

Interim Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Six months ended September 30, 2014 and 2013

(unaudited)

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statements of Financial Position (unaudited)
(Expressed in thousands of Canadian dollars)

	As at,	
	September 30, 2014	March 31, 2014
Assets		
Current assets		
Cash and cash equivalents	116,154	71,365
Restricted short-term investments (3(c))	32,746	35,792
Other short-term investments	56,035	81,006
Trade and other receivables	12,619	16,577
Prepaid expenses	11,961	6,934
Inventories	27,198	25,073
	256,713	236,747
Non-current assets		
Long-term loan receivable	24,515	24,515
Long-term land lease	31,375	31,604
Property, plant and equipment (note 5)	1,515,577	1,539,162
Intangible assets (note 6)	58,476	53,164
	1,629,943	1,648,445
Total assets	1,886,656	1,885,192
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	32,605	48,134
Interest payable on long-term debt	18,432	19,634
Deferred revenue	14,785	14,563
Derivative liabilities	5	5,274
Current portion of long-term debt (note 3)	24,000	270,250
Current portion of accrued employee future benefits	2,204	2,204
Current portion of obligations under finance lease	1,120	1,120
Provisions	46,662	51,801
	139,813	412,980
Non-current liabilities		
Accrued employee future benefits	19,026	15,931
Long-term debt (note 3)	1,253,498	1,066,531
Obligations under finance lease	44,264	44,821
	1,316,788	1,127,283
Total liabilities	1,456,601	1,540,263
Equity		
Share capital	75,478	75,478
Contributed surplus	25,000	25,000
Retained earnings	336,449	246,142
Total equity before reserves	436,927	346,620
Reserves (note 8(a))	(6,872)	(1,691)
Total equity including reserves	430,055	344,929
Total liabilities and equity	1,886,656	1,885,192
Commitments (note 5(b))		

See accompanying notes to the interim consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statements of Comprehensive Income (unaudited)
(Expressed in thousands of Canadian dollars)

	Three months ended, September 30,		Six months ended, September 30,	
	2014	2013	2014	2013
Revenue				
Vehicle and passenger fares	179,641	171,162	311,013	295,545
Ferry service fees	54,195	57,120	99,242	101,179
Retail	28,557	28,075	48,501	47,730
Federal-Provincial Subsidy Agreement	7,089	7,093	14,178	14,186
Fuel surcharges (note 10)	5,786	-	10,148	-
Regulated other income	6,122	5,737	9,521	8,680
Other income	2,777	2,283	4,673	4,119
Total revenue	284,167	271,470	497,276	471,439
Expenses				
Operations	125,359	124,712	240,383	238,889
Maintenance	12,468	12,186	29,117	27,746
Administration	8,020	7,491	15,633	14,522
Cost of retail goods sold	11,157	10,685	19,146	18,410
Depreciation and amortization	35,612	34,114	70,846	68,427
Total operating expenses	192,616	189,188	375,125	367,994
Operating profit	91,551	82,282	122,151	103,445
Net finance and other expenses				
Net finance expense (note 9)				
Finance income	969	726	2,036	1,525
Finance expenses	(16,124)	(18,672)	(33,836)	(36,364)
Net finance expense	(15,155)	(17,946)	(31,800)	(34,839)
Gain (loss) on disposal of property, plant and equipment	23	(16)	(44)	(12)
Net finance and other expenses	(15,132)	(17,962)	(31,844)	(34,851)
Net earnings	76,419	64,320	90,307	68,594
Other comprehensive (loss) income (note 8(b))				
Items not to be reclassified to net earnings	(2,890)	104	(2,890)	104
Items to be reclassified to net earnings	-	-	(2,396)	-
Total other comprehensive (loss) income	(2,890)	104	(5,286)	104
Total comprehensive income	73,529	64,424	85,021	68,698

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statements of Cash Flows (unaudited)

(Expressed in thousands of Canadian dollars)

	Six months ended, September 30,	
	2014	2013
Cash flows from operating activities		
Net earnings	90,307	68,594
Items not affecting cash		
Net finance expense	31,800	34,839
Depreciation and amortization	70,846	68,427
Loss on disposal of property, plant and equipment	44	12
Other non-cash adjustments to property, plant and equipment	(1,781)	(662)
Changes in		
Long-term accrued employee future benefits	205	(415)
Derivative liabilities recognized in net earnings	(14)	(11)
Provisions	(5,139)	(2,871)
Long-term land lease	229	229
Accrued interest costs	246	236
Total non-cash items	96,436	99,784
Movements in operating working capital		
Trade and other receivables	3,958	(167)
Prepaid expenses	(5,027)	586
Inventories	(2,125)	(2,384)
Accounts payable and accrued liabilities	(15,529)	(14,357)
Deferred revenue	222	(50)
Change in non-cash working capital	(18,501)	(16,372)
Change attributable to capital asset acquisitions	7,103	5,670
Change in non-cash operating working capital	(11,398)	(10,702)
Cash generated from operating activities	175,345	157,676
Interest received	1,827	1,230
Interest paid	(36,167)	(39,594)
Net cash generated by operating activities	141,005	119,312

See accompanying notes to the interim consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statements of Cash Flows (unaudited)

(Expressed in thousands of Canadian dollars)

	Six months ended, September 30,	
	2014	2013
Cash flows from financing activities		
Proceeds from issuance of bonds	200,000	-
Repayment of long-term debt	(258,250)	(144,500)
Proceeds from short-term debt	-	39,966
Repayment of finance lease obligations	(557)	(530)
Deferred financing costs incurred	(1,315)	-
Hedge losses on interest rate forward contracts	(7,652)	-
Net cash used in financing activities	(67,774)	(105,064)
Cash flows from investing activities		
Proceeds from disposal of property, plant and equipment	72	32
Purchase of property, plant and equipment and intangible assets	(56,531)	(50,343)
Decrease of debt service reserves	3,046	4,415
Proceeds from short-term investments	24,971	8,895
Net cash used in investing activities	(28,442)	(37,001)
Net increase (decrease) in cash and cash equivalents	44,789	(22,753)
Cash and cash equivalents, beginning of period	71,365	36,641
Cash and cash equivalents, end of period	116,154	13,888

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statements of Changes in Equity (unaudited)

(Expressed in thousands of Canadian dollars)

	Share capital	Contributed surplus	Retained earnings	Total equity before reserves	Reserves (note 8 (a))	Total equity including reserves
Balance as at March 31, 2013	75,478	25,000	234,187	334,665	3,233	337,898
Net earnings for the six months ended September 30, 2013	-	-	68,594	68,594	-	68,594
Other comprehensive income for the six months ended September 30, 2013	-	-	-	-	104	104
Balance as at September 30, 2013	75,478	25,000	302,781	403,259	3,337	406,596
Balance as at March 31, 2014	75,478	25,000	246,142	346,620	(1,691)	344,929
Net earnings for the six months ended September 30, 2014	-	-	90,307	90,307	-	90,307
Other comprehensive income for the six months ended September 30, 2014	-	-	-	-	(5,286)	(5,286)
Hedge losses reclassified to net earnings	-	-	-	-	105	105
Balance as at September 30, 2014	75,478	25,000	336,449	436,927	(6,872)	430,055

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2014 and 2013
(columnar dollars expressed in thousands of Canadian dollars)

British Columbia Ferry Services Inc. (the "Company") was incorporated under the *Company Act (British Columbia)* by way of conversion on April 2, 2003, and now validly exists under the *Business Corporations Act (British Columbia)*. The Company's primary business activity is the provision of coastal ferry services in British Columbia.

The Company is subject to the *Coastal Ferry Act* (the "Act") as amended, which came into force on April 1, 2003. Its common share is held by the B.C. Ferry Authority (the "Authority"), a corporation without share capital, and it is regulated by the British Columbia Ferries Commissioner (the "Commissioner") to ensure that rates are fair and reasonable and to monitor service levels.

The Company's business is seasonal in nature, with the highest activity in the summer (second quarter) and the lowest activity in the winter (fourth quarter), due to the high number of leisure travellers and their preference for travel during the summer months. The Company also takes advantage of the low activity during the winter months to perform a significant portion of the required annual maintenance on vessels and terminals.

1. Accounting policies:

Except as described in note 1(f), the same accounting policies and methods of computation are followed in the interim consolidated financial statements as compared with the annual consolidated financial statements for the year ended March 31, 2014.

(a) Basis of preparation:

British Columbia Ferry Services Inc. is a company domiciled in Canada. The address of the Company's registered office is Suite 500, 1321 Blanshard Street, Victoria, BC Canada, V8W 0B7. These interim consolidated financial statements of the Company as at and for the six months ended September 30, 2014 and 2013 comprise the Company and its subsidiaries (together referred to as the "Group").

(b) Statement of compliance:

These interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and its interpretations and comply with International Accounting Standard (IAS) 34 Interim Financial Reporting.

These interim consolidated financial statements should be read in conjunction with the Group's annual consolidated financial statements and the notes thereto for the year ended March 31, 2014.

These interim consolidated financial statements were approved by the Board of Directors on November 21, 2014.

(c) Basis of measurement:

These interim consolidated financial statements have been prepared using the historical cost method, with the exception of the following assets and liabilities which are measured at fair value: land, derivatives, financial instruments held for trading and available-for-sale financial assets.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2014 and 2013

(columnar dollars expressed in thousands of Canadian dollars)

1. Accounting policies (continued):

(d) Functional and presentation currency:

These interim consolidated financial statements are presented in Canadian dollars ("Cdn") which is the Group's functional currency. All financial data is presented in Canadian dollars rounded to the nearest thousand.

(e) Embedded derivatives:

As at September 30, 2014, the Group has no embedded derivatives that meet the requirements of IAS 39 *Financial Instruments: Recognition and Measurement*, which would require that they are separated from host contracts and valued separately at fair value.

(f) Adoption of new accounting standards:

International Financial Reporting Interpretations Committee (IFRIC) 21 *Levies*:

Effective April 1, 2014, the Group retrospectively applied IFRIC 21, *Levies*. This IFRIC provides guidance on when to recognize a liability for a levy imposed by a government. The application of this IFRIC has had no impact on the Group's interim consolidated financial statements.

2. Future accounting changes:

IFRS 9 Financial Instruments:

This standard replaces the guidance in IAS 39 *Financial Instruments: Recognition and Measurement*, on the classification and measurement of financial assets. The standard eliminates the existing IAS 39 categories of held-to-maturity, available-for-sale and loans and receivables. 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 activities. 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 removed the mandatory effective date of January 1, 2015 for adoption of IFRS 9 with a new date to follow. In February 2014, the IASB decided on a mandatory effective date for IFRS 9 of January 1, 2018. Early adoption of IFRS 9 is permitted. The Group will be adopting IFRS 9 (2013) effective October 1, 2014. The Group does not expect the adoption of this standard to have any impact on its consolidated financial statements other than certain additional disclosures.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2014 and 2013
(columnar dollars expressed in thousands of Canadian dollars)

3. Loans:

Long-term debt:	September 30, 2014	As at March 31, 2014
5.74% Senior Secured Bonds, Series 04-1, due May 2014 (effective interest rate of 5.92%)	-	250,000
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (effective interest rate of 6.41%)	250,000	250,000
5.02% Senior Secured Bonds, Series 07-1, due March 2037 (effective interest rate of 5.06%)	250,000	250,000
5.58% Senior Secured Bonds, Series 08-1, due January 2038 (effective interest rate of 5.62%)	200,000	200,000
4.70% Senior Secured Bonds, Series 13-1, due October 2043 (effective interest rate of 4.75%)	200,000	200,000
4.29% Senior Secured Bonds, Series 14-1, due April 2044 (effective interest rate of 4.45%)	200,000	-
12 Year Loan, maturing March 2020		
Tranche A (effective interest rate of 5.17%)	41,250	45,000
Tranche B (floating interest rate of 1.55% at September 30, 2014)	22,500	20,625
12 Year Loan, maturing June 2020		
Tranche A (effective interest rate of 5.18%)	43,125	46,875
Tranche B (floating interest rate of 1.55% at September 30, 2014)	22,500	20,625
2.95% Loan, maturing January 2021 (effective interest rate of 3.08%)	58,500	63,000
	1,287,875	1,346,125
Less: Deferred financing costs and unamortized bond discounts	(10,377)	(9,344)
Current portion	(24,000)	(270,250)
	1,253,498	1,066,531

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2014 and 2013

(columnar dollars expressed in thousands of Canadian dollars)

3. Loans (continued):

(a) Bonds:

On April 28, 2014, the Group issued \$200 million of senior secured bonds. The Series 14-1 bonds bear interest at 4.289% per annum, payable semi-annually and will mature April 28, 2044. A debt service reserve for these bonds has been established in the amount of \$4.3 million. The net proceeds from the sale of the bonds were, together with additional cash on hand, used to repay the \$250 million Series 04-1 bonds, which matured on May 27, 2014 and to fund the related debt service reserve.

(b) Credit facility:

There were no draws on the \$155.0 million credit facility as at September 30, 2014 (March 31, 2014: nil). Interest expensed during the quarter ended September 30, 2014 was \$nil (September 30, 2013: \$0.2 million). Interest expensed during the six months ended September 30, 2014 was \$nil (September 30, 2013: \$0.2 million). Letters of credit outstanding against this facility at September 30, 2014 totalled \$0.3 million (March 31, 2014: \$0.1 million).

(c) Debt service reserves:

The Group is required to maintain debt service reserves for the Series 04-4, 07-1, 08-1, 13-1, and 14-1 bonds equal to not less than six months forecast debt service, to be increased under certain conditions. Further debt service reserves are required to be maintained for the 12 year loans and the 2.95% loan equal to not less than six months forecast debt service, to be increased under certain conditions.

As a result of their redemption on May 27, 2014, the Group is no longer required to maintain a debt service reserve for the Series 04-1 bonds. As at September 30, 2014, debt service reserves of \$32.7 million were held in short-term investments and have been classified as restricted short-term investments on the statement of financial position (March 31, 2014: \$35.8 million).

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2014 and 2013

(columnar dollars expressed in thousands of Canadian dollars)

4. Financial instruments:

The carrying and fair values of the Group's financial instruments are as follows:

	As at September 30, 2014		As at March 31, 2014	
	Carrying Value	Approx Fair Value	Carrying Value	Approx Fair Value
Available for sale ¹				
Cash	18,343	18,343	11,783	11,783
Financial assets/liabilities at fair value through net earnings or loss ²				
Cash equivalents	3,120	3,120	3	3
Derivative liabilities	5	5	7	7
Financial assets/liabilities at fair value through other comprehensive income ³				
Derivative liabilities	-	-	5,267	5,267
Held-to-maturity ⁴				
Cash equivalents	94,691	94,691	59,579	59,579
Restricted short-term investments	32,746	32,746	35,792	35,792
Other short-term investments	56,035	56,035	81,006	81,006
Loans and receivables ⁴				
Trade and other receivables	12,619	12,619	16,577	16,577
Long-term loan receivable ⁵	24,515	24,515	24,515	24,515
Other financial liabilities ⁴				
Accounts payable and accrued liabilities	32,605	32,605	48,134	48,134
Interest payable on long-term debt	18,432	18,432	19,634	19,634
Provisions	46,662	46,662	51,801	51,801
Long-term debt, including current portion ^{6,7}	1,277,498	1,490,599	1,336,781	1,515,137

¹ Measured at fair value with revaluation gains and losses included in other comprehensive income until the asset is removed from the statement of financial position. Due to the nature of this financial instrument, carrying value approximates fair value.

² Measured at fair value with all gains and losses included in net earnings in the period in which they arise. Fair values for the derivative liabilities have been estimated using period-end market rates. These fair values approximate the amount that the Group would pay to settle the contract at the date of the statement of financial position.

³ If the hedge is effective, measured at fair value with all gains and losses initially included in other comprehensive income in the period in which they arise and subsequently in net earnings or loss when realized or when the hedge ceases to be effective. If the hedge is ineffective, measured at fair value with all gains and losses recognized in net earnings or loss. Fair values for the derivative liabilities have been estimated using period-end market rates. These fair values approximate the amount that the Group would pay to settle the contract at the date of the statement of financial position.

⁴ Measured at amortized cost. Due to the nature of these financial instruments and/or short-term maturity of these financial instruments, carrying value approximates fair value except as noted.

⁵ Measured at amortized cost. Carrying value approximates fair value as the rate of return is variable and is expected to return a market rate of interest.

⁶ Carrying value is measured at amortized cost using the effective interest rate method.

⁷ Fair value is calculated by discounting the future cash flows of each debt issue at the estimated yield to maturity for the same or similar issues at the date of the statement of financial position, or by using available quoted market prices.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2014 and 2013
(columnar dollars expressed in thousands of Canadian dollars)

4. Financial instruments (continued):

The following items shown in the consolidated statements of financial position at September 30, 2014 and March 31, 2014 are measured at fair value on a recurring basis using level 1 or 2 inputs. The fair value of the financial assets and liabilities at September 30, 2014 and at March 31, 2014, using level 3 inputs, was \$nil.

	As at September 30, 2014		As at March 31, 2014	
	Level 1	Level 2	Level 1	Level 2
Asset (liability):				
Cash ¹	18,343	-	11,783	-
Cash equivalents ¹	3,120	-	3	-
Derivatives ²	-	(5)	-	(5,274)
Long-term debt, including current portion ²	-	(1,490,599)	-	(1,515,137)
	21,463	(1,490,604)	11,786	(1,520,411)

¹ Classified in level 1 as the measurement inputs are derived from observable, unadjusted quoted prices in active markets for identical assets.

² Classified in level 2 as the significant measurement inputs used in the valuation models are indirectly observable in active markets (derived from prices).

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 market prices are not available, fair values are estimated using discounted cash flow analysis based on the Group's current borrowing rate for similar borrowing arrangements.

No amounts have been reclassified into or out of fair value classifications in the six months ended September 30, 2014. Financial assets have been pledged as security for liabilities under the master trust indenture. The Group does not hold any multiple embedded derivative financial assets or liabilities. No loans or receivables or financial liabilities have been categorized as fair value through net earnings or loss.

As at September 30, 2014, all available for sale and held-for-trading financial instruments are classified as level 1 in the fair value hierarchy with quoted prices in active markets.

During the six months ended September 30, 2014, no profits resulting from the use of valuation techniques used to measure level 2 or 3 instruments in the fair value hierarchy (i.e. those with no active market price) have been recognized.

The Group may use derivative instruments to hedge its exposure to fluctuations in fuel prices, interest rates and foreign currency exchange rates. The fair value of commodity derivatives reflects only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel. These fair values reflect the estimated amounts that the Group would receive or pay should the derivative contracts be terminated at the stated dates.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2014 and 2013
(columnar dollars expressed in thousands of Canadian dollars)

5. Property, plant and equipment:

(a) Continuity of property, plant and equipment:

	Vessels	Berths, building & equipment under finance lease	Berths, building & equipment	Land under finance lease	Land	Construction in progress	Total
Cost:							
Balance at March 31, 2014	1,225,140	548,765	72,487	5,559	15,887	25,734	1,893,572
Additions	-	-	-	-	-	43,631	43,631
Disposals	(373)	(80)	(81)	-	-	(64)	(598)
Transfers from construction in progress	10,918	9,630	2,910	-	-	(23,458)	-
Balance at September 30, 2014	1,235,685	558,315	75,316	5,559	15,887	45,843	1,936,605
Accumulated depreciation:							
Balance at March 31, 2014	260,915	69,470	24,025	-	-	-	354,410
Depreciation for the period	49,871	12,744	4,448	-	-	-	67,063
Disposals	(335)	(75)	(35)	-	-	-	(445)
Balance at September 30, 2014	310,451	82,139	28,438	-	-	-	421,028
Net carrying value:							
As at March 31, 2014	964,225	479,295	48,462	5,559	15,887	25,734	1,539,162
As at September 30, 2014	925,234	476,176	46,878	5,559	15,887	45,843	1,515,577

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2014 and 2013
(columnar dollars expressed in thousands of Canadian dollars)

5. Property, plant and equipment (continued):

(b) Other disclosures - property, plant and equipment:

During the six months ended September 30, 2014, capitalized financing costs during construction amounted to \$0.6 million (September 30, 2013: \$0.7 million) with an average capitalization rate of 5.35% (September 30, 2013: 5.64%). In addition to the construction in progress referenced above, the contractual commitments at September 30, 2014 for assets to be constructed totalled \$204.9 million (March 31, 2014: \$25.9 million). These contractual commitments include contracts totalling \$165 million for construction of three new intermediate class vessels.

During the three months ended September 30, 2014, the Group received \$0.2 million (September 30, 2013: \$0.1 million) of rental income earned from buildings held for leasing purposes and during the six months ended September 30, 2014, received \$0.5 million (September 30, 2013: \$0.4 million). These buildings have a cost and accumulated depreciation of \$11.9 million and \$1.6 million respectively, as at September 30, 2014.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2014 and 2013
(columnar dollars expressed in thousands of Canadian dollars)

6. Intangible assets:

(a) Continuity of intangible assets:

	Acquired software, licenses & rights	Internally developed software & website	Assets under development	Total
Cost:				
Balance at March 31, 2014	31,373	11,516	30,223	73,112
Additions	-	-	9,095	9,095
Disposals	(276)	-	-	(276)
Transfers from assets under development	410	-	(410)	-
Balance at September 30, 2014	31,507	11,516	38,908	81,931
Accumulated amortization and impairment:				
Balance at March 31, 2014	12,902	7,046	-	19,948
Amortization for the period	2,570	1,213	-	3,783
Disposals	(276)	-	-	(276)
Balance at September 30, 2014	15,196	8,259	-	23,455
Net carrying value:				
As at March 31, 2014	18,471	4,470	30,223	53,164
As at September 30, 2014	16,311	3,257	38,908	58,476

(b) Other disclosures - intangible assets:

Capitalized financing costs during construction for intangible assets for the six months ended September 30, 2014 totalled \$0.9 million (September 30, 2013: \$0.7 million) with an average capitalization rate of 5.35% (September 30, 2013: 5.64%).

During the six months ended September 30, 2014, intangible assets totalling \$9.1 million (September 30, 2013: \$4.8 million) were acquired and \$nil (September 30, 2013: \$0.1 million) were internally developed.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2014 and 2013

(columnar dollars expressed in thousands of Canadian dollars)

7. Accrued employee future benefits:

During the three months ended September 30, 2014 the Group recognized total defined benefit costs of \$0.4 million (September 30, 2013: \$0.3 million) and during the six months ended September 30, 2014 the Group recognized total defined benefit costs of \$0.8 million (September 30, 2013: \$0.7 million).

During the quarter ended September 30, 2014, a loss of \$2.9 million was recognized in other comprehensive income to reflect the actuarial valuation of the liability at March 31, 2014, for the retirement and death benefit plans.

In the year ended March 31, 2014, the Group recognized a gain of \$0.1 million in other comprehensive income to reflect the actuarial valuation of the residual liability at March 31, 2013 for workers' compensation claims arising from the Workers' Compensation Board deposit coverage system.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2014 and 2013
(columnar dollars expressed in thousands of Canadian dollars)

8. Other comprehensive (loss) income:

(a) Continuity of reserves:

	Land revaluation reserves	Employee future benefit revaluation reserves	Hedging reserves ¹	Total
Balance at March 31, 2014	3,245	104	(5,040)	(1,691)
Actuarial losses on defined benefit plans (note 7)		(2,890)		(2,890)
Hedge losses on interest rate forward contracts	-	-	(2,396)	(2,396)
Hedge losses reclassified to net earnings in the period	-	-	105	105
Balance at September 30, 2014	3,245	(2,786)	(7,331)	(6,872)

(b) Other comprehensive (loss) income:

	Three months ended, September 30, 2014		Six months ended, September 30, 2014	
	2014	2013	2014	2013
Items to be reclassified to net earnings:				
Hedge losses on interest rate forward contracts ¹ (note 8 (a))	-	-	(2,396)	-
Items not to be reclassified to net earnings:				
Actuarial (losses) gains on defined benefit plans (note 8 (a))	(2,890)	104	(2,890)	104
Total other comprehensive (loss) income	(2,890)	104	(5,286)	104

¹ During the quarter ended June 30, 2014, the Group refinanced a portion of the Series 04-1 Bonds which matured in May 2014 by issuing a 30 year Cdn denominated fixed-rate bullet bond. The interest on the new bonds is based on the Government of Canada ("GoC") 30 year Cdn bond plus an applicable corporate spread. As at March 31, 2014, the Group had entered into interest rate forward contracts with a total notional value of \$160 million to reduce its exposure to changes in the GoC 30 year Cdn bond benchmark interest rate and applied hedge accounting. These agreements settled in April 2014 and the impact on net earnings or loss will occur over the next 30 years as the interest on the bond is expensed. The hedge loss recognized on these contracts was \$7.6 million with \$5.3 million recognized in the year ended March 31, 2014 and a further \$2.3 million recognized in the quarter ended June 30, 2014. The effective portion of this loss of \$7.4 million has been recognized in other comprehensive income and will be subsequently reclassified to net earnings. The ineffective portion of \$0.2 million was recognized in net earnings during the year ended March 31, 2014. During the six months ended September 30, 2014, the Group reclassified \$0.1 million of the hedge loss to net earnings.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2014 and 2013

(columnar dollars expressed in thousands of Canadian dollars)

9. Net finance expense:

	Three months ended, September 30,		Six months ended, September 30,	
	2014	2013	2014	2013
Finance expenses				
Long-term debt	16,171	18,347	33,778	35,845
Short-term debt	67	295	154	414
Finance leases	497	508	996	1,019
Amortization of deferred financing costs and bond discounts	169	284	388	531
Interest capitalized in the cost of qualifying assets	(780)	(762)	(1,480)	(1,445)
Finance expenses	16,124	18,672	33,836	36,364
Finance income	(969)	(726)	(2,036)	(1,525)
Net finance expense	15,155	17,946	31,800	34,839

10. Economic effect of rate regulation:

The Group is regulated by the Commissioner to ensure, among other things, that tariffs are fair and reasonable. Under the terms of the Act, the tariffs the Group charges its customers are subject to price caps. The Commissioner may, under certain circumstances, allow increases in price caps over the set levels.

IFRS 14 is an interim standard that addresses the accounting for regulatory deferral accounts; however, it does not allow the recognition of regulatory assets and regulatory liabilities that result from the regulated price cap setting process for entities that have already transitioned to IFRS. As a result, the Group is not permitted to recognize its regulatory assets and regulatory liabilities in its consolidated statements of financial position.

Regulatory assets generally represent incurred costs that have been deferred for purposes of rate regulation because they are probable of future recovery in tariffs. Regulatory liabilities represent obligations to customers which will be settled through future tariff reductions. Management continually assesses whether the Group's regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes. Management believes the regulatory assets at September 30, 2014 detailed below are probable of future recovery.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Six months ended September 30, 2014 and 2013

(columnar dollars expressed in thousands of Canadian dollars)

10. Economic effect of rate regulation (continued):

If the Group was permitted under IFRS to recognize the effects of rate regulation, the following regulatory assets and regulatory liabilities would be shown on the consolidated statements of financial position:

Regulatory accounts	As at,	
	September 30, 2014	March 31, 2014
Deferred fuel costs :		
Balance – beginning of period	6,150	(1,415)
Fuel costs deferred	8,681	14,521
Surcharges collected	(10,148)	(2,690)
Fuel price risk recoveries from the Province	(1,088)	(1,675)
Other payments from the Province	(655)	(1,396)
Tariffs in excess of price cap (a)	-	(1,195)
Balance – end of period	2,940	6,150
Performance term submission costs	122	163
Total of regulatory accounts	3,062	6,313
Total regulatory assets	3,062	6,313
Current regulatory assets	82	82
Total long term regulatory assets	2,980	6,231

(a) Tariffs in excess of price cap:

The Act contains provisions which ensure that if tariffs charged by the Group exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. At March 31, 2014, tariffs charged to customers exceeded the price cap by \$1.2 million. In accordance with the Commissioner's Memorandum 45, this \$1.2 million has been applied to reduce the deferred fuel costs account balance. Tariffs charged to customers were below established price caps at September 30, 2014.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Six months ended September 30, 2014 and 2013
(columnar dollars expressed in thousands of Canadian dollars)

10. Economic effect of rate regulation (continued):

If the Group was permitted under IFRS to recognize the affects of rate regulation and to record regulatory assets and regulatory liabilities, total comprehensive income for the six months ended September 30, 2014 would have been \$3.3 million lower (2013: \$3.1 million higher) as detailed below:

	Three months ended, September 30,		Six months ended, September 30,	
	2014	2013	2014	2013
Effect of rate regulation on total comprehensive income				
Regulatory accounts:				
Deferred fuel costs	(2,105)	3,234	(3,210)	5,336
Performance term submission costs	(21)	(20)	(41)	(41)
Tariffs in excess of price cap	-	522	-	(2,230)
Total (decrease) increase in total comprehensive income	(2,126)	3,736	(3,251)	3,065

11. Related party transactions:

In accordance with the Act, the Group is responsible for paying any expenses that are incurred by the Authority, without charge. During the six months ended September 30, 2014, the Group paid \$69,851 (September 30, 2013: \$107,808) of such expenses.

The Province owns the Group's 75,477 non-voting preferred shares, but has no voting interest in either the Group or the Authority.