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

For the three months ended
June 30, 2015

Dated August 20, 2015

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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, 2015. 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, 2015 and 2014, and our audited consolidated financial statements and related notes for the years ended March 31, 2015 ("fiscal 2015") and March 31, 2014, together with our Management's Discussion & Analysis for fiscal 2015. 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 34 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, 2015 (the first quarter of fiscal 2016), we provided over 41,000 sailings, 2,066 fewer than the same period in the prior year. The reduction in the number of sailings primarily represents service level adjustments announced by the Province in February 2014 and implemented in fiscal 2015. These adjustments have resulted in increased capacity utilization, savings in fuel and labour and contributed to strong financial performance in fiscal 2015 and the first quarter of the year ending March 31, 2016 ("fiscal 2016"). During the three months ended June 30, 2015, we carried over five million passengers and two million vehicles and passenger traffic increased 5.0% and vehicle traffic increased 4.7% compared to the same quarter in the prior year. For a discussion of our traffic levels, see "Financial and Operational Overview" below.

Significant events during or subsequent to the first quarter of fiscal 2016 include the following:

- On April 1, 2015, we implemented average tariff increases in accordance with the British Columbia Ferries Commissioner (the "Commissioner") Order 12-02 dated September 30, 2012. Tariff increases were 3.9% on average on our Major and regulated Other Routes. On the Northern Routes, we increased fares by 2% on average. Also on April 1, 2015, due to lower fuel prices, a fuel rebate of 1% was implemented on our Major and regulated Other Routes which helped to lessen the impact of the tariff increase. No fuel surcharges or rebates were implemented on the Northern Routes.

- On April 30, 2015, we completed the installation of the drive and guide cables necessary to move the cable ferry that will provide service between Buckley Bay and Denman Island. On May 8, 2015, we unveiled the name of our cable ferry, the *Baynes Sound Connector.* Following marine tradition for the majority of cable ferries around the world, the name reflects the channel the ferry will be crossing. The cable ferry, which will accommodate 50 vehicles and 150 passengers and crew, is nearing completion. It is expected to be placed in service in the fall of 2015. (See "Outlook - Asset Renewal Program" below for more detail.)

- On July 1, 2015, the first steel cut for the third new intermediate class vessel took place at Remontowa Shipbuilding S.A. in Gdansk, Poland. The construction of the other two vessels started earlier in the year and is progressing on schedule. These vessels will be dual-fuel capable, so they can run predominantly on liquefied natural gas ("LNG") with marine diesel as a backup. On July 28, 2015, we announced the names of our three new intermediate class vessels, the *Salish Orca*, the *Salish Eagle* and the *Salish Raven*. These new vessels are scheduled for delivery in August 2016, October 2016 and February 2017. The *Salish Orca* and the *Salish Eagle* will replace the 50-year old *Queen of Burnaby* on the Comox – Powell River route and the 51-year old *Queen of Nanaimo on the Tsawwassen – Southern Gulf Islands route*, respectively. The *Salish Raven* is also expected to service the Southern Gulf Islands.

- On July 9, 2015, we announced the three shipyards, including one British Columbian yard, we have shortlisted for the mid-life upgrades, including the potential conversion to dual-fuel, of our two largest vessels, the *Spirit of Vancouver Island* and the *Spirit of British Columbia*. The mid-life upgrade of the *Spirit of British Columbia* is expected to be completed during the spring of 2018 and the *Spirit of Vancouver Island* is expected to be completed the following year. We expect the conversion of these vessels could result in significant savings in fuel costs.

- Effective April 1, 2016, the Coastal Ferry Services Contract ("CFSC") was amended for performance term four ("PT4"), being the period from April 1, 2016 to March 31, 2020. The amendments to the contract for PT4 were completed by June 30, 2015 as required by the CFSC. Amendments include the establishment of ferry transportation fees for PT4 and changes in the structure for the funding of BC seniors discounts.

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 regulatory 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.

We adopted IFRS with a transition date of April 1, 2011. At that time, IFRS did not provide any guidance with respect to accounting for rate-regulated activities.

In January 2014, the International Accounting Standards Board ("IASB") issued an interim standard, IFRS 14 *Regulatory Deferral Accounts,* which addresses accounting for rate-regulated activities. However, it does not apply to entities that transitioned to IFRS prior to that date, as we had. 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. Under IFRS, rather than being charged to regulatory asset accounts on our Consolidated 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, 2015 are probable of future recovery and that the obligations as represented by the regulatory liabilities will be settled in the future. These regulatory assets and regulatory liabilities are detailed in note 11 to our June 30, 2015 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 month periods ended June 30, 2015 and 2014 would be as follows:

($ millions)		**Three months ended June 30**	
		2015	**2014**
Total comprehensive income		22.3	11.5
Changes in net earnings:			
Regulatory asset or liability	**Statement line item**		
Deferred fuel costs (a)			
Fuel costs (under)over set price	Operations expense	(1.9)	4.0
Fuel rebates (surcharges collected)	Fuel rebates (surcharge)	1.6	(4.4)
Payments from the Province	Ferry service fees	(0.3)	(0.7)
		(0.6)	(1.1)
Tariffs in excess of price cap (b)			
Obligation incurred during the period	Tariff revenue	(0.9)	-
(Decrease) in total net earnings		(1.5)	(1.1)
Adjusted total comprehensive income		20.8	10.4

(a) Deferred fuel costs: As prescribed by regulatory order, we defer differences between actual fuel costs and regulated fuel costs which were used to develop the regulated price caps. The difference between actual fuel costs (including fuel hedge gains and losses) and the regulated fuel costs (set price) 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 charged exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. Tariffs charged exceed price caps by $1.9 million at June 30, 2015.

FINANCIAL AND OPERATIONAL OVERVIEW

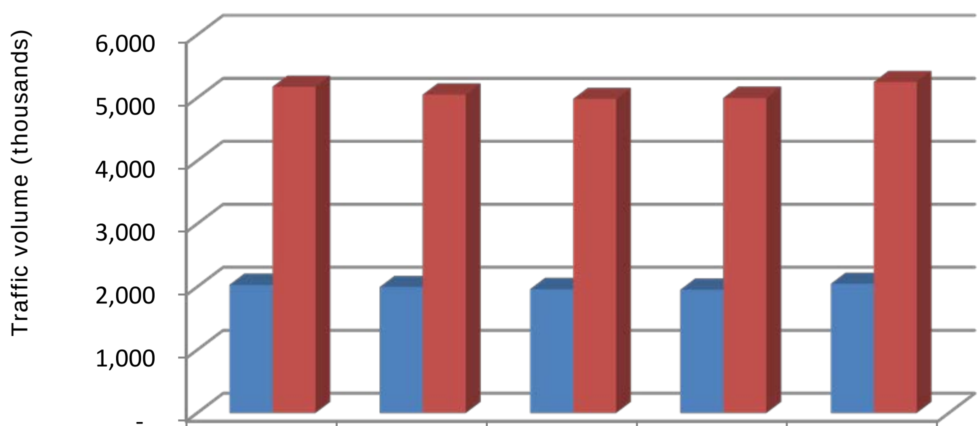
This section provides an overview of our financial and operational performance for the three month periods ended June 30, 2015 and 2014.

($ millions)	Three months ended June 30			
			Variance	
	2015	**2014**	**$**	**%**
Total revenue	217.7	213.1	4.6	2.2%
Operating expenses	184.6	182.5	(2.1)	(1.2%)
Operating profit	33.1	30.6	2.5	8.2%
Net finance and other	14.3	16.7	2.4	14.4%
Net earnings	18.8	13.9	4.9	35.3%
Other comprehensive income (loss)	3.5	(2.4)	5.9	245.8%
Total comprehensive income	22.3	11.5	10.8	93.9%

Our net earnings in the three months ended June 30, 2015 were $4.9 million higher and total comprehensive income was $10.8 million higher than in the three months ended June 30, 2014. The first quarter of fiscal 2015 net earnings reflect the effects of higher traffic levels, increased fares, higher retail sales, higher social program fees and lower financing costs, partially offset by lower ferry transportation fees, fuel rebates and operating cost increases. Other comprehensive income of $3.5 million in the first quarter of fiscal 2016 reflects the change in the fair value of our fuel swap contracts. Other comprehensive loss in the first quarter of fiscal 2015 reflected the loss on interest rate forward contracts related to our April 28, 2014 issuance of $200 million of senior secured bonds.

In the first quarter of fiscal 2016, vehicle traffic increased 4.7% and passenger traffic increased 5.0% compared to the same quarter in the prior year. Vehicle and passenger traffic on our Major, Northern and regulated Other Routes increased. Overall, commercial traffic increased by 3.8% in the quarter, while drop-trailer traffic, a component of commercial traffic, increased by 4.8% in the same period.

The following graph illustrates our vehicle and passenger traffic levels for the first quarter of fiscal 2012 through fiscal 2016:



	2012	2013	2014	2015	2016
Vehicles	2,029	1,995	1,960	1,952	2,044
Passengers	5,172	5,049	4,980	4,997	5,249

Safety and Environment

In fiscal 2015 and 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. In June 2015, we received a $556,000 COR rebate based on our 2014 assessed premiums. In fiscal 2015, we received a $600,000 COR rebate based on our 2013 assessed premiums. Besides confirming our workforce is safer and healthier, the COR certification provides for annual premium reduction from WorkSafeBC of up to 15%.

On May 28, 2015, we received certification from Green Marine as both a ship owner and a terminal operator. Green Marine is a globally recognized, voluntary, industry sustainability initiative for ship operators, ports, terminals, the seaway and shipyards.

Training

Each year we invest heavily in operational and safety training.

In the first quarter of fiscal 2016, in preparation for the busy summer season, training programs for seasonal employees focused on safety, including passenger safety and emergency evacuation systems.

We successfully delivered a pilot of Restricted Proficiency and Survival Craft training at our maintenance facility for new northern employees. A Senior Marine Examiner from Transport Canada was present to assess both the program and the students. The Examiner was satisfied the program met or exceeded all expectations and requirements.

By the end of June 30, 2015, through our Bridge Team Simulation ("BTS") training program, we had delivered Bridge Operations Skills and Systems ("BOSS") Level 2 to 46% of deck officers in the fleet. We expect that all deck officers will have completed BOSS 2 training by the end of 2017.

Our Standardized Education and Assessment ("SEA") training continues to develop programs for three additional job categories that are expected to be implemented in April 2016.

We are preparing a collaborative training plan for familiarization with the new equipment on the Salish Class vessels, including LNG. LNG Safety Awareness training was designed and development of this web-based training commenced in mid-July with a pilot planned for the fall. A request for proposal has been issued for an external contractor to provide trainers and training materials for a basic and advanced course on LNG safety. We plan to transition this training to in-house courses in the future.

Labour relations - Collective agreement

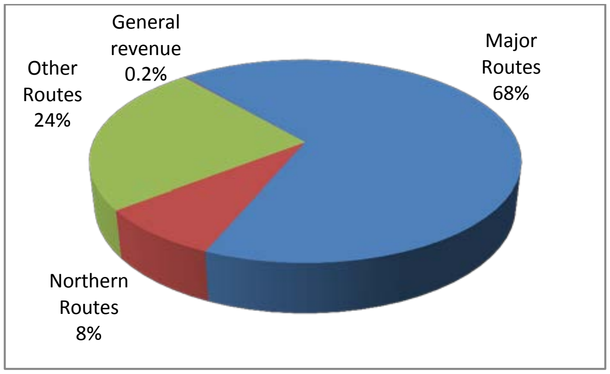
The majority of our employees are members of the BC Ferry & Marine Workers' Union (the "Union"). The current collective agreement with the Union expires October 31, 2015 and the collective bargaining process will begin in the fall.

The current agreement has a mechanism in place that allows for the orderly transition to the next collective agreement without the ability to strike and provides a unique and innovative dispute resolution process to facilitate future collective bargaining.

We will strive to reach a mutually agreeable settlement that provides continued stability for our employees and enhances our ability to deliver the highest level of service to our customers.

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, 2015, the greatest portion of our revenues (68%) was earned on our Major Routes. Revenue from the Northern Routes contributed 8% and Other Routes contributed 24%.

Selected operational statistics and total revenues for the three months ended June 30, 2015 compared to the same period in the prior year are shown in the tables below.

Operational Statistics	**Three months ended June 30**	
	2015	**2014**
Vehicle traffic	2,044,346	1,952,212
Passenger traffic	5,249,478	4,997,235
On-time performance	89.5%	90.9%
Number of round trips	18,632	19,690
Capacity provided (AEQs)	4,172,577	4,250,530
AEQs carried	2,330,718	2,227,453
Capacity utilization	55.9%	52.4%

In the three months ended June 30, 2015, vehicle traffic increased 4.7% and passenger traffic increased 5.0% compared to the same quarter in the prior year. Vehicle and passenger traffic on our Major, Northern and regulated Other Routes increased. Overall, traffic during the first quarter of fiscal 2016 was favourably impacted by lower fuel prices, the lower Canadian dollar, favourable weather and the return of student travel resulting from the resolution of the previous year's teachers' labour dispute.

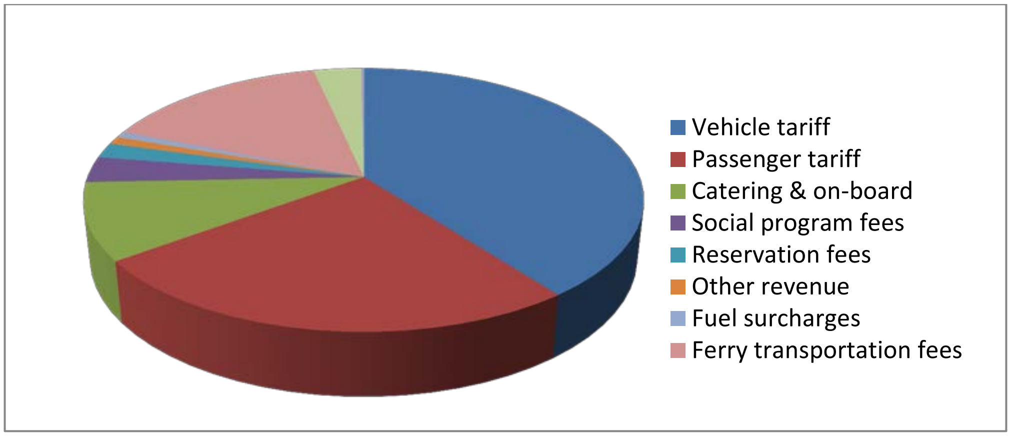
On-time performance on the Major and regulated Other Routes is defined as the percentage of our sailings departing within 10 minutes of the scheduled time. On-time performance on the Northern Routes is defined as the percentage of our sailings arriving no later than 10 minutes after the scheduled time. On-time performance can be impacted by delays due to weather, vessel substitution, terminal dock maintenance or closures and periods of unusually high traffic demand. Meeting customer service expectations and maintaining safety is an important factor in our focus on on-time performance. On-time performance on the Northern and Other Routes was marginally better, however on the Major Routes there was a more pronounced drop as discussed in the following section.

Capacity provided, measured in automobile equivalents ("AEQs"), is the available space on a vessel multiplied by the number of round trips. Round trips normally stay fairly stable as the CFSC stipulates, among other things, the number of round trips to be provided for each regulated ferry service route. However, the number of round trips provided can be impacted by cancellations due to weather, vessel substitution, terminal dock closures and extra round trips made in response to high demand, 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, 2015 compared to the same period in the prior year are mainly due to new schedules resulting from Provincial service level adjustments 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 AEQs carried during the period by the AEQ capacity provided on the vessels. Capacity utilization is impacted by the number of vehicles carried, the mix of vehicle types (the relative number of buses, commercial vehicles, and passenger vehicles), the size of the vessels utilized and the number of round trips in each period. Capacity utilization increased from 52.4% to 55.9% for the three months ended June 30, 2015 compared to the same quarter in the prior year as a result of reduced total capacity provided due to fewer round trips and a higher number of AEQs carried.

Revenue ($millions)	**Three months ended June 30**			
			Increase (Decrease)	
	2015	**2014**	**$**	**%**
Direct Route Revenue				
Vehicle tariff	87.5	80.3	7.2	9.0%
Passenger tariff	55.8	51.1	4.7	9.2%
Fuel (rebate) surcharges	(1.6)	4.4	(6.0)	(136.4%)
Catering & on-board	20.9	19.4	1.5	7.7%
Social program fees	7.0	6.3	0.7	11.1%
Reservation fees	4.1	3.4	0.7	20.6%
Other revenue	2.1	2.0	0.1	5.0%
Total Direct Route Revenue	175.8	166.9	8.9	5.3%
Indirect Route Revenue				
Ferry transportation fees	34.3	38.7	(4.4)	(11.4%)
Federal-Provincial subsidy	7.2	7.1	0.1	1.4%
Total Route Revenue	217.3	212.7	4.6	2.2%
Other general revenue	.4	.4	-	-
Total Revenue	217.7	213.1	4.6	2.2%



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. Catering and on-board services is our second highest source of direct revenue. Catering and on-board services provide a gross margin of approximately 60%.

On April 1, 2015, we implemented tariff increases in accordance with the Commissioner’s Order 12-02 dated September 30, 2012. Tariff increases were 3.9% on average on our Major and regulated Other Routes. On the Northern Routes, we increased fares by 2% on average. These increases are directly associated with increased operating costs, notably fuel, capital replacement and labour.

Surcharges and/or rebates are implemented as a direct result of rising and declining fuel prices. On April 1, 2015, due to lower fuel prices, a fuel rebate of 1% was implemented on our Major and regulated Other Routes which helped to lessen the impact of the tariff increase. Surcharges of 3.4% on average were in place in the first quarter of fiscal 2015 on our Major Routes and our regulated Other Routes. During these periods, no surcharges or rebates were in place on our Northern Routes. For the purpose of rate regulation, these amounts are applied to our deferred fuel cost accounts. (See “The Effect of Rate Regulation” above for more detail.)

From time to time, we utilize promotional fares designed to stimulate growth in traffic or to 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, 2015 and 2014 for the Major, Northern and Other Routes are discussed separately below.

Major Routes

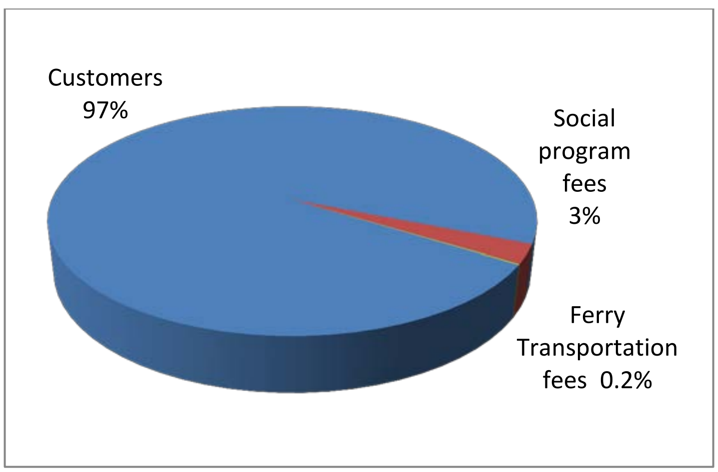
Our Major Routes consist of three regulated routes connecting Metro Vancouver with mid and southern Vancouver Island and our regulated route connecting Horseshoe Bay and Langdale. These are our four busiest routes, carrying 60% of our vehicle traffic and 65% of our passenger traffic during the three month periods ended June 30, 2015 and 2014.

Operational Statistics	Three months ended June 30 2015	2014
Vehicle traffic	1,226,265	1,165,435
Passenger traffic	3,398,980	3,230,773
On-time performance	73.1%	82.1%
Number of round trips	3,134	3,123
Capacity provided (AEQs)	2,254,370	2,253,886
AEQs carried	1,451,881	1,384,908
Capacity utilization	64.4%	61.4%

In the three months ended June 30, 2015, both vehicle and passenger traffic increased 5.2% compared to the same period in the prior year. Overall, commercial traffic increased 1.8% in the quarter, while drop-trailer traffic, a component of total commercial traffic, increased 4.8% in the same period. Traffic during the first quarter of fiscal 2016 was favourably impacted by lower fuel prices, the lower Canadian dollar, favourable weather and the return of student travel resulting from the resolution of the previous year's teachers' labour dispute.

On-time performance during the first quarter of fiscal 2016 was negatively affected by the significant traffic increase as additional time was required for loading procedures.

Utilization on these routes during the three months ended June 30, 2015 was higher compared to the same period in the prior year mainly as a result of a higher number of AEQs carried.



In the three months ended June 30, 2015, 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** 2015	2014	Increase (Decrease)	
Direct Route Revenue				
Vehicle tariff	73,544	67,390	6,154	9.1%
Passenger tariff	45,568	41,693	3,875	9.3%
Fuel (rebates) surcharges	(1,354)	3,653	(5,007)	(137.1%)
Catering & on-board	19,021	17,695	1,326	7.5%
Social program fees	3,892	3,663	229	6.3%
Reservation fees	3,999	3,334	665	19.9%
Parking	1,225	1,070	155	14.5%
Other revenue	790	857	(67)	(7.8%)
Total Direct Route Revenue	146,685	139,355	7,330	5.3%
Indirect Route Revenue				
Ferry transportation fees	236	250	(14)	(5.6%)
Total Route Revenue	146,921	139,605	7,316	5.2%

Average tariff ($)	**Three months ended June 30** 2015	2014	Increase
Vehicle tariff ($000's)	73,544	67,390	
Vehicle traffic	1,226,265	1,165,435	
Average tariff per vehicle	59.97	57.82	2.15
Passenger tariff ($000'S)	45,568	41,693	
Passenger traffic	3,398,980	3,230,773	
Average tariff per passenger	13.41	12.91	0.50

In the three months ended June 30, 2015, average tariff revenue per vehicle increased $2.15 or 3.7% compared to the same period in the prior year. Average tariff revenue per passenger during the same period increased $0.50 or 3.9%. The increase in average tariff revenues reflects the price cap increases authorized by the Commissioner. The increase in both traffic levels and in average fares during the first quarter of fiscal 2015 resulted in a tariff revenue increase of $10.0 million.

On April 1, 2015, due to lower fuel prices, a fuel rebate of 1% was implemented on our Major Routes which helped to lessen the impact of the tariff increase. Fuel surcharges of 3.4% were in place on our Major Routes in the first quarter of fiscal 2015. 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, 2015, catering and on-board sales increased 7.5% 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%. This resulted in an annual decrease of 15% in the number of seniors using the program. In the three months ended June 30, 2015, there was a marginal increase in the number of seniors using the program. This is the first increase since the implementation of the program change. Social program fees increased $0.2 million mainly as a result of more seniors and students travelling and an increase in the number of people using the MTAP program.

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 on the Major Routes 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

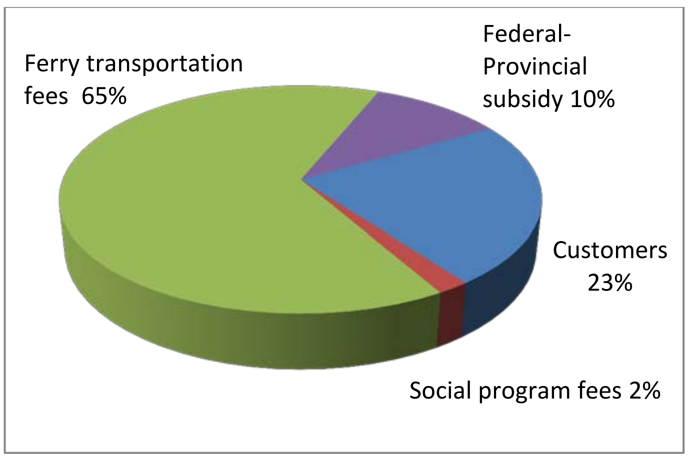
Our Northern Routes consist of two regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island.

Operational Statistics	Three months ended June 30 2015	2014
Vehicle traffic	6,358	6,095
Passenger traffic	17,589	16,400
On-time performance	89.8%	88.9%
Number of round trips	49	55
Capacity provided (AEQs)	12,107	13,642
AEQs carried	7,960	7,721
Capacity utilization	65.7%	56.6%

In the three months ended June 30, 2015, vehicle traffic increased 4.3% and passenger traffic increased 7.3% compared to the same period in the prior year. Traffic during the first quarter of fiscal 2016 was favourably impacted by lower fuel prices, the lower Canadian dollar and the favourable weather.

On-time performance in the three months ended June 30, 2015 improved by 0.9% from 88.9% to 89.8% over the same period in the prior year.

Capacity utilization on these routes during the three months ended June 30, 2015 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 a higher number of AEQs carried.



In the three months ended June 30, 2015, revenue from our Northern Routes consisted of 23% from customers and 77% from the Province (2% social program fees, 65% ferry transportation fees, and 10% from payments under the Federal-Provincial subsidy agreement).

Northern Routes cont'd

Revenue ($ thousands)	Three months ended June 30			
	2015	**2014**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	1,857	1,830	27	1.5%
Passenger tariff	1,414	1,338	76	5.7%
Social program fees	328	279	49	17.6%
Catering & on-board	403	406	(3)	(0.7%)
Stateroom rental	334	322	12	3.7%
Hostling & other	71	39	32	82.1%
Total Direct Route Revenue	4,407	4,214	193	4.6%
Indirect Route Revenue				
Ferry transportation fees	11,372	14,701	(3,329)	(22.6%)
Federal-Provincial subsidy	1,843	1,819	24	1.3%
Total Route Revenue	17,622	20,734	(3,112)	(15.0%)

Average tariff ($)	Three months ended June 30		
	2015	**2014**	**Decrease**
Vehicle tariff ($000's)	1,857	1,830	
Vehicle traffic	6,358	6,095	
Average tariff per vehicle	292.07	300.25	(8.18)
Passenger tariff ($000'S)	1,414	1,338	
Passenger traffic	17,589	16,400	
Average tariff per passenger	80.39	81.59	(1.20)

In the three months ended June 30, 2015, average tariff revenue per vehicle decreased $8.18 or 2.7% compared to the same period in the prior year. Average tariff revenue per passenger during the same period decreased $1.20 or 1.5%. Average tariff revenues reflect a change in the proportion of traffic on routes with lower versus higher tariffs and the price cap increases authorized by the Commissioner. The increase in traffic levels and changes in average fares resulted in a total tariff revenue increase of $0.1 million.

There were no fuel surcharges or rebates in place on our Northern Routes in the first quarter of fiscal 2016 or 2015.

Reimbursements from the Province for social program fees increased primarily as a result of higher usage of all social programs. The largest impact was an increase in the use of the MTAP program of over 18%.

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

Stateroom rental increased mainly due to higher usage.

Hostling and other revenues increased in the three months ended June 30, 2015, mainly as a result of higher traffic levels.

Ferry transportation fees received from the Province decreased $3.3 million in the quarter compared to the same period in the prior year as a result of the following:

- $2.9 million reduction primarily as a result of differences in the monthly schedule of round trips (fiscal 2016 ferry transportation fees are expected to be approximately $1.8 million lower than last year); and
- $0.4 million decrease in fees related to a lower fuel price. 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).

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

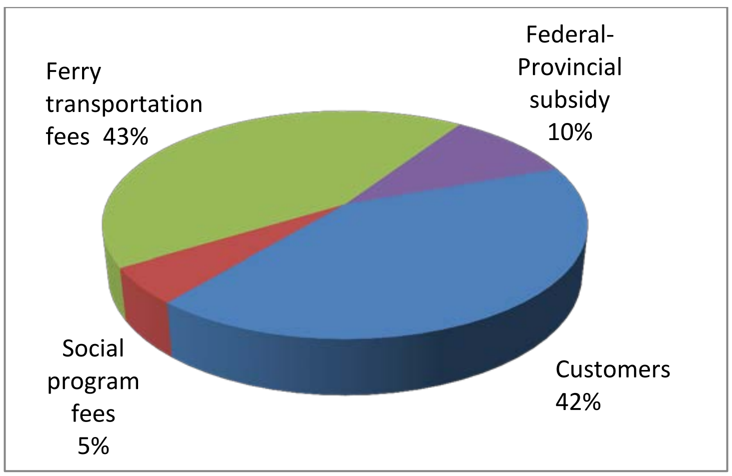
Other Routes

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

Operational Statistics[1]	Three months ended June 30 2015	2014
Vehicle traffic	811,723	780,682
Passenger traffic	1,832,909	1,750,062
On-time performance	92.5%	92.4%
Number of round trips	15,449	16,512
Capacity provided (AEQs)	1,906,100	1,983,002
AEQs carried	870,877	834,824
Capacity utilization	45.7%	42.1%

In the three months ended June 30, 2015, vehicle traffic increased 4.0% and passenger traffic increased 4.7% compared to the same period in the prior year. Traffic during the first quarter of fiscal 2016 was favourably impacted by lower fuel prices, the lower Canadian dollar, favourable weather and the return of student travel resulting from the resolution of the previous year's teachers' labour dispute.

Capacity utilization on these routes during the three months ended June 30, 2015 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 as a result of Provincial service level adjustments and a higher number of AEQs carried.



In the three months ended June 30, 2015, revenue from our Other Routes consisted of 42% from customers and 58% from the Province (5% social program fees, 43% 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			
	2015	**2014**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	12,174	11,063	1,111	10.0%
Passenger tariff	8,786	8,058	728	9.0%
Fuel (rebates) surcharges	(273)	709	(982)	(138.5%)
Social program fees	2,730	2,404	326	13.6%
Catering & on-board	1,143	1,020	123	12.1%
Reservation fees	65	58	7	12.1%
Parking & other	68	43	25	58.1%
Total Direct Route Revenue	24,693	23,355	1,338	5.7%
Indirect Route Revenue				
Ferry transportation fees	22,700	23,750	(1,050)	(4.4%)
Federal-Provincial subsidy	5,340	5,270	70	1.3%
Total Route Revenue	52,733	52,375	358	0.7%

Average tariff ($)	Three months ended June 30		
	2015	**2014**	**Increase**
Vehicle tariff ($000's)	12,174	11,063	
Vehicle traffic	811,723	780,682	
Average tariff per vehicle	15.00	14.17	0.83
Passenger tariff ($000'S)	8,786	8,058	
Passenger traffic	1,832,909	1,750,062	
Average tariff per passenger	4.79	4.60	0.19

In the three months ended June 30, 2015, average tariff revenue per vehicle increased $0.83 or 5.9% compared to the same period in the prior year. Average tariff revenue per passenger during the same period increased $0.19 or 4.1%. The increase in average tariff revenues reflects the price cap increases authorized by the Commissioner and a change in the proportion of traffic on routes with higher versus lower tariffs. The increase in both traffic levels and the average fares resulted in a total tariff revenue increase of $1.8 million.

On April 1, 2015, due to lower fuel prices, a fuel rebate of 1% was implemented on our regulated Other Routes which helped to lessen the impact of the tariff increase. Fuel surcharges of 3.4% were in place on our regulated Other Routes in the first quarter of fiscal 2015. 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%. This resulted in an annual decrease of 8% in the number of seniors using the program. In the three months ended June 30, 2015, there was a marginal increase in the number of seniors using the program. This is the first increase since the implementation of the program change. Social program fees increased $0.3 million as a result of more seniors and students travelling and an increase in the number of people using the MTAP program.

Revenue from catering and on-board services increased by $0.1 million compared to the same period in the prior year as a result of both higher passenger traffic and higher average sales per passenger.

Reservation revenue increased consistent with the general growth in traffic.

Parking and other revenues increased mainly due to higher charter revenues.

Ferry transportation fees received from the Province decreased $1.1 million in the quarter compared to the same period in the prior year, primarily as a result of differences in the monthly schedule of round trips (fiscal 2016 ferry transportation fees are expected to be approximately $2.9 million lower than last year).

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

Expenses
Expenses for the three months ended June 30, 2015 and 2014 are summarized in the tables below:

Operating expenses ($ millions)	**Three months ended June 30**			
	2015	**2014**	**Increase (Decrease)**	
Operations	112.2	115.0	(2.8)	(2.4%)
Maintenance	20.6	16.7	3.9	23.4%
Administration	8.0	7.6	0.4	5.3%
Total operations, maintenance and administration	140.8	139.3	1.5	1.1%
Cost of retail goods sold	8.7	8.0	0.7	8.8%
Depreciation and amortization	35.1	35.2	(0.1)	(0.3%)
Total operating expenses	184.6	182.5	2.1	1.2%

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

The $2.8 million decrease in operations expenses in the three months ended June 30, 2015, compared to the same period in the prior year, was mainly due to:

- $5.4 million decrease in fuel expense reflecting a 17.2% decrease in fuel prices. While IFRS does not permit accounting for rate-regulated entities, we are in fact rate-regulated. For purposes of rate regulation, $1.9 million over our actual fuel expense in the three months ended June 30, 2015 is recorded in deferred fuel cost accounts which is expected to be settled through fuel rebates. (See "The Effect of Rate Regulation" above for more detail.); and
- $0.3 million decrease in insurance claims;

partially offset by:

- $1.8 million increase in wages and benefits costs, mainly due to a bargaining unit wage rate increase of 2% effective April 1, 2015 in accordance with the Collective Agreement, an increase in overtime and in hours spent in training activities;
- $0.8 million increase in contracted services; and
- $0.3 million increase in parts and supplies.

Maintenance costs were $3.9 million higher in the three months ended June 30, 2015 compared to the same period in the prior year as a result of variations in vessel refit scheduling and increased terminal maintenance.

The $0.4 million increase in administration costs is mainly due to $0.3 million in computer software licencing costs.

The $0.7 million increase in cost of retail goods sold reflects the increase in overall sales and rising food costs.

Depreciation and amortization decreased $0.1 million, reflecting lower depreciation resulting from extending our vessel lives from 40 years to 45 years offset by higher depreciation 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**		
	2015	**2014**	**Increase (Decrease)**
Finance expense			
Bond interest	14.3	16.0	(1.7)
KfW bank group (KfW) loans	1.5	1.8	(0.3)
Interest on finance lease	0.5	0.5	-
Short-term debt	0.1	0.1	-
Capitalized interest	(1.2)	(0.7)	(0.5)
Total finance expense	15.2	17.7	(2.5)
Less: finance income	(0.9)	(1.1)	0.2
Net finance expense	14.3	16.6	(2.3)
Loss on disposal of property, plant and equipment	-	0.1	(0.1)
Total net finance and other expenses	14.3	16.7	(2.4)

In the three months ended June 30, 2015, net finance and other expenses decreased $2.4 million compared to the same periods in the prior year due to:

- $1.7 million decrease in bond interest reflecting the lower effective interest rates on the $200 million of senior secured bonds issued in the first quarter of fiscal 2015 and the higher effective interest rate on the $250 million of senior secured bonds which matured in the first quarter of fiscal 2015;
- $0.5 million increase in capitalized interest in the quarter;
- $0.3 million decrease in interest on KfW loans, reflecting $3.8 million in principal repayments; and
- $0.1 million decrease loss on disposal of property, plant and equipment;

partially offset by:

- $0.2 million year-to-date decrease in finance income.

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

Over the next few years, 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, 2015, our unrestricted cash and cash equivalents and other short-term investments totalled $128 million.

Our $155 million credit facility was amended on March 13, 2015 to extend the maturity date of the facility from April 2019 to April 2020. The facility is available to fund capital expenditures and other general corporate purposes. At June 30, 2015, 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, 2015 were “A” (DBRS) with a stable trend and “AA-” (Standard & Poor’s) with a stable outlook.

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

At June 30, 2015 we achieved equity to total capitalization of 21.7% and a DSCR of 3.12.

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, 2015 and 2014 are summarized in the table below:

	Three months ended June 30		
($ millions)	**2015**	**2014**	**Increase (Decrease)**
Cash and cash equivalents, beginning of period	65.6	71.4	(5.8)
Cash from operating activities:			
Net earnings	18.8	13.9	4.9
Items not affecting cash	51.9	47.9	4.0
Changes in non-cash operating working capital	(16.0)	(13.2)	(2.8)
Net interest paid	(18.1)	(20.5)	2.4
Cash generated by operating activities	36.6	28.1	8.5
Cash used in financing activities	(4.0)	(59.2)	55.2
Cash (used in) provided by investing activities	(28.2)	2.2	(30.4)
Net increase (decrease) in cash and cash equivalents	4.4	(28.9)	33.3
Cash and cash equivalents, end of period	70.0	42.5	27.5

For the three months ended June 30, 2015, cash generated by operating activities increased by $8.5 million compared to the same period in the prior year, due to an increase in net earnings, a decrease in interest paid, and a change in the items not affecting cash partially offset by changes in non-cash operating working capital.

Cash used in financing activities in the three months ended June 30, 2015 was $4.0 million. This amount consisted of $3.7 million in long-term debt repayments and $0.3 million repayment of finance lease obligations.

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 investing activities in the three months ended June 30, 2015 decreased by $30.4 million compared to the same period in the prior year, due to a $26.5 million decrease in cash provided by short-term investments and a $2.8 million change in debt service reserve requirements and $1.1 million increase in cash used for capital expenditures. (See “Investing in Our Capital Assets” below for detail of significant capital expenditures.)

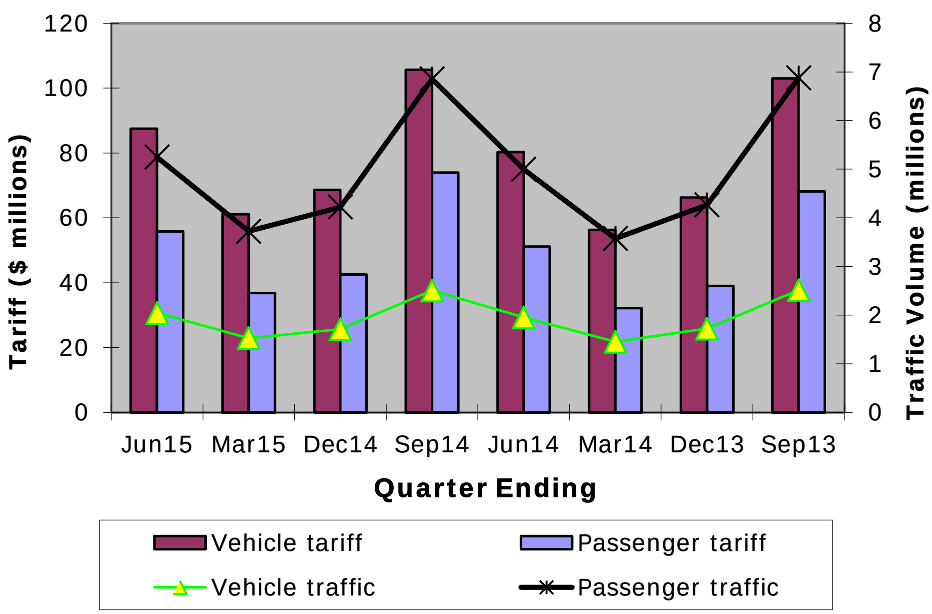
SUMMARY OF QUARTERLY RESULTS

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

	Quarter Ended (unaudited)							
($ millions)	**Jun 15**	**Mar 15**	**Dec 14**	**Sep 14**	**Jun 14**	**Mar 14**	**Dec 13**	**Sep 13**
Total revenue	217.7	161.4	182.4	284.2	213.1	153.9	174.8	271.5
Operating profit (loss)	33.1	(11.8)	8.2	91.6	30.6	(21.3)	3.7	82.3
Net earnings (loss)	18.8	(35.1)	(6.1)	76.4	13.9	(38.3)	(12.3)	64.3
Other comprehensive income (loss)	3.5	2.7	(7.4)	(2.9)	(2.4)	(5.0)	-	0.1
Total comprehensive income (loss)	22.3	(32.4)	(13.5)	73.5	11.5	(43.3)	(12.3)	64.4

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:



INVESTING IN OUR CAPITAL ASSETS

Capital Expenditures
Capital expenditures in the three months ended June 30, 2015 totalled $36.6 million.

	($ millions)
Vessel upgrades and modifications	16.7
Terminal marine structures	9.0
Information technology	7.0
Terminal and building upgrades and equipment	3.9
Total capital expenditures	36.6

Vessel Upgrades and Modifications
Capital expenditures for vessel upgrades and vessel modifications in the three months ended June 30, 2015 included the following:

	($ millions)
Major overhauls and inspections	6.7
New Salish Class vessels	6.7
Queen of Capilano mid-life upgrade	1.2
Queen of Cumberland mid-life upgrade	0.5
Baynes Sound Connector	0.4
Navigational equipment upgrades	0.4
Queen of Oak Bay ¾-life upgrade	0.2
Other projects	0.6
	16.7

The $6.7 million in major overhauls and inspections completed in the quarter ended June 30, 2015 or currently underway include:

- $2.0 million for the *Coastal Inspiration*;
- $1.8 million for the *Howe Sound Queen*;
- $1.4 million for the *Klitsa*;
- $1.0 million for the *Nimpkish;* and
- $0.5 million for the *Queen of Capilano.*

In July 2014, we entered into contracts with Remontowa Shipbuilding S.A. to build three new intermediate class vessels. The contracts, with a total value of $165 million form the majority of the total project budget of $252 million. The new vessels are scheduled for delivery in August 2016, October 2016 and February 2017. On March 5, 2015, the keel-laying for the first of the three new intermediate vessels took place. On April 10, 2015 and on July 1, 2015, the first steel cuts for the second and third vessels, respectively, took place at Remontowa Shipbuilding S.A. in Gdansk, Poland. The new vessels will be dual-fuel capable, so they can run predominantly on LNG with marine diesel fuel as a backup. On July 28, 2015, we announced the names of our three new intermediate class vessels, the *Salish Orca*, the *Salish Eagle* and the *Salish Raven*.

A $13 million project for a mid-life upgrade of the *Queen of Capilano* included installation of gallery decks which increase capacity, 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 vessel returned to service in early May 2015.

A $14 million project for a mid-life upgrade of the *Queen of Cumberland* includes upgrades to the RAD units, passenger accommodation improvements, bridge standardization and safety upgrades. The project is expected to complete in the spring of 2016.

In April 2015, the drive and guide cables necessary to move the *Baynes Sound Connector* that will provide service between Buckley Bay and Denman Island were installed. The cable ferry, which will accommodate 50 vehicles and 150 passengers and crew, is nearing completion and expected to be placed in service in the fall of 2015. (See “Outlook – Asset Renewal Program” below for more detail.)

Fiscal 2016 is our fourth year of a four-year program to upgrade vessels with new navigational equipment. This year we expect to spend $3 million on upgrading the radar equipment and gyro compasses on several vessels to improve navigational safety. This will take us further towards bridge standardization.

A $18 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 replacement of the emergency generator. Phase 1, completed in February 2015, upgraded the fire protection system, the electrical system and propulsion and installed a new generator, with a cost of $6 million. Phase 2 with replace the steering gear system, upgrade the bridge and passenger accommodations and is expected to complete by the end of February 2016.

Other projects include a fire detection system for the *Northern Expedition,* a gearbox for the *Bowen Queen,* mid-life upgrades for the *Spirit of Vancouver Island* and the *Spirit of British Columbia* and the purchase of cylinder heads.

Terminal Marine Structures

Capital expenditures for terminal marine structures in the three months ended June 30, 2015 included the following:

Terminal	**Description**	
		($ millions)
Sointula	Berth rebuild	4.4
Departure Bay	Replace dolphin and gangways	2.9
Denman Island and Buckley Bay	Modifications to accommodate the new cable ferry	0.8
Various	Other projects	0.9
		9.0

At Sointula terminal, a $10 million project to replace the ramp, tower, wingwalls, floating lead and three dolphins to extend the life of the trestle is underway. This project is expected to complete by the end of the second quarter of fiscal 2016.

At Departure Bay terminal, a $4 million project to replace the dolphin with a multi-pile turning dolphin and a $3 million project to install active lift gangways are underway. These projects are expected to be complete by the end of the second quarter and the end of the third quarter of fiscal 2016, respectively.

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 complete and implementation of the cable system is nearing completion. (See “Outlook – Asset Renewal Program” below for more detail.)

Other projects currently in progress include upgrades at Quathiaski Cove, Otter Bay, Whaletown, and Tsawwassen terminals.

Information Technology

Capital expenditures for information technology in the three months ended June 30, 2015 included the following:

	($ millions)
Customer service program	2.6
Payroll system replacement	1.5
Oracle eBusiness upgrade	1.0
Hardware upgrades	0.9
Other projects	1.0
	7.0

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 which began in 2015 with the installation of a customer relationship management application. We believe this program will significantly improve our ability to efficiently respond to the changing needs of our customers.

Our payroll system replacement initiative will replace both our aged payroll and labour distribution systems and provide processing efficiencies and flexibility. It is expected to be complete in 2016.

Our Oracle financial system upgrade included configuration changes to obtain efficiencies. It is now complete.

Hardware upgrades include the replacement of aged computers, printers, servers, routers, closed-circuit cameras and electronic signage.

Other projects include software to automate the management of our server environments, upgrading our catering and retail inventory management system and the fare flexibility and digital experience initiative which will introduce a new system to manage fares and provide customers with a modernized e-commerce platform with greater online functionality and booking options.

Terminal and Building Upgrades and Equipment
Capital expenditures for terminal and building upgrades and equipment in the three months ended June 30, 2015 included the following:

	($ millions)
Drainage system and holding compound upgrade at Prince Rupert terminal	1.5
Asphalt resurfacing, signage and security at Tsawwassen terminal	1.0
Vehicles and other equipment	0.5
Other terminal projects	0.9
	3.9

A $4 million dollar project at Prince Rupert is underway to install an engineered drainage system, and a concrete head wall to reduce overflow and to repave the holding compound. This project is expected to be complete in the fall of 2015.

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, upgrade of lighting for security purposes and replacing flooring and windows in the administration building.

Vehicles and other equipment include welding trucks, tow tractors and a forklift at our maintenance facility.

Other projects currently in progress include upgrades at Saltery Bay and Langdale.

OUTLOOK

We do not anticipate a material change in general economic conditions. The slowing Canadian economy may impact local traffic although we believe that vehicle and passenger traffic will remain strong in the near term, for the tourist season. We are continuing our program of cost containment, 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 fiscal 2016, including standardized vessels, LNG propulsion, other alternative technologies, passenger only vessels, a new reservation and point-of-sale system, increased operational efficiencies and opportunities for federal infrastructure funding to renew our fleet and terminals.

Traffic

Overall, vehicle traffic increased 4.7% while passenger traffic increased 5.0% in the three months ended June 30, 2015 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 US economy and the outlook for the travel industry will continue to improve. With the decline in the value of the Canadian dollar and the lower cost of fuel, we believe that passenger and vehicle traffic will remain strong in the near term, for the tourist season. We expect this will result in a modest improvement in discretionary traffic levels, although the slowing Canadian economy may result in a reduction in local traffic.

Financial performance

We expect positive net earnings in fiscal 2016, reflecting a modest increase in traffic, increases to average fares in accordance with the Commissioner's Order 12-02 and continued cost management, and continued benefits from adjustments to service levels; coupled with a gradual improvement in the overall economy.

We expect an increase in total revenue in fiscal 2016, reflecting the April 1, 2015 tariff increases, higher catering and on-board revenues, higher social program fees, partially offset by marginally lower ferry transportation fees.

We expect a modest increase in total expenses in fiscal 2016, reflecting higher wage and benefit costs partially due to increased traffic levels and other operational related costs, partially offset by lower fuel costs. We continue to manage our costs prudently without compromising safe operations.

Effective April 1, 2016, the CFSC was amended for PT4, being the period from April 1, 2016 to March 31, 2020. The amendments to the contract for PT4 were completed by June 30, 2015 as required by the CFSC. Amendments include the establishment of ferry transportation fees for PT4 and changes in the structure for the funding of BC seniors discounts.

On March 18, 2015, the Commissioner released the Preliminary Decision on Price Caps for PT4, setting increases in price caps of 1.9% per year. The Commissioner will issue his decision on final price caps for PT4 by no later than September 30, 2015.

Asset renewal program

Our capital expenditures are expected to increase over the next twelve years as we begin to replace 18 aged minor and intermediate-sized vessels, make significant improvements at our terminals, and renew our information technology infrastructure.

New vessels - LNG

In July 2014, we entered into contracts with Remontowa Shipbuilding S.A. to build three new Salish Class vessels. The contracts, with a total value of $165 million form the majority of the total project budget of $252 million. These contracts 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 are scheduled for delivery in August 2016, October 2016 and February 2017. The *Salish Orca* and the *Salish Eagle* will replace the 50-year old *Queen of Burnaby* on the Comox – Powell River route and the 51-year old *Queen of Nanaimo on the Tsawwassen – Southern Gulf Islands route*, respectively. The *Salish Raven* is expected to service the Southern Gulf Islands.

On March 5, 2015, the keel-laying for the first of the three new Salish Class vessels took place. On April 10, 2015, and on July 1, 2015, the first steel cut for the second and third vessels, respectively, took place at Remontowa Shipbuilding S.A. in Gdansk, Poland. The new vessels will be dual-fuel capable, so they can run predominantly on LNG with marine diesel fuel as a backup. These vessels will set a new standard of efficiency with standardized bridges, engine rooms and lifesaving equipment moving us to a higher standard and improving interoperability.

Mid-life upgrades - LNG

On October 29, 2012, we submitted a fuel strategies report to the Commissioner which included our plan for transition to alternate fuels and, subsequently, we have provided annual updates. Both LNG and the marine diesel we currently use meet all domestic and international emissions regulations. We have studied the feasibility of converting to LNG and believe that a move to this fuel source would reduce costs and emissions. At this time, even with the current drop in diesel oil prices, LNG is less expensive than the ultra-low sulphur diesel we currently use and has significantly less emissions. We believe that LNG is a viable option for future new vessels and, as noted above, our three new Salish Class vessels will have the capability to run on it.

We also analyzed LNG as an option for existing vessels undergoing major retrofits and intend to pursue the option where it is economically and technically feasible. The *Spirit of Vancouver Island* and the *Spirit of British Columbia,* our two largest vessels*,* will be undergoing mid-life upgrades and we are currently considering converting them to be able to run on LNG as well as diesel. On July 9, 2015, we announced the three shipyards, including one British Columbian yard, that we shortlisted for the mid-life upgrades, including potential conversion to dual-fuel, The mid-life upgrade of the *Spirit of British Columbia* is expected to be completed during the spring of 2018 and the *Spirit of Vancouver Island* is expected to be completed during the spring of 2019.

Cable Ferry

The *Baynes Sound Connector*, which will accommodate 50 vehicles and 150 passengers and crew, is nearing completion. It is expected to be moved to Buckley Bay by the end of August and placed in service later in the fall of 2015.

This is an innovative initiative and is part of our ongoing efforts to identify and pursue opportunities that have the potential to enhance our cost effectiveness in delivering safe, reliable and quality ferry service.

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

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 64 through 67 of our fiscal 2015 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2015. Our 2015 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 67 through 73 of our fiscal 2015 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2015. Our 2015 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

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 adapt to changes in the economic environment and ensure a viable, profitable future. We do not believe that material uncertainties exist in regards to our future as we believe our risk mitigation strategies are sufficient.

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, 2015 and June 30, 2015 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 74 and 75 of our fiscal 2015 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, 2015, or expect to use in the future. Our 2015 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

Adoption of New Accounting Standards
There here are no relevant changes in accounting standards applicable to our fiscal year beginning April 1, 2015. However, we changed the estimate of useful lives of vessel hulls from 40 to 45 years. The change has been applied prospectively effective April 1, 2015, and will result in a decrease in depreciation expense of approximately $1.9 million for the year ending March 31, 2016.

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

Amendments to IAS16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*, explicitly state that revenue-based methods of depreciation cannot be used for property, plant and equipment. The amendments will be effective for us April 1, 2016. The application of these amendments will not have any impact on our consolidated financial statements.

IFRS 15 *Revenue from Contracts with Customers* replaces IAS 18 *Revenue* and IAS 11 Construction Contracts, providing guidance on the amount and/or timing of recognition of revenue. IFRS 15 was issued in May 2014 with an effective date of January 1, 2017. Earlier application is permitted. On July 22, 2015, the IASB confirmed a one-year deferral of this standard and will be effective for us April 1, 2018. We do not expect the application of this standard to have any significant impact on our consolidated financial statements.

IFRS 9 *Financial Instruments* (2014) introduces a new expected credit loss model for calculating impairment, and incorporates guidance on the classification and measurement of financial assets and the final general hedge accounting requirements originally published in IFRS 9 (2013). Mandatory adoption of IFRS 9 (2014) for us will be April 1, 2018. We do not expect the application of this standard to have any material impact on our consolidated financial statements.

The IASB has published a *Disclosure Initiative (Amendments to IAS1)* with narrow-scope amendments with an effective date for us of April 1, 2016. The amendments aim at clarifying IAS 1 to address perceived impediments to preparers exercising their judgement in preparing their financial reports. Earlier application is permitted. We do not expect the application of this standard to have any significant impact on our consolidated financial statements.

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, fuel prices, and fiscal 2016 net earnings; 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, fare flexibility and digital experience initiative, payroll system replacement initiative, vessel replacement program for the *Queen of Burnaby* and the *Queen of Nanaimo*, cable ferry initiative, LNG plans, Spirit Class mid-life upgrades, and safety and training projects; our expectations regarding food sales, and sales of quality apparel; total revenue and expense projections, and how our cash requirements will be met in the near term; and our expectations regarding the impacts of IFRS 9 and IFRS 15 and amendments to IAS 1, IAS 16 and IAS 38 on our consolidated 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: vendor non-performance; capital market access; interest rate, foreign currency, fuel price, and traffic volume fluctuations; the implementation of major capital projects; security, safety, and environmental incidents; confidential or sensitive information breaches; changes in laws; vessel repair facility limitations; economic regulatory environment changes; tax changes; and First Nation 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, number of sailings, 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.