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

For the three months ended
June 30, 2014

Dated August 21, 2014

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The following is our discussion and analysis of the financial condition and financial performance for British Columbia Ferry Services Inc. as of, and for the three months ended, June 30, 2014. This discussion and analysis should be read in conjunction with our unaudited consolidated financial statements and related notes for the three months ended June 30, 2014 and 2013, and our audited consolidated financial statements and related notes for the years ended March 31, 2014 (fiscal 2014) and March 31, 2013, together with our Management's Discussion & Analysis for fiscal 2014. These documents are available on SEDAR at www.sedar.com and on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

Except where indicated, all financial information herein is expressed in Canadian dollars and determined on the basis of International Financial Reporting Standards (IFRS).

BUSINESS OVERVIEW

British Columbia Ferry Services Inc. is an independent company providing passenger and vehicle ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world. We provide frequent year-round transportation service with 35 vessels operating on 24 routes out of 47 terminals spread over 1,000 miles of coastline. We also manage ferry transportation service on other remote routes through contracts with independent operators.

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

We provide a wide range of ferry services for our customers. During the three months ended June 30, 2014 (the first quarter of fiscal 2015), we provided over 43,000 sailings, compared to almost 46,000 sailings during the same period in the prior year, carrying five million passengers and two million vehicles. In the first quarter of fiscal 2015, vehicle traffic decreased 0.4% while passenger traffic increased 0.3% compared to the same quarter in the prior year. On our Major Routes, we experienced a 0.9% increase in vehicle traffic and a 1.7% increase in passenger traffic compared to the same quarter in the prior year while, on our Northern and regulated Other Routes, we experienced a decrease in both vehicle and passenger traffic. For a discussion of our traffic levels, see "Financial and Operational Overview" below.

Significant events during or subsequent to the first quarter of the year ending March 31, 2015 (fiscal 2015) include the following:

- On April 1, 2014, we implemented average tariff increases in accordance with the British Columbia Ferries Commissioner's (the Commissioner) 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 tariffs 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 1, 2014, we also implemented the Province's decision to reduce the passenger fare discount for BC seniors travelling Mondays to Thursdays from 100% to 50% on the Major and regulated Other Routes.

- 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 4.45%, 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 regulated 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 reflect the service reductions determined by the Province in order to better align service levels with demand, and to ensure the coastal ferry system is affordable, efficient and sustainable. This includes the discontinuation of the Discovery Coast Passage Route with direct service to the mid-coast from Port Hardy for three months during the summer peak season. This route was replaced with an extension of one of our other Northern Routes to the mid-coast, which now provides a supplemental indirect service with a much smaller vessel.

- On July 3, 2014, we entered into contracts with Remontowa Shipbuilding S.A. of Gdansk, Poland to build three new intermediate class vessels. These contracts, with a total value of $165 million, form the majority of the total project budget of $252 million. This budget also includes $51 million for Canadian taxes and federal import duties. These are design-build, fixed price contracts that provide us with substantial guarantees related to delivery dates, performance criteria, cost certainty and quality of construction. The new vessels, scheduled for delivery in August 2016, October 2016 and February 2017, will replace the 49-year old *Queen of Burnaby* and the 50-year old *Queen of Nanaimo*. The new vessels will be dual-fuel capable, so they can operate on liquefied natural gas (LNG) or marine diesel fuel. (See Outlook – Asset Renewal Program" below for more detail.)

The Effect of Rate Regulation

We are regulated by the Commissioner to ensure, among other things, that our tariffs are fair and reasonable. Under the terms of the *Coastal Ferry Act* (the Act), the tariffs we charge our customers over a performance term are subject to price caps set by the Commissioner. The Commissioner may, under certain circumstances, allow increases in 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 has an interim standard that addresses accounting for rate-regulated activities, however it does not apply to entities that have already transitioned to IFRS, as we have. As a result, we are not permitted to recognize 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 June 30, 2014 are probable of future recovery. These regulatory assets are detailed in note 10 to our June 30, 2014 unaudited consolidated financial statements.

If IFRS permitted us to report regulatory assets and liabilities in our financial statements, the effect on our Statements of Comprehensive Income for the three months ended June 30, 2014 and 2013 would be as follows:

($ millions)		**Three months ended June 30**	
		2014	**2013**
Total comprehensive income		11.5	4.3
Changes in net earnings:			
Regulatory asset or liability	**Statement line item**		
Deferred fuel costs (a)			
Fuel costs incurred	Operations expense	4.0	2.6
Fuel surcharges collected	Fuel surcharge revenue	(4.4)	-
Payments from the Province	Ferry transportation fees	(0.7)	(0.5)
		(1.1)	2.1
Tariffs in excess of price cap (b)			
Obligation incurred during the period	Tariff revenue	-	(2.8)
(Decrease) in total net earnings		(1.1)	(0.7)
Adjusted total comprehensive income		10.4	3.6

(a) Deferred fuel costs: As prescribed by regulatory order, we defer differences between actual fuel costs and approved fuel costs which were used to develop the regulated price caps. The difference between actual fuel costs and approved fuel costs (including fuel hedge gains and losses) is deferred for settlement in future tariffs. Also, as prescribed by regulatory order, we collect fuel surcharges or provide fuel rebates from time to time which are applied against deferred fuel cost account balances. We may also receive payments from the Province to be 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. Tariffs charged did not exceed price caps at June 30, 2014.

FINANCIAL AND OPERATIONAL OVERVIEW

This section provides an overview of our financial and operational performance for the three months ended June 30, 2014 and 2013.

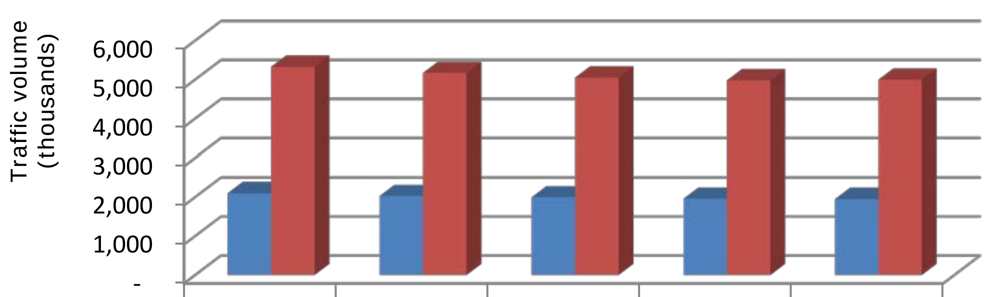
($ millions)	Three months ended June 30			
			Variance	
	2014	**2013**	**$**	**%**
Total revenue	213.1	200.0	13.1	6.6%
Operating expenses	182.5	178.8	(3.7)	(2.1%)
Operating profit	30.6	21.2	9.4	44.3%
Net finance and other	16.7	16.9	0.2	1.2%
Net earnings	13.9	4.3	9.6	223.3%
Other comprehensive loss	2.4	-	(2.4)	n/a
Total comprehensive income	11.5	4.3	7.2	167.4%

Our net earnings in the three months ended June 30, 2014 were $9.6 million higher and total comprehensive income was $7.2 million higher than in the three months ended June 30, 2013. The first quarter of fiscal 2015 net earnings reflect the effects of increased fares, higher ferry transportation fees, fuel surcharges and lower financing costs, partially offset by lower traffic levels, lower social program fees and operating cost increases. Other comprehensive loss in the first quarter of fiscal 2015 reflects the loss on interest rate forward contracts related to our April 28, 2014 issuance of $200 million of senior secured bonds. (See "Liquidity and Capital Resources" below for more detail.)

In the first quarter of fiscal 2015, vehicle traffic decreased 0.4% while passenger traffic increased 0.3% compared to the same quarter in the prior year. Both vehicle and passenger traffic on our Major Routes increased, while on our Northern and regulated Other Routes both vehicle and passenger traffic declined. Overall, commercial traffic decreased by 1.8% in the quarter, while drop-trailer traffic, a component of commercial traffic, increased 4.3% in the same period.

Traffic during the first quarter of fiscal 2015 was favourably impacted by the timing of the Easter holiday. The first quarter of fiscal 2015 included the entire Easter holiday weekend while the first quarter of fiscal 2014 included only the Monday of the Easter holiday weekend. Traffic was negatively impacted by new schedules related to service reductions outlined by the Province to better align service levels to demand and by a reduction in seniors travel related to the lower BC seniors fare discount on the Major and regulated Other Routes effective April 1, 2014.

The following graph illustrates our vehicle and passenger traffic levels for the first quarter of fiscal 2011 through fiscal 2015:



	2011	2012	2013	2014	2015
Vehicles	2,099	2,029	1,995	1,960	1,952
Passengers	5,328	5,172	5,049	4,980	4,997

Safety
In fiscal 2014, we received the Certificate of Recognition (COR) from WorkSafeBC. A COR certification recognizes companies that go beyond the legal requirements of the *Workers Compensation Act* and the Occupational Health & Safety Regulation by taking a best practices approach to implementing health, safety and injury management programs. A third-party audit sampled 15 worksites (vessels and terminals) and interviewed approximately 230 employees, 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 safety improvement. In June 2014, we received a $600,000 rebate from WorkSafeBC based on our 2013 assessed premiums. The COR certification provides for annual premium rebates from WorkSafeBC of up to 15%, which we expect will result in an annual savings of approximately $500,000.

Training
Each year we invest heavily in operational and safety training.

In the first quarter of fiscal 2015, in preparation for the busy summer season, training programs focused on passenger safety and emergency evacuation systems for seasonal employees. Our pilot training program for risk awareness was a success and we have begun the roll-out of the program. This web-based training provides participants with a basic understanding of the principles of risk, how to identify hazards and control measures, and what actions to take to reduce risk. We also continued to strengthen our partnerships with local training institutions to ensure all regulatory and operational training needs are met.

Our Standardized Education and Assessment (SEA) training also focused on the training requirements for new and returning seasonal employees. Programs were rolled out for eight new job categories and programs for three additional job categories are in development for an expected roll out in April 2015. Six SEA workshops for trainers were completed in the first quarter of fiscal 2015, increasing the number of SEA trainers to 384 across all departments.

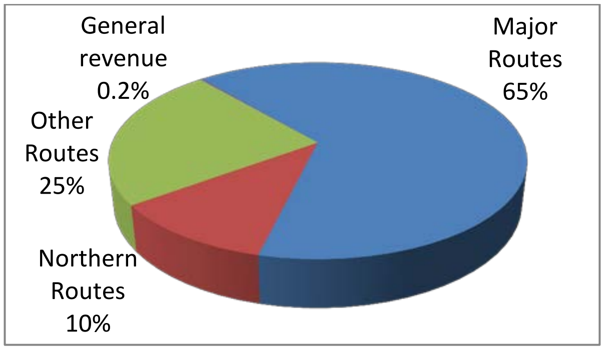
By the end of June 30, 2014, through our Bridge Team Simulation (BTS) training program, we had delivered Bridge Operations Skills and Systems (BOSS) Level 1 training to 88% and BOSS Level 2 to 30% of deck officers in the fleet. We expect that all deck officers will have completed BOSS 1 training by the end of fiscal 2015.

We have also developed a BTS pilot program to support SEA training by providing situational training on the bridge simulator to better equip our deck officers to handle navigational challenges on routes they are unfamiliar with. Further integration of BTS within the SEA program is being explored, beginning with familiarization with our Northern Routes.

We are preparing for facility and program accreditation with DNV GL, one of the leading classification societies and a global leader in maritime education and training accreditation. Achievement of this accreditation will allow us to provide training to external parties.

Collective agreement
On September 9, 2010, an arbitrator issued an award finding that certain shipboard positions were excluded from the bargaining unit by virtue of their managerial functions. The BC Ferry & Marine Workers' Union (the Union) applied for a review of this award, but the application was rejected by the Labour Relations Board. The Union was unsuccessful in an application for judicial review and appealed to the British Columbia Court of Appeal. On November 20, 2013, the Court of Appeal dismissed the Union's appeal. The Union then applied for leave to appeal to the Supreme Court of Canada. On April 3, 2014, the Supreme Court of Canada dismissed the Union's application.

Revenue
The following discussions of revenue are based on IFRS results, with reference to the impacts of rate regulation.



In the three months ended June 30, 2014, the greatest portion of our revenues (65%) was earned on our Major Routes. Revenue from the Northern Routes contributed 10% and Other Routes contributed 25%.

Selected operational statistics and total revenues for the three months ended June 30, 2014 compared to the same period in the prior year are shown in the tables below.

	Three months ended June 30	
Operational Statistics	**2014**	**2013**
Vehicle traffic	1,952,212	1,959,625
Passenger traffic	4,997,235	4,980,187
On-time performance	90.9%	90.7%
Number of round trips	19,690	20,955
Capacity provided (AEQs)	4,250,530	4,384,104
AEQs carried	2,227,453	2,237,404
Capacity utilization	52.4%	51.0%

In the three months ended June 30, 2014, vehicle traffic decreased 0.4% while passenger traffic increased 0.3% compared to the same quarter in the prior year. Both vehicle and passenger traffic on our Major Routes increased, while on our Northern and regulated Other Routes both vehicle and passenger traffic declined. Overall, traffic during the first quarter of fiscal 2015 was favourably impacted by the timing of the Easter holiday. The first quarter of fiscal 2015 included the entire Easter holiday weekend while the first quarter of fiscal 2014 included only the Monday of the Easter holiday weekend.

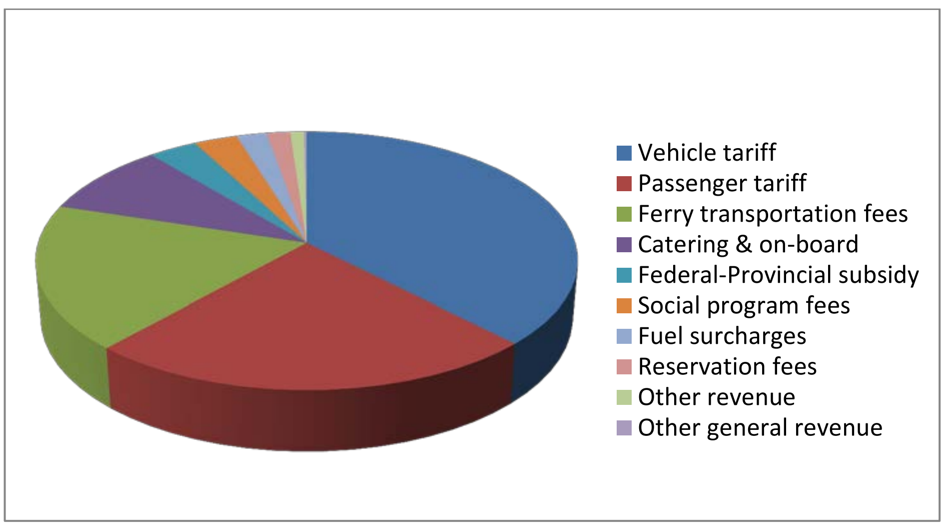
On-time performance on the Major and regulated Other Routes is defined as the percentage of our sailings departing within 10 minutes of the scheduled time. On-time performance on the Northern Routes is defined as the percentage of our sailings arriving within 10 minutes of the scheduled time. On-time 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 automobile equivalents (AEQs), is the available space on the vessel multiplied by the number of round trips. Round trips normally stay fairly stable as the Coastal Ferry Services Contract (CFSC) stipulates, among other things, the number of round trips to be provided for each regulated ferry service route. However, the number of round trips provided can be impacted by cancellations due to weather, vessel substitution, terminal dock closures and extra round trips made, or by changes to the number of trips stipulated by the CFSC. The reduction in round trips and the resulting decrease in capacity provided in the three months ended June 30, 2014 compared to the same period in the prior year is due to the discontinuation of the Discovery Coast Passage Route servicing the mid-coast and replacement with supplementary service, as well as new schedules related to service reductions on our Northern and regulated Other Routes.

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 dividing the AEQ capacity provided on the vessels by the AEQs carried during the period. Capacity utilization is impacted by the number of vehicles carried; the mix of vehicle types (the relative number of buses, commercial vehicles, and passenger vehicles); the size of the vessels utilized; and the number of round trips in each period. Utilization in the three months ended June 30, 2014 is higher than in the same period of the prior year as a result of reduced total capacity provided due to fewer round trips, partly offset by a lower number of AEQs carried.

Revenue ($millions)	**Three months ended June 30**			
	2014	**2013**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	80.3	78.2	2.1	2.7%
Passenger tariff	51.1	46.2	4.9	10.6%
Fuel surcharges	4.4	-	4.4	n/a
Catering & on-board	19.4	19.1	0.3	1.6%
Social program fees	6.3	8.5	(2.2)	(25.9%)
Reservation fees	3.4	2.9	0.5	17.2%
Other revenue	2.0	2.0	-	-
Total Direct Route Revenue	166.9	156.9	10.0	6.4%
Indirect Route Revenue				
Ferry transportation fees	38.7	35.6	3.1	8.7%
Federal-Provincial subsidy	7.1	7.1	-	-
Total Route Revenue	212.7	199.6	13.1	6.6%
Other general revenue	0.4	0.4	-	-
Total Revenue	213.1	200.0	13.1	6.6%



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.

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 tariffs 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. Also, on April 1, 2014, we implemented the Province's decision to reduce the passenger fare discount for BC seniors travelling Mondays to Thursdays from 100% to 50% on the Major and regulated Other Routes.

Effective April 1, 2014, the CFSC was amended to establish the maximum annual amount payable by the Province in respect of senior discounts for fiscal 2015 and fiscal 2016 at $18.0 million and $19.3 million, respectively. These amounts reflect an estimate of what the Province would have paid if there had been no change in the level of senior discounts. To the extent these funds are not required for the reimbursement of discounts provided seniors under the amended policy, the excess will be directed to the ferry transportation fees. These amounts are to be allocated to the regulated Northern and Other Routes.

Surcharges and/or rebates are implemented as a direct result of rising and declining fuel prices. On January 17, 2014, due to the high cost of diesel fuel, we implemented a fuel surcharge of 3.5% on average on our Major Routes and our regulated Other Routes. At the time of the general rate increase on April 1, 2014, no changes were made to the nominal values of the fuel surcharges. Accordingly, these fuel surcharges average 3.4% of the current tariff. For the purpose of rate regulation, these amounts are applied to our deferred fuel cost accounts. No surcharges were put in place on our Northern Routes and no surcharges were in place in the first quarter of fiscal 2014 on any of our regulated routes. (See "The Effect of Rate Regulation" above for more detail.)

From time to time, we utilize promotional fares designed to stimulate growth in traffic or direct traffic towards our less busy sailings while ensuring compliance with approved price cap orders. In calculating the price cap, vehicle and passenger tariffs, as well as reservation fees, are combined. The utilization of promotional fare incentives may cause the average vehicle and passenger tariff rate to be under or over the allowed increase in any one period.

Year to year changes in operational statistics and revenue for the three months ended June 30, 2014 and 2013 for the Major, Northern and Other Routes are discussed separately below.

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 60% of our vehicle traffic and 65% of our passenger traffic during the three months ended June 30, 2014 and 2013.

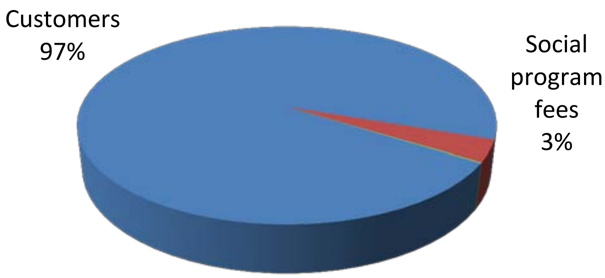
Operational Statistics	Three months ended June 30 2014	2013
Vehicle traffic	1,165,435	1,155,471
Passenger traffic	3,230,773	3,177,611
On-time performance	82.1%	79.5%
Number of round trips	3,123	3,122
Capacity provided (AEQs)	2,253,886	2,251,786
AEQs carried	1,384,908	1,378,016
Capacity utilization	61.4%	61.2%

In the three months ended June 30, 2014, vehicle traffic increased 0.9% and passenger traffic increased 1.7% compared to the same period in the prior year. Overall, commercial traffic decreased 2.9% in the quarter, while drop-trailer traffic, a component of total commercial traffic, increased 4.3% in the same period.

The increase in traffic during the first quarter of fiscal 2015 was partially a result of the timing of the Easter holiday. The first quarter of fiscal 2015 included the entire Easter holiday weekend while the first quarter of fiscal 2014 included only the Monday of the Easter holiday weekend.

In the three months ended June 30, 2014, on-time performance improved compared to the same period in the prior year. The improvement was mainly a result of significant maintenance activities in the prior year at our Horseshoe Bay and Langdale terminals, resulting in berth closures and other conditions negatively impacting arrivals and departures.

Utilization on these routes during the three months ended June 30, 2014 was marginally higher compared to the same period in the prior year as a result of a higher number of AEQs carried, mainly offset by increased capacity.



In the three months ended June 30, 2014, revenue from our Major Routes consisted of 97% from customers and 3% from the Province.

Major Routes cont'd

Revenue ($ thousands)	Three months ended June 30 2014	2013	Increase (Decrease)	
Direct Route Revenue				
Vehicle tariff	67,390	65,322	2,068	3.2%
Passenger tariff	41,693	37,403	4,290	11.5%
Fuel surcharges	3,653	-	3,653	n/a
Catering & on-board	17,695	17,349	346	2.0%
Social program fees	3,663	5,215	(1,552)	(29.8%)
Reservation fees	3,334	2,886	448	15.5%
Parking	1,070	1,017	53	5.2%
Other revenue	857	857	-	-
Total Direct Route Revenue	139,355	130,049	9,306	7.2%
Indirect Route Revenue				
Ferry transportation fees	250	261	(11)	(4.2%)
Total Route Revenue	139,605	130,310	9,295	7.1%

In the three months ended June 30, 2014, average tariff revenue per vehicle increased $1.29 or 2.3% compared to the same period in the prior year. Average tariff revenue per passenger during the same period increased $1.13 or 9.6%. The increase in average tariff revenues reflects the price cap increases authorized by the Commissioner. The average tariff revenue per passenger also reflects the Province's reduction made to BC Senior discounts resulting in seniors now paying a portion of their fares. The increase in both traffic and average fares during the first quarter of fiscal 2015 resulted in a tariff revenue increase of $6.4 million.

On January 17, 2014, due to the high cost of diesel fuel, we implemented fuel surcharges of 3.5% on our Major Routes. No surcharges were in place in the first quarter of fiscal 2014. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

All vessels that provide service on our Major Routes have a gift shop and options for food service. In the three months ended June 30, 2014, catering and on-board sales increased 2.0% compared to the same period in the prior year as a result of both higher passenger traffic and higher average sales per passenger. Food sales remain strong, providing approximately 75% of the total catering and on-board revenue. Sales of quality apparel continue to grow and now comprise over 10% of total catering and on-board revenue.

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). On April 1, 2014, we implemented the Province's decision to reduce the passenger fare discount for BC seniors travelling Mondays to Thursdays from 100% to 50%. Since this reduction, 13% fewer seniors used the program in the three months ended June 30, 2014 compared to the same period in the prior year. The $1.6 million reduction in social program fees consists of a $1.7 million reduction in social program fees as a result of fewer seniors travelling, offset somewhat by an increase in the number of people using the MTAP program and higher fares.

Reservation fees increased primarily as a result of higher usage and higher traffic in the quarter.

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

Ferry transportation fees represent funds received from the Province related to the import duty remission on one of our foreign-built vessels. These funds reduce over time as the vessel depreciates. For the purpose of rate regulation, this amount is applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

Northern Routes

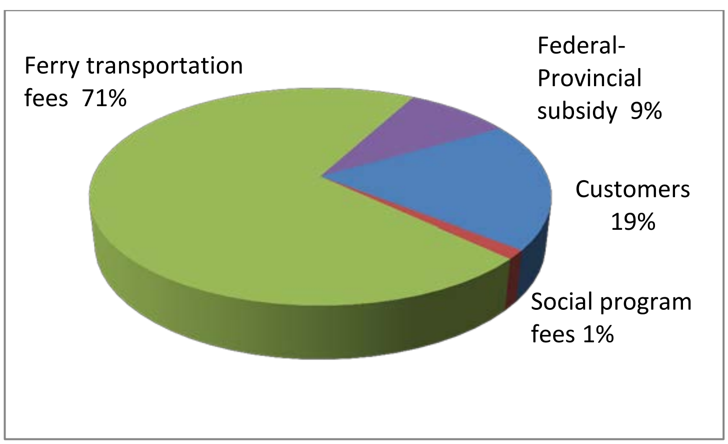
Our Northern Routes consisted of three regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island. An amendment to the CFSC, effective April 1, 2014, discontinued the Discovery Coast Passage Route with direct service to the mid-coast from Port Hardy that provided service for three months during the summer peak season. This route was replaced with an extension of one of our other Northern Routes to the mid-coast, which now provides a supplemental indirect service with a much smaller vessel.

Operational Statistics	Three months ended June 30 2014	2013
Vehicle traffic	6,095	6,583
Passenger traffic	16,400	18,098
On-time performance	88.9%	90.1%
Number of round trips	55	86
Capacity provided (AEQs)	13,642	19,697
AEQs carried	7,721	8,155
Capacity utilization	56.6%	41.4%

In the three months ended June 30, 2014, vehicle traffic decreased 7.4% and passenger traffic decreased 9.4% compared to the same period in the prior year. We believe this is partially due to changes in route schedules and the discontinuation of the Discovery Coast Passage route and replacement with supplementary service. These service adjustments introduced by the Province have generated savings in fuel and labour that more than offset the decline in revenue as a result of lower traffic levels.

On-time performance in the three months ended June 30, 2014 is lower than the same period in the prior year, mainly as a result of the discontinuation of the Discovery Coast Passage route to the mid-coast that had very high on-time performance.

Capacity utilization on these routes during the three months ended June 30, 2014 was significantly higher than the same period in the prior year as a result of decreased capacity provided due to a reduction in the number of round trips and the replacement with a smaller vessel for service to the mid-coast partially offset by the lower number of AEQs carried.



In the three months ended June 30, 2014, revenue from our Northern Routes consisted of 19% from customers and 81% from the Province (1% social program fees, 71% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

Northern Routes cont'd

Revenue ($ thousands)	**Three months ended June 30**			
	2014	**2013**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	1,830	1,949	(119)	(6.1%)
Passenger tariff	1,338	1,521	(183)	(12.0%)
Social program fees	279	332	(53)	(16.0%)
Catering & on-board	406	446	(40)	(9.0%)
Stateroom rental	322	304	18	5.9%
Hostling & other	39	65	(26)	(40.0%)
Total Direct Route Revenue	4,214	4,617	(403)	(8.7%)
Indirect Route Revenue				
Ferry transportation fees	14,701	14,342	359	2.5%
Federal-Provincial subsidy	1,819	1,820	(1)	(0.1%)
Total Route Revenue	20,734	20,779	(45)	(0.2%)

In the three months ended June 30, 2014, average tariff revenue per vehicle increased $4.18 or 1.4% compared to the same period in the prior year. Average tariff revenue per passenger during the same period decreased $2.46 or 2.9%. Average tariff revenues reflect the price cap increases authorized by the Commissioner. The average tariff revenue also reflects changes in the proportionate amount of traffic on the longer routes with higher fares versus the amount of traffic on the shorter routes with lower fares, with the discontinuation of the shorter Discovery Coast Passage route. The reduction in traffic levels and changes in average fares resulted in a total tariff revenue decrease of $0.3 million.

There were no fuel surcharges or rebates in place on our Northern Routes in the first quarter of fiscal 2015 or 2014.

Reimbursements from the Province for social program fees decreased primarily as a result of lower usage of the MTAP program, and fewer students and seniors travelling, partially offset by higher fares. No changes were made to the social program discounts for BC seniors on the Northern Routes.

Revenue from catering and on-board services decreased in the quarter compared to the same period in the prior year as a result lower passenger levels, partially offset by a marginally higher average sales per passenger.

Stateroom rental increased mainly due to higher usage.

Hostling and other revenues decreased in the three months ended June 30, 2014, mainly as a result of lower traffic levels.

Ferry transportation fees received from the Province increased $0.4 million in the quarter compared to the same period in the prior year as a result of the following:

- $0.9 million increase in ferry transportation fees in respect of senior discounts; and
- $0.2 million increase in fees related to the price of fuel. For regulatory purposes, the amounts received relating to the price of fuel are applied to our deferred fuel cost accounts (see "The Effect of Rate Regulation" above for more detail); partially offset by:
- $0.7 million reduction as a result of a lower percentage of total ferry transportation fees being allocated to the Northern Routes due to the elimination of one of the routes, partially offset by an overall increase in fees received under the CFSC.

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

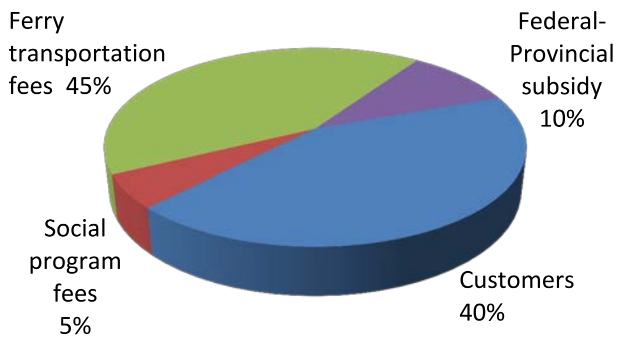
Other Routes

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

Operational Statistics[1]	Three months ended June 30 2014	2013
Vehicle traffic	780,682	797,571
Passenger traffic	1,750,062	1,784,478
On-time performance	92.4%	92.5%
Number of round trips	16,512	17,748
Capacity provided (AEQs)	1,983,002	2,112,621
AEQs carried	834,824	851,233
Capacity utilization	42.1%	40.3%

In the three months ended June 30, 2014, vehicle traffic decreased 2.1% and passenger traffic decreased 1.9% compared to the same period in the prior year. We believe this is mainly due to lower student travel as a result of the ongoing teachers' labour dispute, lower senior travel as a result of the reductions made to BC senior discounts and the changes made to route schedules. We expect that the service adjustments introduced by the Province will generate savings in fuel and labour that will more than offset the decline in revenue as a result of lower traffic levels associated with these adjustments.

Capacity utilization on these routes during the three months ended June 30, 2014 increased compared to the same period in the prior year as a result of decreased capacity provided due to a reduction in the number of round trips, partially offset by the lower number of AEQs carried.



In the three months ended June 30, 2014, revenue from our Other Routes consisted of 40% from customers and 60% from the Province (5% social program fees, 45% ferry transportation fees, and 10% from payments under the Federal-Provincial subsidy agreement).

[1] The statistics provided exclude the unregulated routes

Other Routes cont'd

Revenue ($ thousands)	**Three months ended June 30**			
	2014	**2013**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	11,063	10,915	148	1.4%
Passenger tariff	8,058	7,274	784	10.8%
Fuel surcharges	709	-	709	100.0%
Social program fees	2,404	2,957	(553)	(18.7%)
Catering & on-board	1,020	1,024	(4)	(0.4%)
Reservation fees	58	49	9	18.4%
Parking & other	43	26	17	65.4%
Total Direct Route Revenue	23,355	22,245	1,110	5.0%
Indirect Route Revenue				
Ferry transportation fees	23,750	20,952	2,798	13.4%
Federal-Provincial subsidy	5,270	5,273	(3)	(0.1%)
Total Route Revenue	52,375	48,470	3,905	8.1%

In the three months ended June 30, 2014, average tariff revenue per vehicle increased $0.49 or 3.6% compared to the same period in the prior year. Average tariff revenue per passenger during the same period increased $0.53 or 13.0%. The increase in average tariff revenues reflects the price cap increases authorized by the Commissioner. The increase in average tariff revenue per passenger also reflects the Province's reduction made to BC Senior discounts provided, resulting in seniors now paying a portion of their fares. The increase in average fares, partially offset by the reduction in traffic, resulted in a total tariff revenue increase of $0.9 million.

On January 17, 2014, due to the high cost of diesel fuel, we implemented fuel surcharges of 3.5% on our regulated Other Routes. No surcharges were in place in the first quarter of fiscal 2014. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

On April 1, 2014, we implemented the Province's decision to reduce the passenger fare discount for BC seniors travelling Mondays to Thursdays from 100% to 50%. As a result, 7% fewer seniors used the program in the three months ended June 30, 2014 compared to the same period in the prior year. The reduction in social program fees as a result of fewer seniors travelling was partially offset by an increase in the number of people using the MTAP program and higher fares.

Revenue from catering and on-board services remained at a similar level to the same period in the prior year. The effect of lower passenger traffic levels was mainly offset by higher average sales per passenger. In the prior year, vessel substitutions on routes where these services were offered impacted the average sales per passenger.

Fees for reservations increased due to higher usage, partially offset by lower traffic levels.

Parking and other revenues increased mainly due to commissions from new vendors at two of our terminal locations as well as dock rental fees.

Ferry transportation fees received from the Province increased $2.8 million in the quarter compared to the same period in the prior year due to a $1.5 million increase in ferry transportation fees in respect of senior discounts and a $1.3 million increase as a result of a higher percentage of total ferry transportation fees allocated to the regulated Other Routes with the elimination of one Northern Route, and an overall increase in fees received under the CFSC.

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

Expenses
Expenses for the three months ended June 30, 2014 and 2013 are summarized in the tables below:

Operating expenses ($ millions)	**Three months ended June 30**			
	2014	**2013**	**Increase (Decrease)**	
Operations	115.0	114.2	0.8	0.7%
Maintenance	16.7	15.6	1.1	7.1%
Administration	7.6	7.0	0.6	8.6%
Total operations, maintenance and administration	139.3	136.8	2.5	1.8%
Cost of retail goods sold	8.0	7.7	0.3	3.9%
Depreciation and amortization	35.2	34.3	0.9	2.6%
Total operating expenses	182.5	178.8	3.7	2.1%

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

The $0.8 million increase in operations expenses in the three months ended June 30, 2014, compared to the same period in the prior year was mainly due to:

- $1.0 million increase in fuel expense, reflecting an increase of $2.1 million or 3.4% due to higher fuel prices, partially offset by a $1.0 million or 3.4% 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, $4.0 million of our fuel expense in the three months ended June 30, 2014 is recorded in deferred fuel cost accounts for future recovery. (See “The Effect of Rate Regulation” above for more detail.);

partially offset by:

- $0.2 million decrease in several operational areas.

Vessel maintenance costs were $1.1 million higher in the three months ended June 30, 2014 compared to the same period in the prior year. Terminal maintenance and vessel refit costs remained at a similar level as the prior year.

The $0.6 million increase in administration costs is mainly due to small increases in several areas, including contracted services, legal costs and wages and benefits.

The $0.3 million increase in cost of retail goods sold reflects the increase in overall sales and rising food costs.

Depreciation and amortization increased $0.9 million, reflecting higher depreciation and amortization resulting from the new capital assets that have entered service. (See “Investing in our Capital Assets” below for details of significant capital asset expenditures.)

Net finance and other expenses ($ millions)	**Three months ended June 30**		
	2014	**2013**	**Increase (Decrease)**
Finance expense			
Bond interest	16.0	15.8	0.2
KfW bank group (KfW) loans	1.8	2.0	(0.2)
Interest on finance lease	0.5	0.5	-
Short-term debt	0.1	0.1	-
Capitalized interest	(0.7)	(0.7)	-
Total finance expense	17.7	17.7	-
Less: finance income	(1.1)	(0.8)	(0.3)
Net finance expense	16.6	16.9	(0.3)
Loss on disposal of property, plant and equipment	0.1	-	0.1
Total net finance and other expenses	16.7	16.9	(0.2)

Net finance and other expenses decreased $0.2 million in the three months ended June 30, 2014 compared to the same period in the prior year due to:

- $0.3 million increase in finance income; and
- $0.2 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;

partially offset by:

- $0.2 million increase in bond interest, primarily reflecting the $200 million bond Series 14-1 issued in advance of the maturity of the $250 million bond Series 04-1; partially offset by lower effective interest rates on the new bonds; and
- $0.1 million loss on disposal of property, plant and equipment.

Liquidity and Capital Resources

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

We expect that our cash requirements, in the near term, will be met through operating cash flows and by accessing our credit facility from time to time. At June 30, 2014, our unrestricted cash and cash equivalents and other short-term investments totalled $93 million.

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 on these bonds by entering into interest rate hedges. The effective rate of this issue, net of hedging, is 4.45%, 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 June 30, 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. Our credit ratings at June 30, 2014 were “A” (DBRS) with a stable trend and “AA-” (S&P) with a stable outlook.

Sources & Uses of Cash

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

Sources and uses of cash and cash equivalents for the three months ended June 30, 2014 and 2013 are summarized in the table below:

	Three months ended June 30		
($ millions)	**2014**	**2013**	**Increase (Decrease)**
Cash and cash equivalents, beginning of period	71.4	36.6	34.8
Cash from operating activities:			
Net earnings	13.9	4.3	9.6
Items not affecting cash	47.9	54.1	(6.2)
Changes in non-cash operating working capital	(13.2)	(12.6)	(0.6)
Net interest paid	(20.5)	(21.0)	0.5
Cash generated by operating activities	28.1	24.8	3.3
Cash used in financing activities	(59.2)	(0.3)	(58.9)
Cash provided by (used) in investing activities	2.2	(18.5)	20.7
Net (decrease) increase in cash and cash equivalents	(28.9)	6.0	(34.9)
Cash and cash equivalents, end of period	42.5	42.6	(0.1)

For the three months ended June 30, 2014, cash generated by operating activities increased by $3.3 million compared to the same period in the prior year, due to an increase in net earnings and a decrease in interest paid, partially offset by items not affecting cash and changes in non-cash operating working capital.

Cash used in financing activities in the three months ended June 30, 2014 was $59.2 million. This amount consisted of the redemption of our $250 million bond Series 04-1; $8.9 million in bond financing costs; and $0.3 million repayment of finance lease obligations; partially offset by proceeds of $200 million from our April 2014 bond Series 14-1 issuance.

Cash used in financing activities in the three months ended June 30, 2013 was $0.3 million, reflecting the repayment of finance lease obligations.

Cash used in investing activities in the three months ended June 30, 2014 increased by $20.7 million compared to the same period in the prior year, due to a $21 million increase in cash provided by short-term investments and a $2.9 million decrease in debt service reserve requirements, partially offset by a $3.2 million increase in cash used for capital expenditures. (See “Investing in Our Capital Assets” below for detail of significant capital expenditures.)

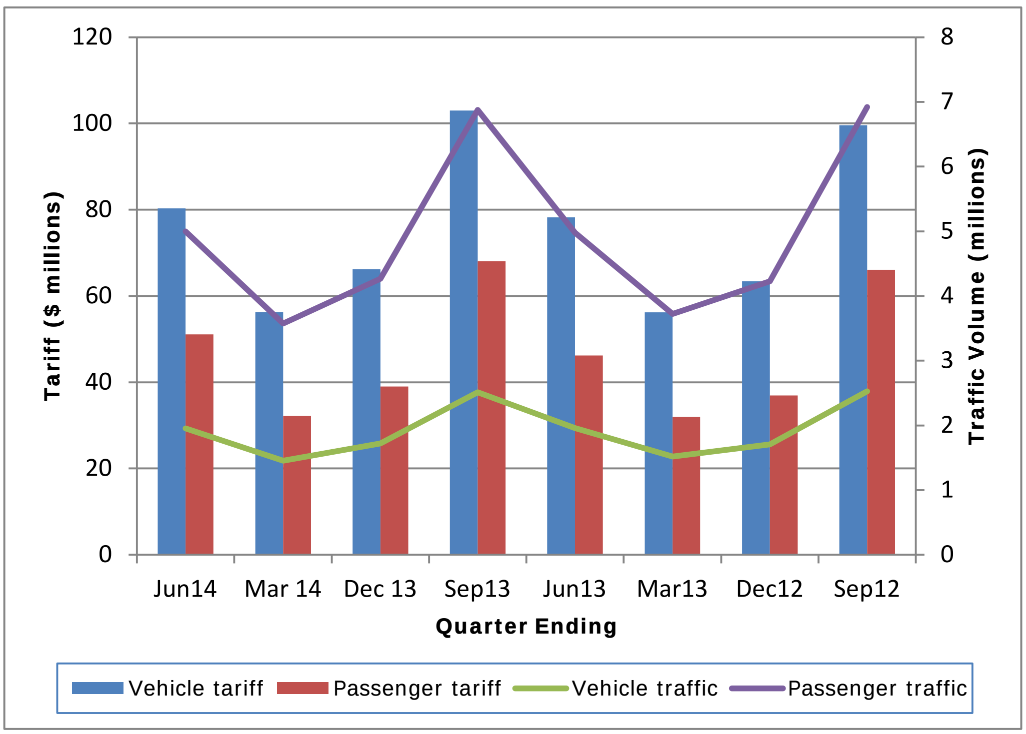
SUMMARY OF QUARTERLY RESULTS

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

($ millions)	Quarter Ended (unaudited)							
	Jun 14	**Mar 14**	**Dec 13**	**Sep 13**	**Jun 13**	**Mar 13**	**Dec 12**	**Sep 12**
Total revenue	213.1	153.9	174.8	271.5	200.0	150.5	169.6	268.6
Operating profit (loss)	30.6	(21.3)	3.7	82.3	21.2	(20.2)	0.2	84.1
Net earnings (loss)	13.9	(38.3)	(12.3)	64.3	4.3	(37.1)	(17.2)	66.5
Other comprehensive (loss) income	(2.4)	(5.0)	-	0.1	-	1.1	-	-
Total comprehensive income (loss)	11.5	(43.3)	(12.3)	64.4	4.3	(36.0)	(17.2)	66.5

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 months ended June 30, 2014 totalled $26.1 million.

	($ millions)
Terminal marine structures	10.8
Vessel upgrades and modifications	8.5
Information technology	5.2
Terminal and building upgrades and equipment	1.6
Total capital expenditures	26.1

Terminal Marine Structures

Capital expenditures for terminal marine structures in the three months ending June 30, 2014 included the following:

Terminal	**Description**	($ millions)
Port McNeill	Replacement of trestle, ramp, apron and towers	4.9
Denman Island and Buckley Bay	Modifications to accommodate the new cable ferry	4.1
McLoughlin Bay	Berth modifications	1.1
Various	Other projects	0.7
		10.8

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.

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 the supply of two concrete floating pontoons, construction of two berths, expansion of the 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 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 complete.

Vessel Upgrades and Modifications
Capital expenditures for vessel upgrades and vessel modifications in the three months ended June 30, 2014 included the following:

	($ millions)
Major overhauls and inspections	4.6
Queen of Oak Bay ¾-life upgrade	0.5
Navigational equipment upgrades	0.5
C-class tail shaft rebuilds	0.4
Queen of Capilano mid-life upgrade	0.4
New intermediate vessels	0.3
Searchlight replacements on several vessels	0.3
Cable ferry	0.2
Spirit of Vancouver Island mid-life upgrade	0.2
Other projects	1.1
	8.5

The $4.6 million in major overhauls and inspections completed in the quarter ended June 30, 2014 or currently underway include:

- $1.8 million for the *North Island Princess*;
- $1.0 million for the *Northern Expedition*;
- $0.9 million for the *Queen of Coquitlam*; and
- $0.9 million for the *Queen of Nanaimo.*

A $16 million project for a three-quarter life upgrade of the *Queen of Oak Bay* includes 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 commenced in August 2013 and is expected to be complete by the end of fiscal 2015.

Fiscal 2015 is our third year of a four-year program to upgrade vessels with new navigational equipment. This year the emphasis will be on upgrading the radar equipment and gyro compasses on several vessels to improve navigational safety. This will take us further towards bridge standardization. We expect to spend $1 million in fiscal 2015 of the total four-year program budget of $4.7 million.

A project to rebuild two spare tail shafts for potential use in upcoming overhauls was completed at the end of June 2014.

A $13 million project for a mid-life upgrade of the *Queen of Capilano* includes upgrades to the electrical system, replacement of generators, upgrades to the fire protection system, standardization of the bridge and upgrades to the emergency evacuation systems. The upgrade commenced in October 2012 and is expected to be complete for the summer of 2015.

On July 3, 2014, we entered into contracts with Remontowa Shipbuilding S.A. of Gdansk, Poland to build three new intermediate class vessels. These contracts, with a total value of $165 million, form the majority of the total project budget of $252 million. These are design-build, fixed price contracts that provide us with substantial guarantees related to delivery dates, performance criteria, cost certainty and quality of construction. The new vessels, scheduled for delivery in August 2016, October 2016 and February 2017, 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 liquefied natural gas (LNG) or marine diesel fuel.

New searchlights have been installed on the *Northern Expedition,* the *Coastal Celebration* and the *Coastal Renaissance* with several more still to be replaced on the *Coastal Celebration*, *Coastal Renaissance* and *Coastal Inspiration*.

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.)

Preliminary work has begun on a mid-life upgrade for the *Spirit of Vancouver Island* which is expected to include upgrades to propulsion systems, standardization of the bridge and upgrades to passenger accommodations.

Information Technology

Capital expenditures for information technology in the three months ending June 30, 2014 included the following:

	($ millions)
Customer service program	3.7
Payroll system replacement	0.9
Other projects	0.6
	5.2

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. 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 by the spring of 2015.

Other information technology projects underway include software and hardware upgrades.

Terminal and Building Upgrades and Equipment

Capital expenditures for terminal and building upgrades and equipment in the three months ending June 30, 2014 included the following:

	($ millions)
Asphalt resurfacing, signage and security at Tsawwassen terminal	0.9
Vehicles and other equipment	0.2
Energy efficiency upgrades at Horseshoe Bay and Swartz Bay terminals	0.1
Other terminal projects	0.4
	1.6

Several improvement projects are substantially complete or underway at Tsawwassen terminal including asphalt resurfacing, upgrade of way-finding signage, installation of digital destination signs at the toll booths and upgrade of lighting for security purposes.

OUTLOOK

We do not anticipate that economic conditions will materially change in the near term, although we expect that service reductions and changes in the BC seniors discount may result in a small reduction in our traffic levels. 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 continue to explore strategies to create an affordable and sustainable ferry system beyond 2016, including standardized vessels, LNG propulsion, other alternative technologies, passenger only vessels, a new reservation and point-of-sale system, increased operational efficiencies and seeking federal infrastructure funding to renew our fleet and terminals.

Traffic

Overall, vehicle traffic decreased 0.4% while passenger traffic increased 0.3% in the three months ended June 30, 2014 compared to the same quarter in the prior year. Traffic levels in the quarter are discussed above in "Financial and Operational Overview".

We believe the outlook for the travel industry and the US economy, have each improved, though not significantly. We also see signs of modest improvement in local leisure travel spending. We expect these improvements will result in a limited recovery in discretionary traffic levels. We believe these improvements will be mainly offset by reductions in traffic due to reductions in service levels and in BC seniors travel. In the near term, we anticipate no significant increase or decrease in overall traffic volume.

Financial performance

We expect positive net earnings in fiscal 2015, reflecting adjustments to service levels, increases to average fares in accordance with the Commissioner's Order 12-02 and continued cost management, coupled with a gradual improvement in the overall economy.

We expect a modest increase in total revenue in fiscal 2015, reflecting the April 1, 2014 tariff increases, lower social program fees, higher catering and on-board revenues and higher ferry transportation fees.

We expect a modest increase in total expenses in fiscal 2015, reflecting higher depreciation and amortization, wage and benefit increases, higher fuel costs and other operational related costs. We continue to manage our costs prudently without compromising safe operations.

Asset renewal program

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

The project for the new cable ferry, for service on our Buckley Bay to Denman Island route, is well underway. It 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.

In July 2014, we signed contracts with Remontowa Shipbuilding S.A. of Gdansk, Poland to build three new intermediate class vessels. These new vessels, scheduled for delivery in August 2016, October 2016 and February 2017, will be designed to operate as dual-fuel capable, so they can run on LNG or marine diesel fuel. 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.

FINANCIAL RISKS

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

A discussion of financial risks can be found on pages 54 through 56 of our fiscal 2014 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2014. Our 2014 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

BUSINESS RISK MANAGEMENT

Understanding and managing operational risk is an important part of our business. We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business. A discussion of enterprise wide risk management can be found on pages 57 through 63 of our fiscal 2014 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2014. Our 2014 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

We do not believe that material uncertainties exist in regards to our future. As part of our risk management strategies, we have considered many items such as profitability levels, cash generating potential, cash utilization requirements including debt repayment schedules and future capital expenditures, and working capital requirements. We have taken measures to allow us to weather the economic downturn and ensure a viable, profitable future.

ACCOUNTING PRACTICES

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and financial performance is based upon our consolidated financial statements, which have been prepared in accordance with IFRS.

Our significant accounting policies are contained in note 1 to our March 31, 2014 and June 30, 2014 consolidated financial statements. Certain of these policies involve critical accounting estimates because they require us to make particularly subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts could be reported under different conditions or using different assumptions. These judgements, estimates and assumptions are subject to change as new events occur, as more experience is acquired, as additional information is obtained and as the general operating environment changes.

Discussion of the most critical accounting policies and estimates that we have used in the preparation of our consolidated financial statements can be found on pages 64 and 65 of our fiscal 2014 Management's Discussion & Analysis. The following describes the changes to critical accounting policies we have used in the preparation of our consolidated financial statements for the three months ended June 30, 2014, or expect to use in the future. Our 2014 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

Adoption of New Accounting Standards
The following is a discussion of mandatory accounting changes that were effective for us April 1, 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 retrospective application of this IFRIC did not have an impact on our consolidated financial statements.

Future Accounting Changes
There are no relevant changes in accounting standards applicable to our fiscal year beginning April 1, 2015. The following is a discussion of accounting changes that will be effective for us in future periods:

IFRS 9 *Financial Instruments* replaces the guidance in IAS 39 *Financial Instruments: Recognition and Measurement*, on the classification and measurement of financial assets. Financial assets will be classified into one of two categories on initial recognition: financial assets measured at amortized cost; or financial assets measured at fair value.

In November 2013, the International Accounting Standards Board issued amendments to IFRS 9. The amendments include changes which will align hedge accounting more closely with risk management. Mandatory adoption of IFRS 9 for us will be April 1, 2018. The amended standard is available for early adoption.

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

FORWARD LOOKING STATEMENTS

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

Forward looking statements included in this document include statements with respect to: economic conditions, traffic levels, tariff revenue, fuel surcharges, and fiscal 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 COR from WorkSafeBC; 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, vessel replacement program for the *Queen of Burnaby* and the *Queen of Nanaimo*, cable ferry initiative, and safety and training projects; our expectations regarding ferry transportation fee amounts, food sales, and sales of quality apparel; total revenue and expense projections, how our cash requirements will be met in the near term, and the amount of savings to be achieved through service level adjustments; and our expectations regarding the impact of 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, vehicle and passenger traffic, on-time performance, capacity provided and utilized, AEQs carried, number of round trips, and average tariff revenue per vehicle and per passenger. These measures do not have any standardized meaning prescribed by IFRS and therefore are unlikely to be comparable to similar measures presented by other companies. These supplemental non-IFRS measures are provided to assist readers in determining our ability to generate cash from operations and improve the comparability of our results from one period to another. We believe these measures are useful in assessing operating performance of our ongoing business on an overall basis.