back each fiscal year and payable upon achievement of pre-approved objectives and targets.

On an annual basis, the board, led by the Human Resources & Compensation Committee sets the performance requirements for the President & CEO and evaluates his performance against those requirements. The amount of the salary holdback earned by the President & CEO is determined based on the evaluation results and the available room under the total remuneration limit set for the position in the executive compensation plan. With the assistance of the independent, third-party compensation expert, the Human Resources & Compensation Committee periodically reviews the remuneration limit set in the executive compensation plan in conjunction with market data from appropriate comparator organizations, and provides advice to the board on possible changes to the plan for recommendation to the Authority. Changes in the President & CEO's remuneration, if any, are made in consideration of his performance, leadership skills, retention risk, and value to achieving corporate strategy, and in accordance with the executive compensation plan approved by the Authority.

The board, led by the Human Resources & Compensation Committee, evaluates each of the other executive officers annually with respect to the achievement of annual performance objectives set by the President & CEO. The evaluation results are used to determine the amount of the salary holdback earned by each executive officer. Changes, if any, to the compensation of these executive officers are made in consideration of the individual's performance, leadership skills, retention risk, and value to achieving corporate strategy, and in conjunction with market compensation data obtained by the independent third-party compensation expert.

On an annual basis, the President & CEO formally assesses the development of each of the other executive officers, as well as other executive members. The President & CEO uses these assessments to design and update succession plans for all senior executive positions, including the position of President & CEO. These plans are reviewed by the Human Resources & Compensation Committee on an annual or more frequent basis. With respect to all executive officers, succession planning is an important issue that receives ongoing and regular attention by the board and the President & CEO.

Director Compensation
The CFA requires that the compensation of directors of BC Ferries be set and administered within a remuneration limit prescribed by a directors' compensation plan. The Authority is responsible under the CFA for approving a directors' compensation plan and any amendments to such plan. The remuneration provided under such a plan must be consistent with the remuneration that organizations in Canada that are of a similar size and scope to BC Ferries provide to their directors, and not be greater than the remuneration that provincial public sector organizations in British Columbia provide to their directors.

In the fiscal year ended March 31, 2011, upon the recommendation of the BC Ferries board, the Authority approved a directors' compensation plan with an effective date of October 1, 2010. The plan was developed with the assistance of an independent third-party compensation expert and describes the philosophy for the compensation of BC Ferries' directors and the remuneration that can be provided to them. Remuneration for directors of BC Ferries was amended and set by the Authority effective October 1, 2010, in accordance with the approved directors' compensation plan. The plan is available for public view on the Authority's website.

The Governance & Nominating Committee reviews director compensation regularly and provides advice to the board on any amendments to the directors' compensation plan to be recommended to the Authority.

Protocol Agreement
The Authority and BC Ferries have entered into a protocol agreement which clarifies and confirms their respective roles and responsibilities in relation to the authority of BCFA as shareholder of BC Ferries and the matters set forth in the CFA respecting the appointment and remuneration of BC Ferries' directors and the remuneration of certain executive officers of the Company.

Board Committees
The board has developed guidelines for the establishment and operation of committees of the board. Each committee operates according to a specific mandate approved by the board. The committee structure is set out below. The board chair is an ex-officio (non-voting) member of each of the Committees.

Audit & Finance Committee:
Members during the fiscal year ended March 31, 2014:
Chair: Brian G. Kenning
Members: John A. Horning, Guy D. Johnson, P. Geoffrey Plant and Graham M. Wilson

John A. Horning was appointed a member of the committee effective June 22, 2013, and Guy D. Johnson ceased to be a director and a member of the committee effective November 22, 2013.

The Audit & Finance Committee is appointed by the board to assist the board in fulfilling its oversight responsibilities. The committee has the mandate to:

- review the financial reports and other financial information provided by the Company to its security holders;
- review the annual operating and capital budgets, modifications thereto, and details of any proposed financing;
- monitor the integrity of the financial reporting process and the system of internal controls that the board and management have established;
- monitor the management of the principal risks that could impact the financial reporting of the Company, and the Company's compliance with legal and regulatory requirements as they relate to the Company's financial statements;
- review and approve the audit plan, process, results, and performance of the Company's external auditors and the internal audit department (the internal auditor) while providing an open avenue of communication between the board, management, external auditors, and the internal auditor; and
- assess the qualifications and independence of the external auditors, and recommend to the board the nominations of the external auditors and the compensation to be paid to the external auditors.

The committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the external auditors as well as anyone in the organization. The committee has the authority to retain special legal, accounting, and other advisors or experts it deems necessary in the performance of its duties.

Each of the members of the committee has been determined by the board to be independent, that is, without any direct or indirect relationship with the company that could reasonably interfere with the exercise of the member's independent judgment.

All members of the committee are financially literate within the meaning of Multilateral Instrument 52-110, that is, each has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the Company's financial statements.

Since April 2, 2003, all recommendations of the committee to nominate or compensate an external auditor have been adopted by the board.

The aggregate fees billed by the Company's external auditor in each of the last two fiscal years were:

	Year ended March 31	
External Auditor billings ($ thousands)	2014	2013
Audit and audit related	176.5	173.5
Tax services	2.8	2.2
IFRS advisory services	-	7.1
Accounting advisory and forensic data analytics	-	1.2
	179.3	184.0

Pursuant to its terms of reference, the committee must pre-approve retaining the external auditors for any non-audit service to be provided to the Company or its subsidiaries, provided that no approval shall be provided for any service that is prohibited under the rules of the Canadian Public Accountability Board or the Public Company Accounting Oversight Board, or the Independence Standards of the Canadian Institute of Chartered Accountants.

Before retaining the external auditors for any non-audit service, the committee must consider the compatibility of the service with the external auditors' independence. The committee may pre-approve retaining the external auditors for the engagement of any non-audit services by establishing policies and procedures to be followed prior to the appointment of the external auditors for the provision of such services. To date, no such policies and procedures have been established. In addition, the committee may delegate to one or more members the authority to pre-approve retaining the external auditors for any non-audit services to the extent permitted by applicable law.

***Safety, Health, Environment & Security Committee*:**
Members during the fiscal year ended March 31, 2014:
Chair: Jane M. Bird (current); Wayne H. Stoilen (former)
Members: Holly A. Haston-Grant, Gordon R. Larkin and Maureen V. Macarenko

Effective June 22, 2013, Jane M. Bird was appointed a member and chair of the committee, Wayne H. Stoilen ceased to be a member and chair of the committee, and Holly Haston-Grant ceased to be a member of the committee.

The Safety, Health, Environment & Security Committee is appointed by the board to assist the board in fulfilling its oversight responsibilities. The committee has the mandate to:

- exercise due diligence over the safety, health, environmental and security operations of the Company;
- develop, review, and make recommendations, as required, on matters related to the Company's safety, health, environmental and security policies and practices; and
- monitor compliance with government regulations and with the Company's commitment to excellence on these issues.

Governance & Nominating Committee:
Members during the fiscal year ended March 31, 2014:
Chair: P. Geoffrey Plant
Members: Jane M. Bird, Gordon R. Larkin and Wayne H. Stoilen

Effective June 22, 2013, Jane M. Bird was appointed a member of the committee and Wayne H. Stoilen ceased to be member of the committee.

The Governance & Nominating Committee is appointed by the board to assist the board in fulfilling its oversight responsibilities with respect to ensuring that the corporate governance system of BC Ferries is effective. The committee has the mandate to:

- review, assess, and make recommendations regarding the effectiveness of the policies and practices of the board;
- ensure the board's continuing ability to fulfill its legislative mandate;
- implement effective due diligence over the operations of the Company;
- make recommendations on the skills, experience and expertise that board members collectively and individually should have in order to oversee the operation of BC Ferries in an efficient and cost effective manner;
- establish and implement effective processes for identifying and recommending suitable candidates for appointment as directors of BC Ferries; and
- make recommendations on the remuneration of directors of BC Ferries.

Human Resources & Compensation Committee:

Members during the fiscal year ended March 31, 2014:

Chair:	Graham M. Wilson
Members:	Holly A. Haston-Grant, John A. Horning, Guy D. Johnson, Brian G. Kenning and Maureen V. Macarenko

Effective June 22, 2013, John A. Horning was appointed a member of the committee and Holly A. Haston-Grant ceased to be a member of the committee. Guy D. Johnson ceased to be a director and a member of the committee effective November 22, 2013.

The Human Resources & Compensation Committee is appointed by the board to assist the board in fulfilling its oversight responsibilities regarding the human resources and compensation strategies and policies of BC Ferries. The committee has the mandate to:

- regularly review, at a strategic level, the approach taken to manage the Company's human resources, including the recruitment, retention, motivation, and engagement of employees in the interests and success of the Company;
- regularly review the succession and development plans for the President & CEO and executive management; and
- review and recommend to the board a total compensation philosophy for the President & CEO and executive management that, subject to the CFA, attracts and retains executives, links total compensation to financial and operational performance, and provides competitive total compensation opportunities at a reasonable cost, while enhancing the ability to fulfill the Company's overall business strategies and objectives.

Assessments

As part of its dedication to best governance practices, the board is committed to regular assessments of the effectiveness of the board, the board chair, committees, committee chairs, and individual directors. The Governance & Nominating Committee annually reviews and makes recommendations to the board on the method and content for these assessments.

In the prior fiscal year, the board engaged an independent consultant to coordinate the board evaluation. The consultant obtained the directors' views on matters related to the effectiveness of the board through the use of questionnaires and individual discussions with each director. The evaluation included an assessment of the performance of the board as a whole with respect to best practices in board governance, as well as a director self-assessment and peer review related to best practices for board directors. The peer review results for each director were shared with the respective director and the chairs of the board and the Governance & Nominating Committee, and discussions on the results were held between the individual directors and the board chair. The results of the board evaluation, including the results of the peer reviews, were provided to the board, together with the consultant's recommendations for action. The results and the recommendations arising from the board evaluation informed the deliberations and decisions of the board on various matters respecting board governance and succession in the fiscal year ended March 31, 2014.

The performance of the board as a whole, and the performance of individual directors, is assessed regularly throughout the year. This occurs primarily through discussions between the individual directors and the board chair.