Interim Consolidated Financial Statements of

# BRITISH COLUMBIA FERRY SERVICES INC.

Nine months ended December 31, 2014 and 2013

(unaudited)

# BRITISH COLUMBIA FERRY SERVICES INC.

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

| | As at, | |
|---|---|---|
| | December 31,2014 | March 31, 2014 |
| **Assets** | | |
| ***Current assets*** | | |
| Cash and cash equivalents | 96,632 | 71,365 |
| Restricted short-term investments (3(c)) | 32,651 | 35,792 |
| Other short-term investments | 62,698 | 81,006 |
| Trade and other receivables | 10,807 | 16,577 |
| Prepaid expenses | 8,854 | 6,934 |
| Inventories | 26,037 | 25,073 |
| | 237,679 | 236,747 |
| ***Non-current assets*** | | |
| Long-term loan receivable | 24,515 | 24,515 |
| Long-term land lease | 31,260 | 31,604 |
| Property, plant and equipment (note 5) | 1,525,607 | 1,539,162 |
| Intangible assets (note 6) | 61,184 | 53,164 |
| | 1,642,566 | 1,648,445 |
| **Total assets** | 1,880,245 | 1,885,192 |
| **Liabilities** | | |
| ***Current liabilities*** | | |
| Accounts payable and accrued liabilities | 35,453 | 48,134 |
| Interest payable on long-term debt | 16,563 | 19,634 |
| Deferred revenue | 14,568 | 14,563 |
| Derivative liabilities | 7,359 | 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 | 1,225 | 1,120 |
| Provisions | 48,140 | 51,801 |
| | 149,512 | 412,980 |
| ***Non-current liabilities*** | | |
| Accrued employee future benefits | 18,885 | 15,931 |
| Long-term debt (note 3) | 1,249,847 | 1,066,531 |
| Obligations under finance lease | 43,882 | 44,821 |
| Long-term liabilities (note 12) | 1,500 | - |
| | 1,314,114 | 1,127,283 |
| **Total liabilities** | 1,463,626 | 1,540,263 |
| **Equity** | | |
| Share capital | 75,478 | 75,478 |
| Contributed surplus | 25,000 | 25,000 |
| Retained earnings | 330,304 | 246,142 |
| ***Total equity before reserves*** | 430,782 | 346,620 |
| Reserves (note 9(a)) | (14,163) | (1,691) |
| **Total equity including reserves** | 416,619 | 344,929 |
| **Total liabilities and equity** | 1,880,245 | 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, December 31, 2014 | Three months ended, December 31, 2013 | Nine months ended, December 31, 2014 | Nine months ended, December 31, 2013 |
|---|---|---|---|---|
| **Revenue** | | | | |
| Vehicle and passenger fares | 111,074 | 105,206 | 422,087 | 400,751 |
| Ferry service fees | 38,913 | 40,643 | 138,155 | 141,822 |
| Retail | 17,386 | 17,172 | 65,887 | 64,902 |
| Federal-Provincial Subsidy Agreement | 7,089 | 7,094 | 21,267 | 21,280 |
| Fuel surcharges (note 11) | 3,045 | - | 13,193 | - |
| Regulated other income | 2,979 | 2,978 | 12,500 | 11,658 |
| Other income | 1,899 | 1,718 | 6,572 | 5,837 |
| **Total revenue** | 182,385 | 174,811 | 679,661 | 646,250 |
| **Expenses** | | | | |
| Operations | 105,074 | 106,253 | 345,457 | 345,142 |
| Maintenance | 19,188 | 17,431 | 48,305 | 45,177 |
| Administration | 7,364 | 7,428 | 22,997 | 21,950 |
| Cost of retail goods sold | 7,169 | 6,842 | 26,315 | 25,252 |
| Depreciation and amortization | 35,354 | 33,148 | 106,200 | 101,575 |
| **Total operating expenses** | 174,149 | 171,102 | 549,274 | 539,096 |
| **Operating profit** | 8,236 | 3,709 | 130,387 | 107,154 |
| **Net finance and other expenses** | | | | |
| Net finance expense (note 10) | | | | |
| Finance income | 1,056 | 1,078 | 3,092 | 2,603 |
| Finance expenses | (15,432) | (17,039) | (49,268) | (53,403) |
| Net finance expense | (14,376) | (15,961) | (46,176) | (50,800) |
| Loss on disposal of property, plant and equipment | (5) | (57) | (49) | (69) |
| **Net finance and other expenses** | (14,381) | (16,018) | (46,225) | (50,869) |
| **Net (loss) earnings** | (6,145) | (12,309) | 84,162 | 56,285 |
| Other comprehensive (loss) income (note 9(b)) | | | | |
| Items not to be reclassified to net earnings | - | - | (2,890) | 104 |
| Items to be reclassified to net earnings | (7,354) | - | (9,750) | - |
| Total other comprehensive (loss) income | (7,354) | - | (12,640) | 104 |
| **Total comprehensive (loss) income** | (13,499) | (12,309) | 71,522 | 56,389 |

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)

| | Nine months ended, December 31, 2014 | 2013 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net earnings | 84,162 | 56,285 |
| Items not affecting cash | | |
| Net finance expense | 46,176 | 50,800 |
| Depreciation and amortization | 106,200 | 101,575 |
| Loss on disposal of property, plant and equipment | 49 | 69 |
| Other non-cash adjustments to property, plant and equipment | (888) | (62) |
| Changes in | | |
| Long-term accrued employee future benefits | 64 | (443) |
| Derivative liabilities recognized in net earnings | (13) | (12) |
| Provisions | (3,661) | 326 |
| Long-term land lease | 344 | 344 |
| Accrued interest costs | 55 | (1,020) |
| Total non-cash items | 148,326 | 151,577 |
| Movements in operating working capital | | |
| Trade and other receivables | 5,770 | 5,082 |
| Prepaid expenses | (1,920) | 2,107 |
| Inventories | (964) | (1,711) |
| Accounts payable and accrued liabilities | (12,681) | (10,018) |
| Deferred revenue | 5 | (511) |
| Change in non-cash working capital | (9,790) | (5,051) |
| Change attributable to capital asset acquisitions | 4,229 | (91) |
| Change in non-cash operating working capital | (5,561) | (5,142) |
| Cash generated from operating activities | 226,927 | 202,720 |
| Interest received | 3,453 | 3,586 |
| Interest paid | (54,639) | (56,589) |
| Net cash generated by operating activities | 175,741 | 149,717 |

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)

| | Nine months ended, December 31, | |
|---|---|---|
| | 2014 | 2013 |
| **Cash flows from financing activities** | | |
| Proceeds from issuance of bonds | 200,000 | 200,000 |
| Repayment of long-term debt | (262,000) | (144,500) |
| Repayment of finance lease obligations | (834) | (800) |
| Deferred financing costs incurred | (1,315) | (1,387) |
| Hedge losses on interest rate forward contracts | (7,652) | - |
| Net cash (used in) generated by financing activities | (71,801) | 53,313 |
| **Cash flows from investing activities** | | |
| Proceeds from disposal of property, plant and equipment | 115 | 39 |
| Purchase of property, plant and equipment and intangible assets | (100,237) | (86,524) |
| Changes in debt service reserves | 3,141 | (287) |
| Net proceeds from (purchase of) short-term investments | 18,308 | (53,111) |
| Net cash used in investing activities | (78,673) | (139,883) |
| Net increase in cash and cash equivalents | 25,267 | 63,147 |
| Cash and cash equivalents, beginning of period | 71,365 | 36,641 |
| **Cash and cash equivalents, end of period** | 96,632 | 99,788 |

See accompanying notes to the interim consolidated financial statements.

# 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 9 (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 nine months ended December 31, 2013 | - | - | 56,285 | 56,285 | - | 56,285 |
| Other comprehensive income for the nine months ended December 31, 2013 | - | - | - | - | 104 | 104 |
| Balance as at December 31, 2013 | 75,478 | 25,000 | 290,472 | 390,950 | 3,337 | 394,287 |
| Balance as at March 31, 2014 | 75,478 | 25,000 | 246,142 | 346,620 | (1,691) | 344,929 |
| Net earnings for the nine months ended December 31, 2014 | - | - | 84,162 | 84,162 | - | 84,162 |
| Other comprehensive income for the nine months ended December 31, 2014 | - | - | - | - | (12,640) | (12,640) |
| Hedge losses reclassified to net earnings | - | - | - | - | 168 | 168 |
| Balance as at December 31, 2014 | 75,478 | 25,000 | 330,304 | 430,782 | (14,163) | 416,619 |

See accompanying notes to the interim consolidated financial statements.

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 nine months ended December 31, 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 February 13, 2015.

(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, cash and cash equivalents.

**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 December 31, 2014, the Group has no embedded derivatives that meet the requirements of IFRS 9 *Financial Instruments (2013)*, which would require that they are separated from host contracts and valued separately at fair value.

(f) Financial assets and liabilities:

Financial assets include trade receivables, loan receivables, derivatives with a positive market value, investments in securities and cash.

Financial liabilities include bank borrowings, bonds, obligations related to lease contracts, derivatives with a negative market value and trade payables.

Financial assets and liabilities presented are "non-current" except those with a maturity of less than twelve months from the period-end date. Financial assets with maturities of less than twelve months are presented as "current assets" or "cash equivalents" depending on the circumstances.

*(i) Recognition and measurement of non-derivative financial instruments*

In accordance with IFRS 9 (2013), financial assets are classified into one of three categories:

- amortised cost (the asset is held in order to collect contractual cash flows and the contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI); or
- fair value through other comprehensive income (the business objective is achieved by both collecting contractual cash flows and selling assets, and the cash flows represent SPPI); or
- fair value through net earnings or loss (all financial assets not recognized in one of the two previous categories).

Classification depends on the nature and objective of each financial asset and is determined when first recognized.

Financial liabilities are classified as either amortized cost or at fair value through net earnings or loss.

*(ii) Loans and advances*

When initially recognized, loans and advances are measured at fair value. These financial assets are then carried at amortized cost using the effective interest rate method, less impairment losses, if any. Loans and advances are subject to recoverable value tests, carried out whenever there are objective indicators that the recoverable value of these assets would be lower than the carrying value and, at the very least, on each statement of financial position date.

**1. Accounting policies (continued):**

(f) Financial assets and liabilities (continued):

*(iii) Trade and other receivables*

Trade and other receivables are recorded at fair value (in most cases the same as nominal value) minus any loss of value recorded in a special impairment account. As receivables are due in less than one year, they are not discounted. If there is any indication that these assets may be impaired, they will be subject to an analysis based primarily on the following criteria: age of the receivable, the debtor's financial position and negotiation of a payment schedule. The difference between the carrying amount and the recoverable value is recorded as a provision in net earnings or loss. Impairment may be reversed if the asset regains its value in future periods and the reversal is booked in the same line item as the initial provision. Impairment is deemed permanent when the receivable itself is considered to be permanently non-recoverable and written off.

*(iv) Cash and cash equivalents*

Cash and cash equivalents include cash on hand and demand deposits with a maturity of less than three months, are held to maturity and 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. The instruments held in this category can be liquidated or sold on short notice, and do not bear any significant risk of loss in value.

*(v) Borrowings and other financial liabilities*

Trade and other debts are initially recorded at fair value, which is generally the same as nominal value plus or minus any premiums or discounts. Bank borrowings and other financial liabilities are subsequently measured at amortized cost calculated using the effective interest rate method. Interest accrued on short-term borrowings is included in "accounts payable and accrued liabilities" on the statement of financial position. Cash flows linked to short-term payable amounts are not discounted. Long-term cash flows are discounted whenever the impact is significant.

*(vi) Recognition and measurement of financial derivatives*

Financial derivatives are held from time to time to manage exposure to fuel price, interest rate and foreign exchange risks. Derivatives are initially recorded at fair value and associated transaction costs are recognized in net earnings or loss when incurred. After initial recognition, derivatives are measured at fair value. Changes in the fair value of these instruments are recorded in net earnings or loss except where the instrument has been designated as a hedging item. The Group derecognizes a financial liability when its contractual obligations are discharged, cancelled or expired.

**1. Accounting policies (continued):**

(f) Financial assets and liabilities (continued):

*(vii) Fair value hierarchy*

In estimating fair value, the Group uses quoted market prices when available. Models incorporating observable market data along with transaction specific factors are also used in estimating fair value. Financial assets and liabilities are classified in the fair value hierarchy according to the lowest level of observability of inputs that are significant to the fair value measurement. Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect placement within the following fair value hierarchy levels:

- level 1 – quoted prices in active markets for identical assets or liabilities,
- level 2 – techniques (other than quoted prices included in level 1) that are observable for the asset or liability, either directly (as prices), or indirectly (as derived from prices), and
- level 3 – techniques which use inputs which have a significant effect on recorded fair values for the asset or liability that are not based on observable market data (unobservable inputs).

(g) Hedging relationships:

Derivative financial instruments are utilized by the Group to manage market risk against the volatility in foreign currency, interest rate, and fuel price exposures. The Group does not utilize derivative financial instruments for trading or speculative purposes. At the inception of each hedge the Group determines whether it will or will not apply hedge accounting.

When applying hedge accounting, the Group documents all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the statement of financial position or to specific firm commitments or forecasted transactions. The Group also assesses, 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.

When a derivative is designated in a cash flow hedging relationship, the effective portion of changes in the fair value of the derivative are recognized in other comprehensive income. Gains or losses on derivatives used in cash flow hedges of forecasted purchases of non-financial assets are reclassified from other comprehensive income and are included in the initial carrying amount of the non-financial asset acquired. Gains or losses on derivatives for hedging relationships related to other cash flow hedges are reclassified from other comprehensive income to net earnings or loss when the hedged item affects net earnings or loss. Any ineffective portion of a hedge relationship is recognized immediately in net earnings or loss.

**1. Accounting policies (continued):**

(g) Hedging relationships (continued):

The Group has elected to exclude the time value component of options from the hedging relationships, with these amounts recorded in other comprehensive income as a cost of hedging. For hedge items other than the purchase of non-financial assets, the cost of hedging amounts are classified to the net earnings or loss when the underlying hedged transaction affects net earnings or loss. When hedging a forecasted transaction that results in the recognition of a non-financial asset, cost of hedging amounts are classified to the carrying amount of the non-financial asset acquired.

When a derivative in a hedging relationship is terminated, expired, sold or no longer qualifies for hedge accounting, hedge accounting is discontinued prospectively. Any amounts recorded in other comprehensive income remain in other comprehensive income. Amounts recognized in other comprehensive income are recognized in net earnings or loss in the period in which the underlying hedged transaction is completed. Gains or losses arising subsequent to the derivative not qualifying for hedge accounting are recognized in earnings or loss immediately.

(h) Adoption of new accounting standards:

IFRS 9 *Financial Instruments (2013):*

The Group early adopted all the requirements of IFRS 9 (2013) with an application date of October 1, 2014. This standard replaces the guidance in IAS 39 *Financial Instruments*: *Recognition and Measurement*. The standard eliminates the existing IAS 39 categories of held-to-maturity, available-for-sale and loan and receivables. Financial assets and liabilities are classified into one of two categories on initial recognition: amortized cost or fair value. As a result of the early adoption, the Group has changed its accounting policy with respect to financial instruments. The standard includes changes which will align hedge accounting more closely with risk management activities and increases the scope of hedged items eligible for hedge accounting. The adoption of this standard did not have any impact on the Group’s consolidated financial statements other than the classification of the Group’s financial assets and liabilities and certain additional disclosures. These additional disclosures required under IFRS 9 (2013) are provided in Note 4.

(columnar dollars expressed in thousands of Canadian dollars)

## 1. Accounting policies (continued):

(h) Adoption of new accounting standards (continued):

The Group's financial instruments are classified as follows under IFRS 9 (2013) as compared to the Group's previous policy under IAS 39:

| October 1, 2014 | | |
|---|---|---|
| **Assets/Liabilities** | **IAS 39** | **IFRS 9 (2013)** |
| Cash | Available for sale | Fair value through other comprehensive income |
| Cash equivalents | Fair value through net earnings or loss | Fair value through net earnings or loss |
| Derivatives | Fair value through net earnings or loss | Fair value through net earnings or loss |
| Derivatives (hedges) | Fair value through other comprehensive income | Fair value through other comprehensive income |
| Cash equivalents | Held-to-maturity | Amortized cost |
| Restricted short-term investments | Held-to-maturity | Amortized cost |
| Other short-term investments | Held-to-maturity | Amortized cost |
| Trade and other receivables | Loans and receivables | Amortized cost |
| Long-term loan receivable | Loans and receivables | Amortized cost |
| Accounts payable and accrued liabilities | Other financial liabilities | Amortized cost |
| Interest payable on long-term debt | Other financial liabilities | Amortized cost |
| Provisions | Other financial liabilities | Amortized cost |
| Long-term debt including current portion | Other financial liabilities | Amortized cost |

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 (2014):*

In July 2014, the International Accounting Standards Board issued the completed version of IFRS 9. IFRS 9 (2014) introduces a new expected credit loss model for calculating impairment, and incorporates the guidance on the classification and measurement of financial assets and the final general hedge accounting requirements originally published in IFRS 9 (2013). IFRS 9 (2014) is effective for annual periods beginning on or after January 1, 2018.

(columnar dollars expressed in thousands of Canadian dollars)

**3. Loans:**

| | As at | |
|---|---|---|
| Long-term debt: | December 31, 2014 | 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%) | 39,375 | 45,000 |
| Tranche B (floating interest rate of 1.58% at December 31, 2014) | 22,500 | 20,625 |
| 12 Year Loan, maturing June 2020 | | |
| Tranche A (effective interest rate of 5.18%) | 41,250 | 46,875 |
| Tranche B (floating interest rate of 1.58% at December 31, 2014) | 22,500 | 20,625 |
| 2.95% Loan, maturing January 2021 (effective interest rate of 3.08%) | 58,500 | 63,000 |
| | 1,284,125 | 1,346,125 |
| Less: Deferred financing costs and unamortized bond discounts | (10,278) | (9,344) |
| Current portion | (24,000) | (270,250) |
| | 1,249,847 | 1,066,531 |

**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 December 31, 2014 (March 31, 2014: $nil). Interest expensed during the quarter ended December 31, 2014 was $nil (December 31, 2013: $0.1 million). Interest expensed during the nine months ended December 31, 2014 was $nil (December 31, 2013: $0.3 million). Letters of credit outstanding against this facility at December 31, 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 December 31, 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).

(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 December 31, 2014 | | As at March 31, 2014 | |
|---|---|---|---|---|
| | Carrying Value | Approx Fair Value | Carrying Value | Approx Fair Value |
| Financial assets/liabilities at fair value through other comprehensive income | | | | |
| Cash[1] | 44,089 | 44,089 | 11,783 | 11,783 |
| Derivative liabilities (hedges)[2] | 7,354 | 7,354 | 5,267 | 5,267 |
| Financial assets/liabilities at fair value through net earnings or loss [3] | | | | |
| Cash equivalents | 2,928 | 2,928 | 3 | 3 |
| Derivative liabilities | 5 | 5 | 7 | 7 |
| Financial assets/liabilities at amortized cost [4] | | | | |
| Cash equivalents | 49,615 | 49,615 | 59,579 | 59,579 |
| Restricted short-term investments | 32,651 | 32,651 | 35,792 | 35,792 |
| Other short-term investments | 62,698 | 62,698 | 81,006 | 81,006 |
| Trade and other receivables | 10,807 | 10,807 | 16,577 | 16,577 |
| Long-term loan receivable [5] | 24,515 | 24,515 | 24,515 | 24,515 |
| Accounts payable and accrued liabilities | 35,453 | 35,453 | 48,134 | 48,134 |
| Interest payable on long-term debt | 16,563 | 16,563 | 19,634 | 19,634 |
| Provisions | 48,140 | 48,140 | 51,801 | 51,801 |
| Long-term debt, including current portion [6, 7] | 1,273,847 | 1,536,685 | 1,336,781 | 1,515,137 |

[1] Due to the nature of this financial instrument, carrying value approximates fair value.
[2] 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 the 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] 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.
[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.

(columnar dollars expressed in thousands of Canadian dollars)

## 4. Financial instruments (continued):

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

| | As at December 31, 2014 | | As at March 31, 2014 | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 1 | Level 2 |
| Asset (liability): | | | | |
| Cash [1] | 44,089 | - | 11,783 | - |
| Cash equivalents [1] | 2,928 | - | 3 | - |
| Derivatives [2] | - | (7,359) | - | (5,274) |
| Long-term debt, including current portion [2] | - | (1,536,685) | - | (1,515,137) |
| | 47,017 | (1,544,044) | 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 nine months ended December 31, 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 December 31, 2014, all financial instruments measured at fair value (excluding derivatives) have been classified as level 1 in the fair value hierarchy with quoted prices in active markets.

During the nine months ended December 31, 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.

(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 | - | - | - | - | - | 87,291 | 87,291 |
| Disposals | (10,169) | (180) | (155) | - | - | (64) | (10,568) |
| Transfers from construction in progress | 14,481 | 23,478 | 3,984 | - | - | (41,943) | - |
| **Balance at December 31, 2014** | **1,229,452** | **572,063** | **76,316** | **5,559** | **15,887** | **71,018** | **1,970,295** |
| **Accumulated depreciation:** | | | | | | | |
| Balance at March 31, 2014 | 260,915 | 69,470 | 24,025 | - | - | - | 354,410 |
| Depreciation for the period | 74,715 | 19,155 | 6,670 | - | - | - | 100,540 |
| Disposals | (10,027) | (175) | (60) | - | - | - | (10,262) |
| **Balance at December 31, 2014** | **325,603** | **88,450** | **30,635** | **-** | - | - | **444,688** |
| **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 December 31, 2014** | **903,849** | **483,613** | **45,681** | **5,559** | **15,887** | **71,018** | **1,525,607** |

**5. Property, plant and equipment (continued):**

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

During the nine months ended December 31, 2014, capitalized financing costs during construction amounted to $1.1 million (December 31, 2013: $1.3 million) with an average capitalization rate of 5.30% (December 31, 2013: 5.56%). In addition to the construction in progress referenced above, the contractual commitments at December 31, 2014 for assets to be constructed totalled $187.4 million (March 31, 2014: $25.9 million). These contractual commitments include $156.7 million of the total contract value of $165 million for construction of three new intermediate class vessels.

During the three months ended December 31, 2014, the Group received $0.2 million (December 31, 2013: $0.2 million) of rental income earned from buildings held for leasing purposes and during the nine months ended December 31, 2014, received $0.7 million (December 31, 2013: $0.6 million). These buildings have a cost and accumulated depreciation of $11.9 million and $1.7 million respectively, as at December 31, 2014.

(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 | - | - | 13,680 | 13,680 |
| Disposals | (276) | - | - | (276) |
| Transfers from assets under development | 1,640 | - | (1,640) | - |
| **Balance at December 31, 2014** | **32,737** | **11,516** | **42,263** | **86,516** |
| **Accumulated amortization and impairment:** | | | | |
| Balance at March 31, 2014 | 12,902 | 7,046 | - | 19,948 |
| Amortization for the period | 3,851 | 1,809 | - | 5,660 |
| Disposals | (276) | - | - | (276) |
| **Balance at December 31, 2014** | **16,477** | **8,855** | - | **25,332** |
| **Net carrying value:** | | | | |
| **As at March 31, 2014** | **18,471** | **4,470** | **30,223** | **53,164** |
| **As at December 31, 2014** | **16,260** | **2,661** | **42,263** | **61,184** |

(b) Other disclosures - intangible assets:

Capitalized financing costs during construction for intangible assets for the nine months ended December 31, 2014 totalled $1.3 million (December 31, 2013: $1.1 million) with an average capitalization rate of 5.30% (December 31, 2013: 5.56%).

During the nine months ended December 31, 2014, intangible assets totalling $13.7 million (December 31, 2013: $8.2 million) were acquired and $nil (December 31, 2013: $0.1 million) were internally developed.

## 7. Accrued employee future benefits:

During the three months ended December 31, 2014 the Group recognized total defined benefit costs of $0.4 million (December 31, 2013: $0.4 million) and during the nine months ended December 31, 2014 the Group recognized total defined benefit costs of $1.2 million (December 31, 2013: $1.1 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.

## 8. Financial risk management:

Market risk:

Exposure to market risk arises in the normal course of the Group’s business. The Group manages market risk arising from the exposure to volatility in foreign currency, interest rates, and fuel prices in part through the use of derivative financial instruments including forward contracts, swaps and options. The Group does not utilize derivative financial instruments for trading or speculative purposes. At the inception of each hedge the Group determines whether it will or will not apply hedge accounting. As at December 31, 2014, the Group has entered into Ultra-low Sulfur Diesel (ULSD) fuel swap contracts with a notional value of $62.3 million to reduce its exposure to changes in the ULSD and foreign exchange risk components associated with forecast diesel fuel purchases (note 8(a)) and has applied hedge accounting to these contracts. The ULSD swaps are converted to Canadian dollars at forward market prices.

Through analysis of the diesel fuel market structure, the Group determined ULSD and foreign exchange are components of forecast fuel purchases. The Group’s ULSD fuel supply contract includes a price formula of Vancouver Rack ULSD fuel less discounts plus delivery charges and taxes. The Vancouver Rack ULSD fuel price is comprised of New York Harbour ULSD, foreign exchange and locational basis risk components. The Group has designated the New York Harbour ULSD and the foreign currency risk components as hedged risks. These risk components are being hedged using ULSD swaps and are converted to CAD at forward market rates. The forward market price is included in the hedge designation.

An economic relationship exists between the hedged item and the hedging instrument as the fair values of both the hedged item and hedging instrument move in opposite directions in response to the same risk. The Group uses a 1:1 hedge ratio by volume for hedging its diesel fuel purchases using ULSD swaps. The inclusion of credit risk in the fair value of the hedging instrument which is not replicated in the hedged item is a source of ineffectiveness.

During the three months ended December 31, 2014 the unrealized hedge loss on these contracts was $7.4 million. The effective portion of this unrealized loss of $7.4 million has been recognized in other comprehensive income. There was no hedge ineffectiveness.

**8. Financial risk management (continued):**

(a) As at December 31, 2014, the Group's outstanding derivative contracts, which qualified for hedge accounting, and the periods in which the cash flows are expected to occur and to impact net earnings (loss), are as follows:

| | Fiscal 2015 | Fiscal 2016 | Total |
|---|---|---|---|
| Cash flow hedges | | | |
| Fuel price risk | | | |
| Fuel contracts (litres in thousands) | 17,100 | 78,445 | 95,545 |
| Contract price range ($/litre) | $0.6362 - $0.6617 | $0.6299 - $0.6708 | |

(b) Additional information on hedging instruments and hedged items as at December 31, 2014:

| | | | | | Fair value changes used for calculating hedge ineffectiveness | |
|---|---|---|---|---|---|---|
| | Nominal amount of the hedging instrument | Carrying amount of the hedging instrument - liability | Item location | Cash flow hedge reserve | Hedging instruments | Hedged items |
| Cash flow hedges | | | | | | |
| Fuel price risk | 62,338 | (7,354) | Included in derivative liabilities | 7,354 | 7,354 | 7,378 |

(c) Hedging gains (losses):

| | Hedging losses recognized in cash flow hedge reserve | | Hedging losses reclassified from cash flow hedge reserve | |
|---|---|---|---|---|
| | Three months ended December 31, 2014 | Nine months ended December 31, 2014 | Three months ended December 31, 2014 | Nine months ended December 31, 2014 |
| Fuel price risk | | | | |
| Fuel swap contracts | (7,354) | (7,354) | - | - |
| Interest rate risk | | | | |
| Interest rate forward contracts | | | | |
| Recognized loss | | (2,396) | | |
| Amortization of loss | - | | 62 | 168 |
| | (7,354) | (9,750) | 62 | 168 |

**8. Financial risk management (continued):**

(c) Hedging gains (losses) (continued):

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 on these contracts recognized 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 was $7.4 million and has been recognized in other comprehensive income and will subsequently be 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 three months ended December 31, 2014, $0.1 million of the net loss from the hedging reserve was reclassified to interest expense in the consolidated statement of comprehensive income or loss. During the nine months ended December 31, 2014, $0.2 million of the net loss from the hedging reserve was reclassified to interest expense in the consolidated statement of comprehensive income or loss.

There was no hedge ineffectiveness recorded in net earnings or loss in the periods presented.

(columnar dollars expressed in thousands of Canadian dollars)

## 9. Other comprehensive (loss) income:

(a) Continuity of reserves:

| | Land revaluation reserves | Employee future benefit revaluation reserves | Hedging reserves | 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 (note 8(c)) | - | - | (2,396) | (2,396) |
| Less losses reclassified to net earnings in the period (note 8(c)) | - | - | 168 | 168 |
| Hedge losses on fuel swaps (note 8(c)) | | | (7,354) | (7,354) |
| **Balance at December 31, 2014** | **3,245** | **(2,786)** | **(14,622)** | **(14,163)** |

(b) Other comprehensive (loss) income:

| | Three months ended, December 31, 2014 | Three months ended, December 31, 2013 | Nine months ended, December 31, 2014 | Nine months ended, December 31, 2013 |
|---|---|---|---|---|
| Items to be reclassified to net earnings: | | | | |
| Hedge losses on interest rate forward contracts (note 8(c)) | - | - | (2,396) | - |
| Hedge losses on fuel swaps (note 8(c)) | (7,354) | - | (7,354) | - |
| Items not to be reclassified to net earnings: | | | | |
| Actuarial (losses) gains on defined benefit plans (note 7) | - | - | (2,890) | 104 |
| **Total other comprehensive (loss) income** | (7,354) | - | (12,640) | 104 |

(columnar dollars expressed in thousands of Canadian dollars)

## 10. Net finance expense:

| | Three months ended, December 31, | | Nine months ended, December 31, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Finance expenses | | | | |
| Long-term debt | 16,100 | 17,158 | 49,879 | 53,003 |
| Short-term debt | 67 | 121 | 221 | 535 |
| Finance leases | 499 | 505 | 1,495 | 1,524 |
| Amortization of deferred financing costs and bond discounts | 162 | 215 | 549 | 746 |
| Interest capitalized in the cost of qualifying assets | (954) | (960) | (2,434) | (2,405) |
| Interest rate support (a) | (442) | - | (442) | - |
| Finance expenses | 15,432 | 17,039 | 49,268 | 53,403 |
| Finance income | (1,056) | (1,078) | (3,092) | (2,603) |
| Net finance expense | 14,376 | 15,961 | 46,176 | 50,800 |

(a) Interest rate support

During the quarter ended December 31, 2014 the Group interest rate support recorded as a reduction of interest expense totalled $0.4 million (December 31, 2013: $nil). These funds, received through the Structured Financing Facility Program offered by the Government of Canada, reflect the completion of the funding related to the purchase of the *Island Sky*.

## 11. 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 December 31, 2014 detailed below are probable of future recovery.

(columnar dollars expressed in thousands of Canadian dollars)

## 11. 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:

| | As at, | |
|---|---|---|
| **Regulatory accounts** | December 31, 2014 | March 31, 2014 |
| Deferred fuel costs : | | |
| Balance – beginning of period | 6,150 | (1,415) |
| Fuel costs deferred | 10,478 | 14,521 |
| Surcharges collected | (13,193) | (2,690) |
| Fuel price risk recoveries from the Province | (1,200) | (1,675) |
| Other payments from the Province | (983) | (1,396) |
| Tariffs in excess of price cap (a) | - | (1,195) |
| Balance – end of period | 1,252 | 6,150 |
| Performance term submission costs | 102 | 163 |
| **Total of regulatory accounts** | **1,354** | **6,313** |
| | | |
| **Total regulatory assets** | **1,354** | **6,313** |
| **Current regulatory assets** | **82** | **82** |
| **Total long term regulatory assets** | **1,272** | **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 December 31, 2014.

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 nine months ended December 31, 2014 would have been $5.0 million lower (2013: $5.8 million higher) as detailed below:

| | Three months ended, December 31, | | Nine months ended, December 31, | |
|---|---|---|---|---|
| **Effect of rate regulation on total comprehensive income** | 2014 | 2013 | 2014 | 2013 |
| **Regulatory accounts:** | | | | |
| Deferred fuel costs | (1,687) | 2,221 | (4,898) | 7,557 |
| Performance term submission costs | (21) | (20) | (61) | (61) |
| Tariffs in excess of price cap | - | 564 | - | (1,666) |
| **Total (decrease) increase in total comprehensive income** | (1,708) | 2,765 | (4,959) | 5,830 |

## 12. Long-term liabilities:

During the three months ended December 31, 2014, the Group received the first payment from FortisBC Energy Inc. of $1.5 million of the total contribution of $6 million as part of the Natural Gas for Transportation ("NGT") incentive funding. The contribution is dependent upon the Group purchasing at least 3 million gigajoules of liquefied natural gas. The NGT incentive funding will be applied towards the purchase of three new intermediate class vessels.

## 13. 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 nine months ended December 31, 2014, the Group paid $91,943 (December 31, 2013: $138,788) of such expenses.

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