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

For the fiscal year ended
March 31, 2016

Dated June 17, 2016

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Management's Discussion & Analysis
of Financial Condition and Financial Performance
For the year ended March 31, 2016
Dated June 17, 2016

The following is our discussion and analysis of the financial condition and financial performance for British Columbia Ferry Services Inc. ("BC Ferries") for the year ended March 31, 2016 and has been prepared with the information available as of June 17, 2016. This discussion and analysis should be read in conjunction with our audited consolidated financial statements and related notes for the years ended March 31, 2016 ("fiscal 2016") and March 31, 2015 ("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 services on other remote routes through contracts with independent operators.

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

We provide a wide range of ferry services for our customers. During fiscal 2016, we carried 20.7 million passengers and 8.1 million vehicles, an increase of 4.5% and 4.9%, respectively, compared to the prior year. During fiscal 2016, we provided over 170,000 sailings, 1,061 fewer sailings than in the prior year. This reflects service level adjustments on our regulated Other Routes announced by the Province in February 2014 and implemented in fiscal 2015. These adjustments have resulted in increased capacity utilization and savings in fuel and labour, and had a positive impact on financial performance in both fiscal 2015 and fiscal 2016. For a discussion of our traffic levels, see "Financial and Operational Overview" below.

Significant events during or subsequent to 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 September 16, 2015, the Commissioner issued Order 15-03 which established final price cap increases of 1.9% for each of the four years of performance term four ("PT4"), being the four year period commencing on April 1, 2016 and ending on March 31, 2020. The order also required a fuel management plan to be submitted prior to the start of PT4 setting out our strategies for fuel procurement, minimizing fuel consumption and the transition to alternate fuels during PT4. The plan was submitted on March 30, 2016.

- On September 28, 2015, the Commissioner issued Order 15-03A which maintained the existing fuel deferral accounts and set the price per litre for the operation of the fuel deferral accounts at 91.5 cents per litre for marine diesel and 46.4 cents per litre for liquefied natural gas ("LNG") starting in the first year of PT4, both of which will be inflated by 2% per year for the balance of PT4. The set price per litre is an input into the calculation of fuel surcharges or rebates.

- On November 12, 2015, we executed an export loan agreement with KfW IPEX-Bank GmbH, a German export credit bank. This loan agreement is secured under the Master Trust Indenture ("MTI") and allows for three loans of up to $45 million each. These amortizing loans will be repaid over a 12-year term and bear an annual interest rate of 2.09%. The net proceeds from the loans will be used to partially finance the purchase of the three new Salish Class vessels. No amounts have been drawn under the loan agreement.

- On December 18, 2015, we announced the ratification of a Memorandum of Agreement that was reached on October 30, 2015 with the BC Ferry & Marine Workers' Union ("Union"). The Collective Agreement provides for wage increases aggregating 8.55% over the five-year term ending October 31, 2020, which is 1.71% on average per year. This agreement provides certainty for our employees, helps ensure uninterrupted ferry service for our customers and marks 17 years of labour stability.

- On January 15, 2016, we submitted a supplemental application to the Commissioner for our Spirit Class Mid-Life Upgrades Project, reflecting updated capital cost estimates for the project. On January 29, 2016, the Commissioner issued confidential Order 14-03B, approving the revised maximum amount of the major capital expenditure for the project, and on February 1, 2016 confirmed that the conditions precedent to contract award set out in Order 14-03 were satisfied.

- On January 29, 2016, we signed an agreement to receive up to a $10 million contribution from FortisBC Energy Inc. as part of the Natural Gas for Transportation ("NGT") incentive funding. This funding will go towards partially offsetting the capital cost of converting our two Spirit Class vessels to dual fuel capability. While this agreement does not obligate us to purchase LNG from FortisBC, the funding is conditional upon a number of factors including a long-term LNG procurement contract for these vessels.

- On February 9, 2016, our new cable ferry, the *Baynes Sound Connector*, commenced regularly scheduled service between Buckley Bay on Vancouver Island and Denman Island following extensive crew training and familiarization and Transport Canada certification. The *Baynes Sound Connector* accommodates 50 vehicles and 150 passengers and crew. The cable ferry will provide environmental benefits and significant fuel cost savings, using less than half the fuel of the *Quinitsa,* which was previously on the route, and will serve the route for the next 40 years.

- On March 24, 2016, we announced the award of a contract totalling $140 million to Remontowa Ship Repair Yard S.A. of Gdansk, Poland to conduct mid-life upgrades, including conversion to dual-fuel, of our two largest vessels, the *Spirit of Vancouver Island* and the *Spirit of British Columbia*. The upgrade of the *Spirit of British Columbia* is expected to be completed during the spring of 2018 and the upgrade of the *Spirit of Vancouver Island* is expected to be completed the following year. We expect the conversion of these vessels to result in significant savings, as LNG costs are significantly less than marine diesel.

- On April 1, 2016, upon commencement of PT4, certain amendments to the Coastal Ferry Services Contract ("CFSC") became effective. These amendments include the establishment of ferry transportation fees for PT4 and changes in the structure for the funding of BC seniors' discounts.

- On April 1, 2016, we implemented average tariff increases in accordance with the Commissioner's Order 15-03 dated September 16, 2015. Tariff increases were 1.9% on average. Also on April 1, 2016, due to lower fuel prices, coupled with the fact that we have, through our fuel hedging program locked in pricing for a significant portion of our forecast fuel consumption to the end of 2017, a fuel rebate increase of 1.9% was implemented across the system. This completely offset the 1.9% average tariff increase, effectively resulting in no net increase to our customers at the beginning of PT4. Fuel rebates increased from 1.0% to 2.9% on our Major and regulated Other Routes and a fuel rebate of 1.9% was implemented on the Northern Routes.

- On April 25, 2016, the Province confirmed the Government of Canada's expansion of the criteria eligibility for projects to be funded under the New Building Canada Fund. This will provide an opportunity for us to apply for funding for our ferries and related infrastructure.

- On May 17, 2016, we finalized the sale of the 52 year-old *MV Tenaka*, to Lady Rose Marine Services of Port Alberni, BC.

- On June 2, 2016, the *Salish Eagle* and the *Salish Raven,* the second and third of the new Salish (intermediate) Class vessels, were launched and christened at Remontowa Shipbuilding S.A. in Gdansk, Poland. The *Salish Orca* was previously launched and christened on November 24, 2015. The contracts with Remontowa Shipbuilding S.A, with a total value of $165 million, form the majority of the total project budget of $206 million. The original project budget of $252 million has been reduced by $46 million reflecting the elimination of tariffs to import the vessels into Canada. These vessels will be dual-fuel capable, designed to run primarily on LNG with marine diesel as a backup. The *Salish Orca* is scheduled for delivery in the third quarter of fiscal 2017, and the *Salish Eagle* and *Salish Raven* are scheduled for delivery in the fourth quarter of fiscal 2017.

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

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

Economic Regulatory Environment

The office of the Commissioner was created under the Act on April 1, 2003. The Act has been amended from time to time to expand and broaden the Commissioner's role and regulatory responsibilities. The primary responsibility of the Commissioner is to regulate ferry operators in such a way as to balance the interests of ferry users, taxpayers and the financial sustainability of the ferry operators. The Commissioner establishes price caps for designated ferry route groups for the purpose of regulating our tariffs. The Commissioner has the authority to authorize the establishment of deferred fuel cost accounts and to set the terms and conditions for their use, including fuel surcharges or rebates. The Commissioner is also responsible for regulating the reduction of service and discontinuance of routes, monitoring the service provided under the CFSC, authorizing major capital expenditures, conducting performance reviews, regulating ferry transportation services where the Commissioner has determined an unfair competitive advantage exists and approving the customer complaints process.

The Commissioner conducted a Performance Review of the Efficiency of BC Ferries for fiscal 2009 through 2014, and in March 2015, he issued his report concluding that:

- *"BC Ferries is demonstrating good cost control";*
- *"cost control has been achieved while obtaining good outcomes with customer satisfaction and passenger and employee safety"; and*
- *"BC Ferries appear to have a strong culture of efficiency".*

The efficiency assessment also found that:

- on an inflation-adjusted basis, administrative expenses have declined by 15.1% since 2009;
- a reduction in headcount and lower overtime hours have assisted in moderating labour costs;
- absenteeism rates are below the average for comparable businesses;
- executive compensation is comparable with provincial crown corporations and appears to be appropriate for an organization of BC Ferries' size and complexity; and
- the number of managers does not appear excessive.

Also on March 18, 2015, the Commissioner released his reports on the performance reviews of BC Ferries' homeporting arrangements (homeporting refers to the location where vessels are docked overnight), fuel management, and BC Ferries Vacations. These reviews concluded that:

- significant measures to manage fuel consumption have been implemented;
- fuel procurement policies and procedures appear to be appropriate;
- some homeporting arrangements may not be ideal but changing them would be cost-prohibitive; and
- BC Ferries Vacations is making a positive contribution to net income and, as such, is helping keep fares lower than they would otherwise need to be.

The Commissioner's orders and reports are available on the Commissioner's website at www.bcferrycommission.com.

Performance term three

In March 2011, the Commissioner set preliminary price cap increases for performance term three ("PT3"), being the four year period commencing April 1, 2012 and ending March 31, 2016. The increases were 4.15% on the three Major Routes and 8.23% on all other regulated routes for each of the four years, effective April 1, 2012.

On June 2, 2011, the *Coastal Ferry Amendment Act*, *2011* ("Bill 14") was enacted, establishing a price cap increase for the first year of PT3, effective April 1, 2012. Bill 14 established a price cap increase for each route group of 4.15% from the weighted average of the tariffs in place at March 31, 2012. The Province agreed to compensate us for the reduction in the price cap set forth in the Commissioner's preliminary price cap order. The value of this price cap change was $11.5 million.

On September 30, 2012, the Commissioner issued Order 12-02 which established the final price caps for the remaining three years of PT3. In addition, the Commissioner reset the price caps for each route group to an index level of 100 as of April 1, 2012 based on the weighted average tariffs that existed as of March 31, 2012. The established price caps incorporated efficiency targets of $54.2 million, over and above the benefits associated with any service level adjustments, to be achieved by us over the four years of PT3. In his order, the Commissioner stated:

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

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

- Grouping our route connecting Horseshoe Bay and Langdale with the three Major Routes connecting Metro Vancouver with mid and southern Vancouver Island. (Subsequently, on March 31, 2013, we reached an agreement with the Province to amend the CFSC to consolidate all regulated routes into a single group effective April 1, 2013);
- A reduction of up to 400 round trips in the minimum service requirement on our Major Routes as well as principles and targets for further service level reductions system wide;
- Service adjustments to be determined on regulated routes to achieve $30 million in net savings over PT3; and
- Ferry transportation fee enhancements of $54.5 million through PT3 provided by the Province in order to reduce the pressure for future fare and price cap increases. We received $21.5 million (which included $11.5 million as compensation for price cap adjustments as detailed above), $10.5 million, $11.0 million and $11.5 million, in fiscal 2013, 2014, 2015 and 2016, respectively.

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

- $4.0 million were reductions in annual round trips on three of the Major Routes where the traffic levels no longer warranted extra service or where service was significantly under-utilized;
- $7.1 million received from the Province to mitigate the impact of the delay in identifying service level adjustments to provide the Province sufficient time to complete its consultation process regarding service level adjustments;
- $14.0 million in reductions in annual round trips on the Northern and Other Routes; and
- $4.9 million in further reductions in annual round trips on three of the Major Routes. (Subsequently, we reviewed opportunities for further service level reductions on the three Major Routes and, as a result of traffic increases, determined that the economics of further reductions were no longer favourable; however, we committed to saving the $4.9 million through other efficiencies.)

On March 31, 2014, the Province confirmed its decision to amend its program to reduce the passenger fare discount for BC seniors from 100% to 50% for BC seniors travelling Monday through Thursday on the Major and Other Routes effective April 1, 2014. The program does not provide for any discounts for BC seniors travelling on these routes Friday through Sunday. The discount for BC seniors on the Northern Routes remained unchanged at 33% every day. In respect of the corresponding reduction in social program funding and to reduce the magnitude of future tariff increases, the amendment also confirmed a maximum increase in ferry transportation fees of $18.0 million in fiscal 2015 and $19.3 million in fiscal 2016. These amounts reflect an estimate of what the Province would have paid if there had been no change in the level of senior discounts. It was agreed that, to the extent these funds were not required for the reimbursement of discounts provided BC seniors under the amended policy, the excess would be directed to the ferry transportation fees. In fiscal 2015, we received $9.7 million in ferry transportation fees and $8.3 million in social program funding for seniors travel, totalling $18.0 million. In fiscal 2016, we received $10.7 million in ferry transportation fees and $8.6 million in social program funding for seniors travel, totalling $19.3 million.

Performance term four

On September 30, 2014, we filed our submission for PT4, being the four year period commencing April 1, 2016 and ending on March 31, 2020, with the Commissioner. This began the process of price cap setting by the Commissioner and negotiations with the Province regarding amendments to the CFSC for PT4. We also filed our efficiency plan which focused on four strategies, comprised of the use of LNG, business transformation strategies enabled by technology, a strategy for the Southern Gulf Islands and a strategy for the Major Routes. The major catalyst for the Major Routes Strategy was the estimated capital investment of $1.1 billion on the Major Routes, including over $200 million in terminal infrastructure at the Horseshoe Bay terminal that will be required over the next 10 years.

On February 1, 2016, the Commissioner issued a notice of procedures regarding drop-trailer regulation under section 45.1 of the Coastal Ferry Act. The notice set out five questions the Commissioner would consider in making a determination to reset the Minimum Allowed Average Tariff (“MAAT”) for drop-trailer services. Order 11-01 and Memorandum 42 issued in February 2011, regulate our drop-trailer services by way of a MAAT which became effective on April 1, 2011. Under this order when we reach a certain volume of drop-trailer traffic, or at the discretion of the Commissioner, the MAAT shall be reset in light of experience with actual costs and drop-trailer traffic volumes. As we have reached this volume, the Commissioner has commenced a review.

In September 2015, the Commissioner issued Order 15-03 and Order 15-03A. These orders included the following:

- Establishment of final price cap increases of 1.9% for each of the four years of PT4;
- Incorporation of an efficiency target ($27.6 million over the four years of PT4);
- Requirement for a fuel management plan to be submitted prior to the start of PT4 setting out our strategies for fuel procurement, minimizing fuel consumption and the transition to alternate fuels during PT4;
- Authorization to continue to use fuel cost deferral accounts in PT4;
- Establishment of the set price per litre at 91.5 cents for marine diesel (reduced from 99.0 cents per litre in fiscal 2015);
- Establishment of the set price per litre at 46.4 cents per litre for LNG in the first year of PT4;
- Incorporation of an inflation factor of 2% per year on the price per litre of both marine diesel and LNG for the balance of PT4. (The set price per litre is a required input into the calculation of fuel surcharges or rebates.

In addition, the Commissioner reset the price caps to an index level of 100 as of April 1, 2016 based on the weighted average tariffs that existed as at March 31, 2016.

Effective April 1, 2016, the CFSC was amended for PT4 to, among other things, establish ferry transportation fees for the four year term and change the structure for the funding of BC seniors' discounts. It was also established that the consolidated route group effective April 1, 2013, will be in effect until March 31, 2020. In the absence of any further amendments, on April 1, 2020, the route group structure in the CFSC will revert back to the structure that was in place at March 31, 2013. The structure at that time was comprised of three individual route groups, being the Major Routes, Northern Routes and Minor Routes.

The Effect of Rate Regulation
We are regulated by the Commissioner to ensure, among other things, that our tariffs are fair and reasonable. Under the terms of the Act, the tariffs we charge our customers over a performance term are subject to price caps set by the Commissioner. The Commissioner may, under certain circumstances, allow increases in price caps over the set levels. Certain decisions and orders of the Commissioner may give rise to 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, like ours, that transitioned to IFRS prior to that date. 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 14, rather than being charged to regulatory asset or liability 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. We are regulated by the Commissioner and these items are treated as assets and liabilities for regulatory purposes. Reporting for rate-regulated activities provides additional information which we use to assess performance and to make operating decisions.

Regulatory assets and liabilities do not have standardized meaning within IFRS. Our regulatory assets and liabilities should be considered in addition to, but not as a substitute for, measures of financial performance in accordance with IFRS.

We continually assess whether our regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes. We believe the obligations represented by the regulatory liabilities at March 31, 2016, will be settled in the future. These regulatory assets and regulatory liabilities are detailed in note 22 to our March 31, 2016 audited consolidated financial statements.

If IFRS permitted us to report regulatory assets and liabilities in our financial statements, the effect on our net earnings for the quarters and years ended March 31, 2016 and 2015 would be as follows:

($ millions)		Three months ended March 31 2016	Three months ended March 31 2015	Years ended March 31 2016	Years ended March 31 2015
Net earnings		(30.0)	(35.1)	69.6	49.1
Changes in net earnings:					
Regulatory asset or liability	**Statement line item**				
Deferred fuel costs (a)					
Fuel costs (under) over set price	Operations expense	(4.7)	(1.4)	(11.0)	9.1
Fuel rebates (surcharges)	Fuel rebates (surcharges)	1.3	-	6.4	(13.2)
Payments from the Province	Ferry service fees	(0.2)	(0.3)	(1.1)	(2.5)
		(3.6)	(1.7)	(5.7)	(6.6)
Tariffs in excess of price cap (b)					
Obligation (incurred) settled during the period	Vehicle and Passenger Fares	-	(1.0)	1.0	(1.0)
Performance term submission costs (c)					
Amortization	Depreciation and amortization expense	-	-	(0.1)	(0.1)
Decrease in total net earnings		(3.6)	(2.7)	(4.8)	(7.7)
Adjusted net earnings		(33.6)	(37.8)	64.8	41.4

(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 the 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 fuel cost account balances.

(b) Tariffs in excess of price cap: The Act contains provisions which ensure that, if the average of the tariffs we charge exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. Average tariffs charged did not exceed price caps at March 31, 2016.

(c) Performance term submission costs: Costs for incremental contracted services relating to PT3. Our regulator approved recovery of these costs over PT3 which ended on March 31, 2016.

FINANCIAL AND OPERATIONAL OVERVIEW

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

($ millions)	Years ended March 31 2016	2015	2014
Total revenue	869.8	841.1	800.2
% increase	*3.4%*	*5.1%*	*1.8%*
Operating expenses	744.2	722.5	714.3
Operating profit	125.6	118.6	85.9
Net finance and other	56.0	69.5	67.9
Net earnings	69.6	49.1	18.0
Other comprehensive loss	23.8	10.0	4.9
Total comprehensive income	45.8	39.1	13.1
	As at March 31		
Total assets	1,899.3	1,856.6	1,885.2
Total long-term financial liabilities	1,281.0	1,305.5	1,127.3
Dividends on preferred shares	6.0	6.0	6.0

Net earnings in fiscal 2016 were $20.5 million higher, than in fiscal 2015. The increase in fiscal 2016 net earnings compared to fiscal 2015 net earnings, is due primarily to higher revenues, lower financing costs and lower impairment costs, partially offset by higher asset depreciation and higher operating expenses.

The fiscal 2015 net earnings also included a one-time adjustment of $3.9 million in taxes and $0.2 million in interest recoverable from Canada Revenue Agency (“CRA”). The CRA audited the period April 2003 through June 2005 and denied certain input tax credits (“ITCs”) that we had claimed. A judgement from the Tax Court of Canada was issued October 14, 2014, in which we were successful in our claim that our method for calculating ITCs for our vessel operating costs was fair and reasonable.

Our total comprehensive income in fiscal 2016 was $6.7 million higher, than in fiscal 2015. The other comprehensive loss of $23.8 million in fiscal 2016 reflects a $24.2 million loss for the change in the fair value of our fuel swap contracts, partially offset by a $0.4 million gain on the revaluation of our land.

Our total comprehensive income was $26.0 million higher, and net earnings were $31.1 million higher in fiscal 2015, than in fiscal 2014. The increase in fiscal 2015 net earnings compared to fiscal 2014 net earnings, reflects higher revenues and lower financing costs, partially offset by higher asset depreciation and impairment costs. The increase in fiscal 2015 net earnings also includes $4.1 million in taxes and interest recoverable from CRA as discussed above. The other comprehensive loss of $10.0 million in fiscal 2015 reflects a $4.5 million loss for the change in the fair value of our fuel swap contracts, a $2.9 million loss on the actuarial valuation of our retirement and death benefit plans, a $2.4 million loss on interest forward contracts related to our April 28, 2014 issuance of $200 million of senior secured bonds, and a $0.2 million loss on the revaluation of our land.

Traffic

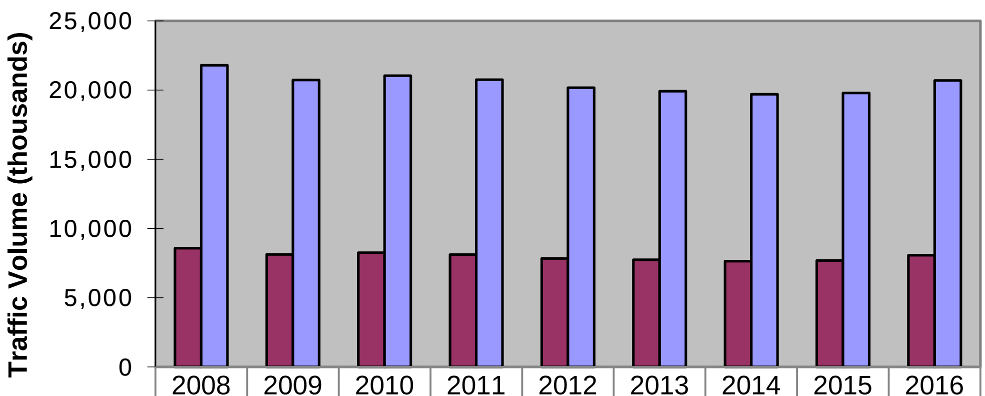
In fiscal 2016, we experienced a 4.9% increase in vehicle traffic and a 4.5% increase in passenger traffic compared to fiscal 2015. This increase returns us to traffic levels experienced in fiscal 2009.

Prior to fiscal 2009, our traffic levels were relatively stable. However, the long-term traffic trend-line shifted significantly during fiscal 2009, when vehicle and passenger traffic were lower than the prior year by 5.2% and 4.9%, respectively. In fiscal 2009, the Canadian and world economies experienced turbulence in the financial markets, followed by a lengthy period of economic uncertainty and low economic growth. These economic conditions negatively impacted our commercial and discretionary travel markets. In fiscal years 2010 through 2014, we experienced a general decline in traffic due in part to these continuing economic conditions. In fiscal 2015, we experienced a 0.6% increase in vehicle traffic and a 0.5% increase in passenger traffic compared to fiscal 2014.

In fiscal 2016, traffic was favourably impacted by lower fuel prices, the lower Canadian dollar, and our promotional fare incentives. Throughout fiscal 2016 there was a general increase in tourism and other economic activity in British Columbia which contributed positively to ferry passenger and vehicle traffic. In addition, we offered a variety of pricing promotions. We believe that these pricing promotions played a part in shifting some discretionary traffic to off-peak sailings, resulting in higher capacity utilization and, to a small degree, an increase in traffic compared to the prior year. The promotions are described in the following Major, Northern and Other Route sections.

In fiscal 2016, traffic levels were also positively impacted by the Easter holiday, with two Easter holiday weekends falling in fiscal 2016 compared to one in fiscal 2015, and a partial recovery of BC seniors travelling Mondays to Thursdays on our Major and regulated Other Routes. In fiscal 2015, there was a small negative impact on traffic levels resulting from a reduction in seniors travel owing to the lower passenger fare discount for BC seniors travelling Mondays to Thursdays on our Major and regulated Other Routes effective April 1, 2014.

The following graph illustrates our annual vehicle and passenger traffic levels from fiscal 2008 through fiscal 2016:



	2008	2009	2010	2011	2012	2013	2014	2015	2016
Vehicles	8,579	8,130	8,255	8,120	7,838	7,749	7,644	7,691	8,069
Passengers	21,788	20,727	21,036	20,746	20,170	19,919	19,697	19,796	20,689

Cost Containment
We continue to take proactive measures to contain and manage our expenses as prudently as possible without compromising safe operations.

These measures were recognized by the Commissioner in his report on the Performance Review of the Efficiency of BC Ferries released March 18, 2015. The report included an assessment of the efficiency of operating, maintenance, administration costs, labour costs and the organizational design. The significant report findings conclude that we are demonstrating good cost control while obtaining good outcomes with customer satisfaction and passenger and employee safety and that we appear to have a strong culture of efficiency. The report concludes that the financial and management controls and processes addressing planning, budgeting, reporting and internal controls appear to be appropriate.

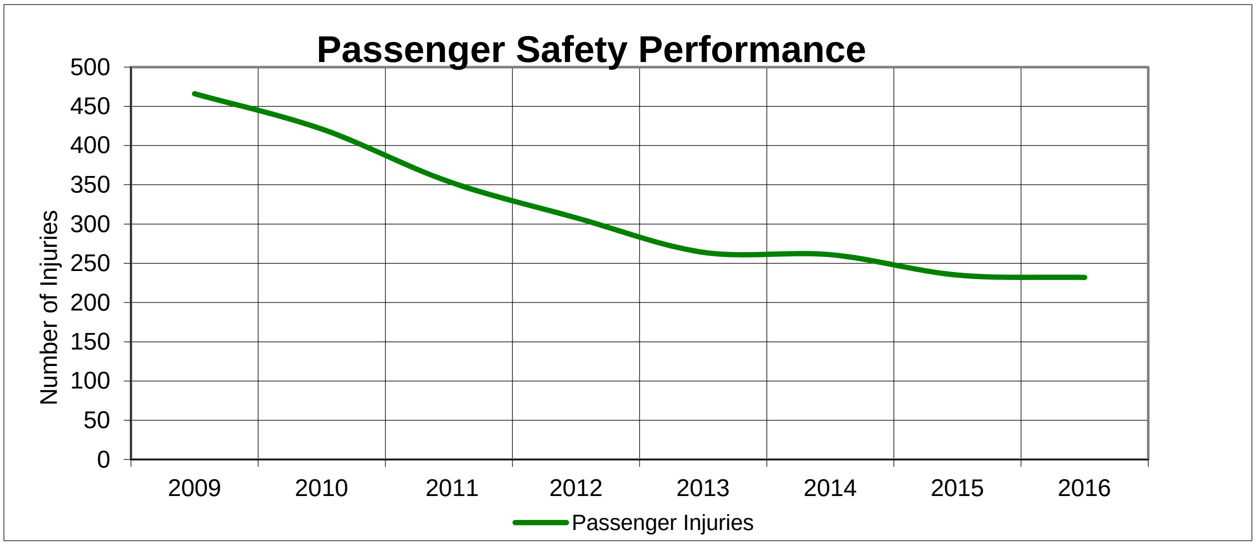
Service level adjustments completed in fiscal 2015 have generated savings in fuel and labour and we continue to benefit from these changes. We reviewed opportunities for further service level reductions of $4.9 million on three of the Major Routes and determined that the economics of further reductions were no longer favorable; however we remain committed to saving this through other efficiencies, including cost containment. In addition to the savings of $4.9 million per year, the PT4 price caps incorporate an additional productivity improvement of $2.0 million per year, resulting in a total efficiency target for PT4 of $27.6 million.

We continue to strive to ensure services are provided in a safe, cost effective and sustainable manner. Our new cable ferry, the *Baynes Sound Connector*, commenced regularly scheduled service in the last quarter of fiscal 2016. We expect the cable ferry will provide significant cost savings over the next 40 years as it services the route.

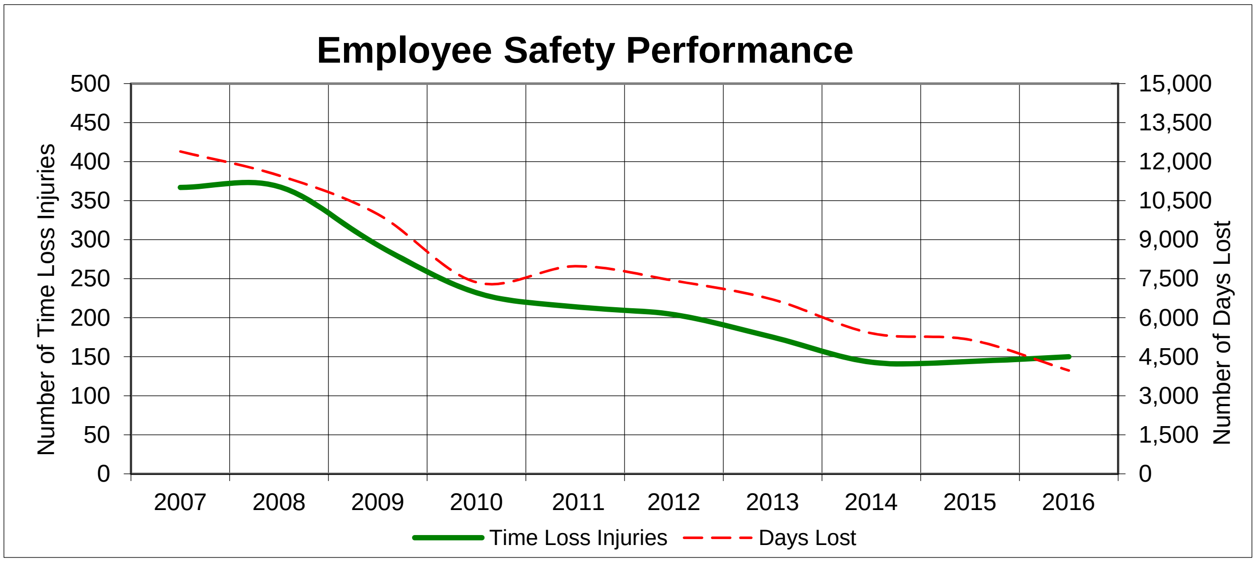
Labour Relations -
Collective Agreement
The majority of our employees are members of the Union. On December 18, 2015, we announced the ratification of a Memorandum of Agreement that was reached on October 30, 2015 with the Union. The settlement took several months of extensive negotiations and was achieved before the October 31, 2015 expiration of the previous Collective Agreement. This agreement provides certainty for our employees, helps ensure uninterrupted ferry service for our customers and marks 17 years of labour stability. The terms of the new Collective Agreement provide for wage increases aggregating 8.55% over the five-year term of the agreement ending October 31, 2020, which is a 1.71% increase on average per year.

Safety
Over the past ten years, we have invested heavily in workplace and operational safety, including launching our SailSafe program, introducing new bridge protocols and simulator training, implementing the Standardized Education and Assessment ("SEA") program, establishing an Operations and Security Centre ("OSC"), developing a comprehensive heavy weather policy for ships and terminals, installing voyage data recorders on all vessels and implementing real life operational readiness exercises.

Our investments in safety and security have yielded significant and positive results. Injuries to passengers continue to decline. In fiscal 2016, we carried 20.7 million passengers and had a 1.3% decrease in passenger injuries compared to fiscal 2015; our total passenger injuries were 232 for the fiscal year. Since 2009, the number of injuries to passengers has been reduced by half. The results for fiscal years 2009 through 2016 are below:



Time loss injuries to employees increased from 144 in fiscal 2015 to 150 in fiscal 2016. Over the last ten years, the number of time loss injuries we experience each year has dropped from over 360 to 150 and the number of days lost due to injury has declined from over 12,000 per year to under 4,000 per year. The results for fiscal 2007 through fiscal 2016 are below:



Our 24-hour OSC officially began operations in 2009 and is a central location for monitoring day-to-day operations and providing incident management support. The primary purpose of the OSC is to collect information from throughout the company, and to provide enhanced situational awareness and assessments, increased security monitoring and a coordinated response during any incidents.

Our SailSafe program, which is designed to achieve world class safety performance, is in the sustainment phase. It transitioned at the beginning of fiscal 2013, from the implementation of a safety program to embodying safety as a normal part of all business activities and an integral part of our culture. SailSafe is driven by our employees who play a vital part in identifying areas and methods for enhancing current safety practices. In addition to their normal duties, over 400 employees are also SailSafe champions and are engaged in identifying areas for improvement, developing plans and implementing new or revised processes. We continue to ensure safety becomes completely ingrained in every activity undertaken, every day, throughout our business.

Specific areas of focus remain:

- Renewing awareness of our processes for reporting safety learning events;
- Researching, understanding and addressing the impact of fatigue on our employees;
- Ensuring operational safety drills that are as realistic as possible to hone employee skills in a practical manner; and
- Maintaining a Health & Wellness team to focus on the wellbeing of all employees.

We received the Certificate of Recognition ("COR") from WorkSafeBC in fiscal 2014. A COR recognizes companies that go beyond the legal requirements of the *Workers' Compensation Act* and the Occupational Health & Safety Regulations by taking a best practices approach to implementing health, safety and return to work programs. In fiscal 2015, the COR audit resulted in a combined score of 94.1% and in fiscal 2016, the COR audit resulted in a 96% score in Health and Safety and 92% in Injury Management for a combined score of 95.7%. In fiscal 2014 and 2015, WorkSafeBC provided us with a rebate on each of our 2013 and 2014 assessed premiums of approximately $600,000 and we expect to receive a similar rebate on our 2015 assessed premiums as a result of the audit.

Training

Each year we invest heavily in operational and safety training. In fiscal 2016, we conducted 7,820 personal training days ("PTDs") of operational training, an increase of 7.9% compared to the prior year. Operational training focused on several programs including confined space entry, hazardous materials, and oil spill response.

In fiscal 2016, our SEA program delivered 12,209 PTDs, an increase of 37.9% PTDs over fiscal 2015. Our SEA program leverages technology and e-learning to enhance hands-on training in a phased, auditable and sustainable manner. This program is an innovative, award-winning approach that is transforming training in the marine industry through the use of technology. Since inception of the SEA project, programs have been developed for 35 operational positions identified for SEA training. The job positions specific to the new cable ferry and Salish Class vessels have also been created within our SEA training program. SEA is continuing to develop and now has a pilot underway for a career navigator system which will assist in planning and tracking employee career progression and succession.

A comprehensive training plan for familiarization with the new equipment on the Salish Class vessels is nearing completion. This plan includes LNG training, manufacturer's equipment training and SEA and operational training for all employees working on a Salish Class vessel. A web-based LNG safety awareness program provided all employees involved with the Salish Class vessels with additional advanced LNG training for deck and engineering crews.

Our Simulation Training Centre ("STC") signature course is Bridge Operations Skills and Systems ("BOSS") 2, for which we received a Lloyd's List Safety Training award for outstanding commitment in training our employees ashore and at sea. STC has received facility and program accreditation with DNV GL, one of the leading classification societies and a global leader in maritime education and training accreditation. BOSS 2 focuses on gaining, maintaining and enhancing shared bridge team situational awareness. BOSS 2 includes a blended approach of simulation and classroom learning over three days and culminates in a team assessment to assist with students' learning transfer back to the fleet. The curriculum developed for BOSS 3 focuses on decision making.

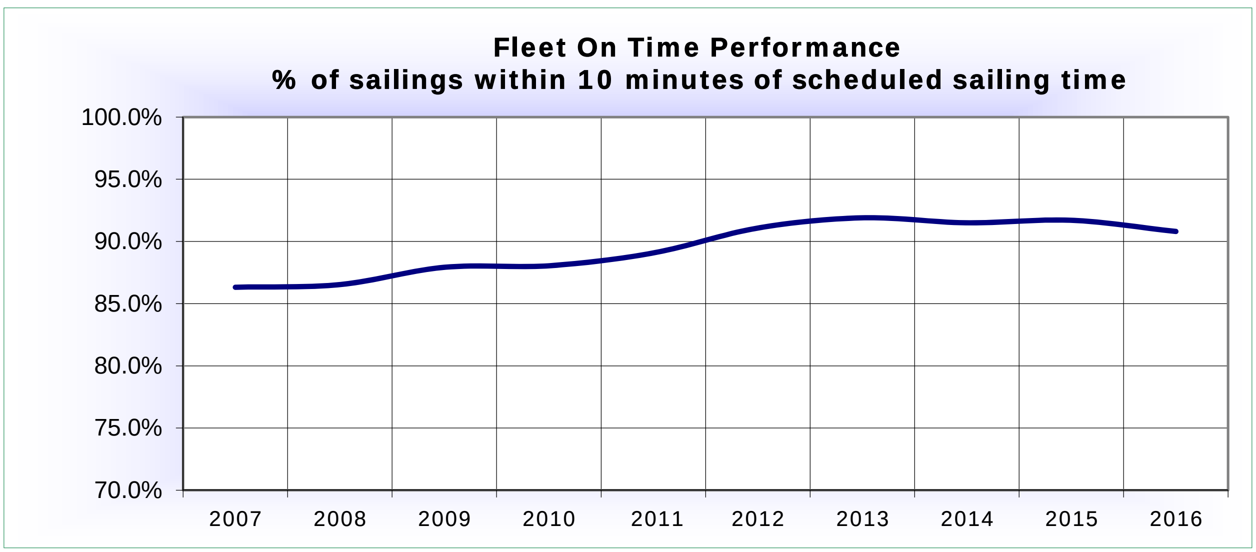
By the end of fiscal 2016, through our STC training program, we had delivered BOSS 2 to 56% and BOSS 3 to 10% of deck officers in the fleet. We expect that all deck officers will have completed BOSS 2 by the end of 2018.

During fiscal 2016, we also designed and delivered training to employees working on our new cable ferry.

Customer Service

In fiscal 2016, our on-time performance rate was 90.8% with a fleet reliability score of 99.72%. This reliability score means that only 0.3% of sailings in fiscal 2016 were cancelled due to mechanical issues related to the vessels or terminals, or crew availability. Our 2015 Customer Service Satisfaction Tracking Surveys indicated that 87% of customers surveyed (compared to 85% in 2014) reported being satisfied with their overall trip experience. A copy of the full report is available at http://www.bcferries.com/about/cst_archive.html.

The on-time performance results for fiscal 2007 through fiscal 2016 are below:



We have been engaging with ferry dependent communities since 1993 and continue to work closely with 13 ferry advisory committees that represent the communities we serve. These committees are appointed in cooperation with local governments, the Islands Trust and First Nations and discuss day-to-day operations, planned improvements, broader policy issues and strategic planning.

We consulted with stakeholders during the decision-making process leading to the acquisition of the three new Salish Class vessels. Feedback and operational experience were incorporated into the design of the vessels to ensure high levels of safety, customer service, environmental leadership and reliability.

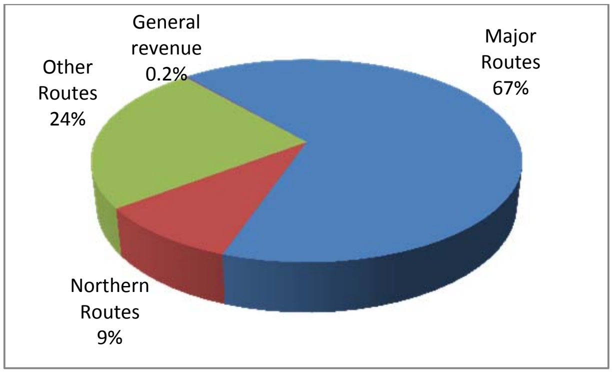
We will engage with stakeholders to improve service and better align customer needs with sailing schedules as well as balance seasonal service, capacity and demand with operating efficiencies through the use of surveys, open houses, public meetings, community working groups, ferry advisory committees and meetings with community leaders.

In the past year we established a new strategic planning and community engagement function to build a long-term vision which incorporates customer service and environmental, operational, financial and community goals. Our strategic planning process captures internal and external factors as well as direct input from our community engagement processes.

Revenue

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

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



In fiscal 2016, the greatest portion of our revenues, 67%, was earned on our Major Routes. The revenue from the Northern Routes contributed 9% and revenue from Other Routes contributed 24%.

Operational Statistics	2016	2015	2014
Vehicle traffic	8,069,489	7,690,914	7,644,344
% increase (decrease)	4.9%	0.6%	(1.3%)
Passenger traffic	20,689,087	19,796,022	19,696,710
% increase (decrease)	4.5%	0.5%	(1.1%)
On-time performance	90.8%	91.7%	91.5%
Number of round trips	76,871.5	77,433.0	83,972.0
Capacity provided (AEQs)	16,919,811	16,819,072	17,394,237
AEQs carried	9,152,873	8,735,828	8,675,549
Capacity utilization	54.1%	51.9%	49.9%

In fiscal 2015, we experienced a modest increase in traffic compared to the prior year. Throughout the year, traffic levels experienced a slight negative impact due to a reduction in seniors travel related to the April 1, 2014 lower passenger fare discount for BC seniors travelling Mondays to Thursdays on the Major and regulated Other Routes (see below), the service level adjustments mainly on the Northern and Other Routes as well as the reduction in travel resulting from the teachers' labour dispute. This negative impact was offset by a significant increase in traffic in the last two months of fiscal 2015, due to favourable weather, lower fuel prices and the lower Canadian dollar.

In fiscal 2016, vehicle and passenger traffic increased 4.9% and 4.5%, respectively, compared to fiscal 2015. Traffic was favourably impacted by lower fuel prices, the lower Canadian dollar, a general increase in tourism and economic activity in BC and our promotional fare incentives. Traffic was also positively impacted by the Easter holiday, with two Easter holiday weekends falling in fiscal 2016 compared to one in fiscal 2015.

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

Throughout fiscal 2016 we offered a variety of pricing promotions. These pricing promotions, normalized for traffic growth and tariff increases, had a net cost of approximately $4.4 million. We believe that discounts to passenger fares had a positive impact on both passenger and vehicle traffic. We also believe that these pricing promotions played a part in shifting some discretionary traffic to off-peak sailings, resulting in higher capacity utilization and, to a small degree, an increase in traffic compared to the prior year. There are indicators that suggest incremental traffic was generated on promotional sailings, and to a lesser amount, on non-promotional sailings. This may have been due to travelers using a promotional sailing in one direction and a non-promotional sailing on the return trip. The promotions are described in the following Major, Northern and Other Route sections.

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. In each case, 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 in a safe and reliable manner is an important factor in our focus on on-time performance. In fiscal 2015, on-time performance was flat to fiscal 2014. In fiscal 2016 on-time performance decreased by 0.9% compared to the prior year, primarily due to the impact from increased traffic demand and delays due to weather.

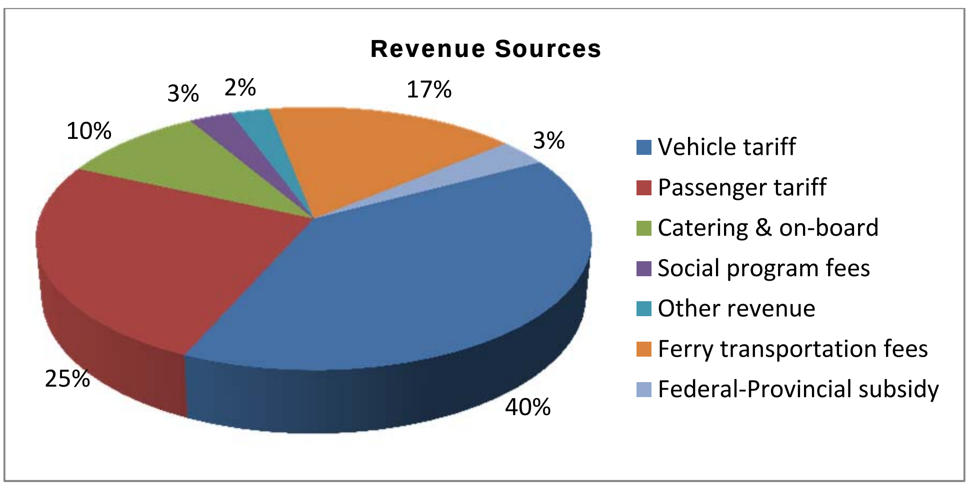
Minimum crewing levels are set by Transport Canada and these levels determine our maximum allowable passenger capacity for each sailing. Passengers are counted as they arrive for a sailing, both as a walk-on and by vehicle, to ensure we do not exceed the maximum allowable passenger capacity.

Vehicle capacity provided, measured in automobile equivalents ("AEQs"), is the available vehicle deck 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 minimum number of round trips to be provided for each regulated ferry service route. The number of round trips provided can be positively or negatively 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. In fiscal 2015, the reduction in round trips and the resulting decrease in capacity compared to the prior year were 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 regulated Other Routes. In fiscal 2016, we provided 76,871.5 round trips, 561.5 less than in fiscal 2015. The reduction in round trips is mainly due to the timing of implementation of the Province's service level adjustments on our regulated Other Routes. Most service level adjustments on the regulated Other Routes were not implemented until April 28, 2014, in the first quarter of fiscal 2015. Although the total number of round trips decreased, the number of round trips on the Major Routes increased, resulting in an overall increase in capacity in fiscal 2016 compared to fiscal 2015.

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 mix of vehicle types and actual size 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. In fiscal 2015, capacity utilization increased 2.0% compared to the prior year as a result of an increase in AEQs carried due to increased traffic levels and a decrease in capacity provided. In fiscal 2016, capacity utilization increased 2.2% compared to fiscal 2015 as a result of an increase in AEQs carried due to increased traffic levels partially offset by an increase in capacity provided due to the variation in the size of vessels utilized.

Revenue ($ millions)	**Years ended March 31**		
	2016	**2015**	**2014**
Direct Route Revenue			
Vehicle tariff	342.8	315.7	303.7
Passenger tariff	218.4	204.3	185.6
Fuel (rebates) surcharges	(6.4)	13.2	2.7
Catering & on-board	84.9	78.3	76.8
Social program fees	25.0	23.5	30.7
Reservation fees	18.1	14.5	13.4
Other revenue	9.0	8.7	7.9
Total Direct Route Revenue	691.8	658.2	620.8
Indirect Route Revenue			
Ferry transportation fees	147.4	152.4	149.4
Federal-Provincial subsidy	28.7	28.4	28.4
Total Route Revenue	867.9	839.0	798.6
Other general revenue	1.9	2.1	1.6
Total Revenue	869.8	841.1	800.2



Vehicle and passenger tariffs account for the majority (65%) of our revenues. Our year over year tariff revenues may be impacted by such things as changes in overall traffic levels, tariffs and the proportion of total traffic on routes with higher versus lower tariffs. Catering and on-board services account for 10% of our total revenues and is a growth sector. Catering, retail and other on-board services are impacted by traffic, price, service quality and product offerings and provide a gross margin of approximately 60%.

On April 1, 2014 and on April 1, 2015, we implemented tariff increases in accordance with the Commissioner's Order 12-02 dated September 30, 2012. On April 1, 2015, 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 and capital replacement costs.

Effective April 1, 2014, we implemented the Province's decision to amend its program to reduce the passenger fare discount for BC seniors travelling Mondays through Thursdays from 100% to 50% on the Major and regulated Other Routes. There continues to be no discount for BC seniors travelling Friday through Sunday. 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 were not required for the reimbursement of discounts provided to BC seniors under the amended policy, the excess was directed to the ferry transportation fees and allocated to the regulated Northern and Other Routes. Since the implementation of this policy change, travel by BC seniors Mondays through Thursdays decreased 12% in fiscal 2015 from fiscal 2014 and increased 7% in fiscal 2016 from fiscal 2015.

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 partially mitigated the impact of the tariff increase. On April 1, 2016, the fuel rebate on our Major and regulated Other Routes was increased by 1.9%, from 1% to 2.9% due to fuel prices remaining low, coupled with the fact that we have, through our fuel hedging program, locked in pricing for a significant portion of our forecast fuel consumption to the end of 2017. Also, on April 1, 2016, a fuel rebate was implemented for the first time on the Northern Routes. The 1.9% fuel rebate on the Northern Routes and the 1.9% rebate increase on the Major and regulated Other Routes completely offset the 1.9% average tariff increase. In fiscal 2015, fuel surcharges of 3.4% on average were in place from April 1, 2014 to December 17, 2014 on our Major Routes and our regulated Other Routes. Prior to April 1, 2016, no surcharges or rebates were in place on our Northern Routes. A history of fuel surcharges in effect for fiscal 2014 through to the current date is below:

Date range	% surcharge (rebate)	Applicable routes
April 1, 2013 – January 16, 2014	0.0%	All regulated routes
January 17, 2014 – December 17, 2014	3.5%	Major and regulated Other Routes
December 18, 2014 – March 31, 2015	0.0%	All regulated routes
April 1, 2015 – March 31, 2016	(1.0%)	Major and regulated Other Routes
April 1, 2016 -	(2.9%)	Major and regulated Other Routes
April 1, 2016 -	(1.9%)	Northern Routes

For the purpose of rate regulation, surcharges and/or rebates are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" for more detail.)

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

Year to Year Comparison of Revenues and Operational Statistics 2016 – 2015

Major Routes

Our Major Routes consist of three regulated routes connecting Metro Vancouver with mid and southern Vancouver Island and our regulated route connecting Horseshoe Bay and Langdale. These are our four busiest routes, carrying approximately 60% of our vehicle traffic and 65% of our passenger traffic during fiscal 2014 through fiscal 2016.

Operational Statistics	2016	2015	Increase (Decrease)
Vehicle traffic 5.3% increase	4,848,721	4,603,748	244,973
Passenger traffic 4.9% increase	13,449,358	12,818,963	630,395
On-time performance	80.7%	83.1%	(2.4%)
Number of round trips	12,681.5	12,542.0	139.5
Capacity provided (AEQs)	9,094,852	8,997,380	97,472
AEQs carried	5,707,424	5,433,864	273,560
Capacity utilization	62.8%	60.4%	2.4%

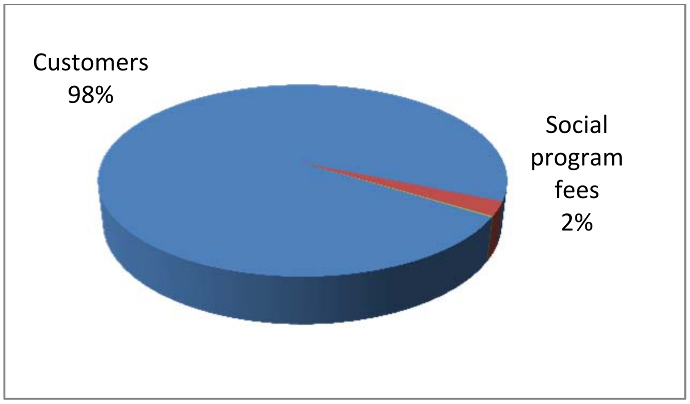
In fiscal 2016, vehicle traffic increased 5.3% and passenger traffic increased 4.9% compared to the prior year. Traffic was favourably impacted by lower fuel prices, the lower Canadian dollar and our fare discounts on under-utilized sailings. Traffic was also positively impacted by the Easter holiday, with two Easter holiday weekends falling in fiscal 2016 compared to one in fiscal 2015. Overall, commercial traffic increased by 2.7% in the year, while drop-trailer, a component of total commercial traffic, increased 2.8% in the year. Our drop-trailer service is available on two of our Major Routes, where commercial customers can drop their trailers off at one terminal and pick them up at the other with our drivers loading and unloading the commercial trailers on and off the ferry with a hostling unit.

From mid-November to mid-December 2015, we offered a 50% vehicle fare discount; through mid-September to mid-October 2015 we offered a 50% passenger fare discount; and for approximately three weeks in March, which covered spring break and the Easter long weekend, we offered a 30% passenger fare discount. We believe that these pricing promotions, offered on under-utilized sailings, played a part in shifting some discretionary traffic to off-peak sailings, and, to a small degree, to an increase in traffic compared to the same periods in the prior year.

In fiscal 2016, on-time performance decreased by 2.4% compared to the prior year, primarily due to the impact of the significant traffic increase and delays due to weather.

Capacity utilization on these routes increased by 2.4% in fiscal 2016 compared to the prior year as a result of a higher number of AEQs carried due to higher traffic levels, partially offset by an increase in capacity provided from additional round trips.

Major Routes cont'd



Fiscal 2016 revenue from our Major Routes consisted of 98% from customers and 2% in social program fees from the Province.

Revenue ($ thousands)	**Years ended March 31**			
	2016	**2015**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	287,178	264,411	22,767	8.6%
Passenger tariff	177,571	165,861	11,710	7.1%
Fuel (rebates) surcharges	(5,295)	11,034	(16,329)	(148.0%)
Catering & on-board	76,959	70,874	6,085	8.6%
Social program fees	14,108	13,160	948	7.2%
Reservation fees	17,730	14,226	3,504	24.6%
Parking	4,816	4,569	247	5.4%
Other revenue	3,620	3,667	(47)	(1.3%)
Total Direct Route Revenue	576,687	547,802	28,885	5.3%
Indirect Route Revenue				
Ferry transportation fees	945	999	(54)	(5.4%)
Total Route Revenue	577,632	548,801	28,831	5.3%

Average tariff ($)	**Years ended March 31**		
	2016	**2015**	**Increase**
Vehicle tariff ($000's)	287,178	264,411	
Vehicle traffic	4,848,721	4,603,748	
Average tariff per vehicle	59.23	57.43	1.80
Passenger tariff ($000's)	177,571	165,861	
Passenger traffic	13,449,358	12,818,963	
Average tariff per passenger	13.20	12.94	0.26

In fiscal 2016, average tariff revenue per vehicle increased $1.80 or 3.1% and average tariff revenue per passenger increased $0.26 or 2.0% compared to the prior year. The increase in average tariff revenues in fiscal 2016 reflects the price cap increases authorized by the Commissioner, partially offset by the impact of our fare discounts on under-utilized sailings. The increase in both traffic levels and in average tariffs during fiscal 2016 resulted in a tariff revenue increase of $34.5 million.

Major Routes cont'd

On April 1, 2015, due to lower fuel prices and successfully locking in pricing for a significant portion of our forecast fuel consumption to the end of 2017, a fuel rebate of 1% was implemented on our Major Routes. This rebate partially mitigated the impact of the tariff increase. In fiscal 2015, fuel surcharges of 3.4% on average were in place from April 1, 2014 to December 17, 2014 on our Major Routes. 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 fiscal 2016, catering and on-board sales increased 8.6% compared to 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 approximately 11% 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%. In fiscal 2015, we experienced a decrease of 15% in the number of seniors using the program. In fiscal 2016, the number of seniors using the program increased by 4.3%. Social program fees increased $0.9 million in fiscal 2016 compared to the prior year mainly as a result of more seniors and students travelling and an increase in the number of people using the MTAP program.

Reservation fee revenue increased $3.5 million or 24.6% in fiscal 2016 compared to the prior year as a result of higher traffic levels and a greater percentage of customers reserving space.

Revenue from parking increased $0.2 million or 5.4% in fiscal 2016 compared to the prior year mainly as a result of higher traffic levels.

Other revenue decreased mainly as a result of a decrease in retail commissions, primarily from the reduced sale of magazines, partially offset by increases in retail space rental revenues.

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.

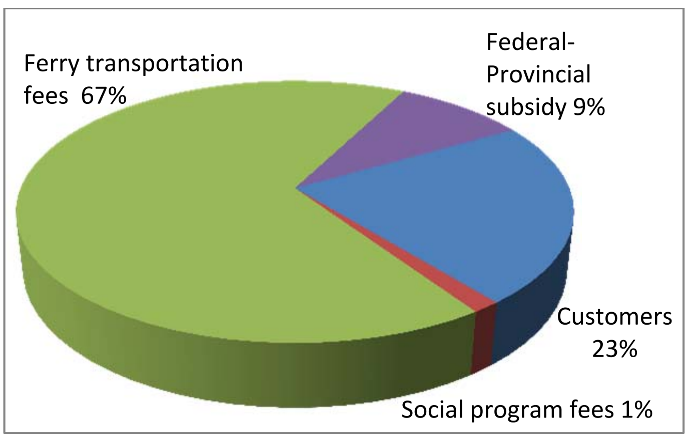
Operational Statistics	2016	2015	Increase (Decrease)
Vehicle traffic	29,101	26,642	2,459
9.2% increase			
Passenger traffic	80,868	75,108	5,760
7.7 % increase			
On-time performance	91.0%	90.0%	1.0%
Number of round trips	227	227	-
Capacity provided (AEQs)	61,471	61,870	(399)
AEQs carried	35,449	32,741	2,708
Capacity utilization	57.7%	52.9%	4.8%

In fiscal 2016, vehicle traffic increased 9.2% and passenger traffic increased 7.7% compared to the prior year. Traffic was favourably impacted by lower fuel prices, the lower Canadian dollar and our fare discounts.

From mid-November to mid-December 2015, we offered a 50% vehicle fare discount; throughout the month of October 2015 we offered a 50% passenger fare discount; and for approximately three weeks in March, which covered spring break and the Easter long weekend, we offered a 30% passenger fare discount. We believe that these pricing promotions which were applied to all sailings, contributed, to a small degree, to an increase in both vehicle and passenger traffic compared to the same periods in the prior year.

On-time performance improved by 1.0% in fiscal 2016 compared to the prior year mainly as a result of schedule changes which allowed for operational efficiencies at the terminals.

Capacity utilization on these routes for fiscal 2016 was 4.8% higher than the prior year mainly as a result of a higher number of AEQs carried due to higher traffic levels.



Fiscal 2016 revenue from our Northern Routes consisted of 23% from customers and 77% from the Province (1% social program fees, 67% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

Northern Routes cont'd

Revenue ($ thousands)	**Years ended March 31**			
	2016	**2015**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	7,918	7,505	413	5.5%
Passenger tariff	6,664	6,265	399	6.4%
Catering & on-board	2,091	1,927	164	8.5%
Social program fees	1,151	1,052	99	9.4%
Stateroom rental	1,390	1,289	101	7.8%
Hostling & other	233	235	(2)	(0.9%)
Total Direct Route Revenue	19,447	18,273	1,174	6.4%
Indirect Route Revenue				
Ferry transportation fees	54,633	57,426	(2,793)	(4.9%)
Federal-Provincial subsidy	7,372	7,275	97	1.3%
Total Route Revenue	81,452	82,974	(1,522)	(1.8%)

Average tariff ($)	**Years ended March 31**		
	2016	**2015**	**Decrease**
Vehicle tariff ($000's)	7,918	7,505	
Vehicle traffic	29,101	26,642	
Average tariff per vehicle	272.09	281.70	9.61
Passenger tariff ($000's)	6,664	6,265	
Passenger traffic	80,868	75,108	
Average tariff per passenger	82.41	83.41	1.00

In fiscal 2016, average tariff revenue per vehicle decreased $9.61 or 3.4% and average tariff revenue per passenger decreased $1.00 or 1.2% compared to the prior year. Average tariff revenues reflect a change in the proportion of traffic on routes with lower versus higher tariffs, the price cap increase authorized by the Commissioner and the impact of our fare discounts in the last two quarters of fiscal 2016. The increase in traffic levels, partially offset by the decrease in average fares, resulted in a total tariff revenue increase of $0.8 million during fiscal 2016 compared to the prior year.

There were no fuel surcharges or rebates in place on our Northern Routes during fiscal 2016 or fiscal 2015.

Reimbursements from the Province for social program fees increased primarily 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 8.5% in fiscal 2016 compared to the prior year as a result of higher passenger levels and higher average sales per passenger.

Revenue from stateroom rental increased 7.8%, primarily due to higher sales attributable to higher passenger levels.

Northern Routes cont'd

Ferry transportation fees received from the Province were $2.8 million lower than the prior year as a result of the following:

- $1.8 million decrease resulting from a reduction in the total annual ferry transportation fees and
- $1.4 million decrease 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);

partially offset by:

- $0.4 million increase in respect of BC senior discounts.

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

Other Routes

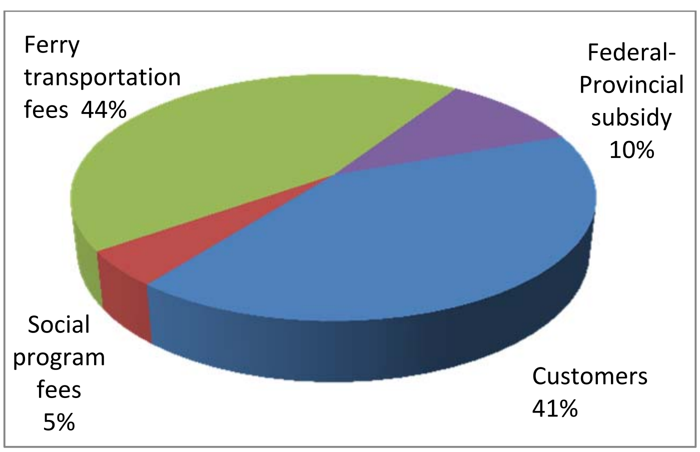
Our Other Routes consist of 18 regulated routes and 8 small unregulated routes primarily serving the northern and southern Gulf Islands and the northern Sunshine Coast. One of the regulated routes and all of the unregulated routes are operated under contract by alternative service providers. We receive fees from the Province for the provision of contracted services on these routes, which are included in the ferry transportation fees below. Operational statistics for the unregulated routes are not incorporated in the following analysis.

Operational Statistics	2016	2015	Increase (Decrease)
Vehicle traffic	3,191,667	3,060,524	131,143
4.3% increase			
Passenger traffic	7,158,861	6,901,951	256,910
3.7% increase			
On-time performance	92.6%	93.2%	(0.6%)
Number of round trips	63,963	64,664	(701.0)
Capacity provided (AEQs)	7,763,488	7,759,822	3,666
AEQs carried	3,410,000	3,269,223	140,777
Capacity utilization	43.9%	42.1%	1.8%

In fiscal 2016, vehicle traffic increased 4.3% and passenger traffic increased 3.7% compared to the prior year. Traffic was favourably impacted by lower fuel prices, the lower Canadian dollar and the impact of our fare discounts on under-utilized sailings.

From mid-November to mid-December 2015, we offered a 50% vehicle fare discount; through mid-September to mid-October 2015 we offered a 50% passenger fare discount; and for approximately three weeks in March, which covered spring break and the Easter long weekend, we offered a 30% passenger fare discount. We believe that these pricing promotions, offered on under-utilized sailings, played a part in shifting some discretionary traffic to off-peak sailings and contributed, to a small degree, to an increase in traffic compared to the same periods in the prior year.

Capacity utilization in fiscal 2016 increased 1.8% compared to the prior year as a result of a higher number of AEQs carried due to higher traffic levels and a reduction in the number of round trips in the first quarter of fiscal 2016 as a result of Provincial service level adjustments.



Fiscal 2016 revenue from our Other Routes consisted of 41% from customers and 59% from the Province (5% social program fees, 44% ferry transportation fees, and 10% from payments under the Federal-Provincial subsidy agreement).

Other Routes cont'd

Revenue ($ thousands)	**Years ended March 31**			
	2016	**2015**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	47,715	43,817	3,898	8.9%
Passenger tariff	34,187	32,132	2,055	6.4%
Fuel (rebates) surcharges	(1,062)	2,161	(3,223)	(149.1%)
Social program fees	9,765	9,246	519	5.6%
Catering & on-board	4,451	4,212	239	5.7%
Reservation fees	310	249	61	24.5%
Parking & other	315	302	13	4.3%
Total Direct Route Revenue	95,681	92,119	3,562	3.9%
Indirect Route Revenue				
Ferry transportation fees	91,770	94,053	(2,283)	(2.4%)
Federal-Provincial subsidy	21,358	21,080	278	1.3%
Total Route Revenue	208,809	207,252	1,557	0.8%

Average tariff ($)	**Years ended March 31**		
	2016	**2015**	**Increase**
Vehicle tariff ($000's)	47,715	43,817	
Vehicle traffic	3,191,667	3,060,524	
Average tariff per vehicle	14.95	14.32	0.63
Passenger tariff ($000's)	34,187	32,132	
Passenger traffic	7,158,861	6,901,951	
Average tariff per passenger	4.78	4.66	0.12

In fiscal 2016, the average tariff revenue per vehicle increased $0.63 or 4.4% and average tariff revenue per passenger increased $0.12 or 2.6% compared to the prior year. On the majority of these routes, the average tariff per vehicle and passenger is calculated on a round trip basis. The increase in average tariff revenues reflects the price cap increase authorized by the Commissioner and a change in the proportion of traffic on routes with higher versus lower tariffs, partially offset by the impact of our fare discounts on under-utilized sailings. The increase in both the traffic levels and the average fares resulted in a total tariff revenue increase of $6.0 million.

On April 1, 2015, due to lower fuel prices and successfully locking in pricing for a significant portion of our forecast fuel consumption to the end of 2017, a fuel rebate of 1% was implemented on our regulated Other Routes. This rebate partially mitigated the impact of the tariff increase. In fiscal 2015, fuel surcharges of 3.4% on average were in place from April 1, 2014 to December 17, 2014 on these routes. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" for more detail.)

Other Routes cont'd

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%. In fiscal 2015, we experienced a decrease of 8% in the number of seniors using the program. In fiscal 2016, the number of seniors using the program increased by 9%. Social program fees increased 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 $0.2 million compared to the prior year mainly as a result of higher passenger traffic.

Reservation revenue increased as a result of higher traffic levels and a greater percentage of customers reserving space.

Parking and other revenues increased mainly due to increased charter revenue, partially offset by lower commission from vendors.

Ferry transportation fees received from the Province decreased $2.3 million compared to the prior year as a result of the following:

- $2.9 million decrease resulting from a reduction in total annual ferry transportation fees as per the contract;

partially offset by:

- $0.6 million increase in respect of senior discounts.

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

Year to Year Comparison of Revenues and Operational Statistics 2015 – 2014

Major Routes

Operational Statistics	2015	2014	Increase (Decrease)
Vehicle traffic	4,603,748	4,556,839	46,909
1.0% increase			
Passenger traffic	12,818,963	12,708,731	110,232
0.9% increase			
On-time performance	83.1%	82.7%	0.4%
Number of round trips	12,542.0	12,543.0	(1.0)
Capacity provided (AEQs)	8,997,380	8,999,280	(1,900)
AEQs carried	5,433,864	5,380,708	53,156
Capacity utilization	60.4%	59.8%	0.6%

In fiscal 2015, vehicle traffic increased 1.0% and passenger traffic increased 0.9% compared to the prior year. In the last two months of the year, vehicle traffic was 7.0% higher and passenger traffic was 5.3% higher than the same period in the prior year. We believe this increase was partially due to lower gas prices, favourable weather in February and March 2015, and unfavourable weather in the same period in the prior year. The lower Canadian dollar and a general increase in tourism and economic activity may also have had a positive impact towards the latter part of the year. Traffic was also positively impacted by the Easter holiday, with two additional days of the holiday weekend in fiscal 2015 compared to fiscal 2014. Overall, commercial traffic increased by 0.2% in the year, while drop-trailer, a component of total commercial traffic, increased 10.0% in the year.

Revenue ($ thousands)	Years ended March 31			
	2015	**2014**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	264,411	253,707	10,704	4.2%
Passenger tariff	165,861	150,351	15,510	10.3%
Fuel surcharges	11,034	2,268	8,766	386.5%
Catering & on-board	70,874	69,500	1,374	2.0%
Social program fees	13,160	18,954	(5,794)	(30.6%)
Reservation fees	14,226	13,196	1,030	7.8%
Parking	4,569	4,217	352	8.3%
Other revenue	3,667	3,403	264	7.8%
Total Direct Route Revenue	547,802	515,596	32,206	6.2%
Indirect Route Revenue				
Ferry transportation fees	999	1,045	(46)	(4.4%)
Total Route Revenue	548,801	516,641	32,160	6.2%

Major Routes cont'd

In fiscal 2015, average tariff revenue per vehicle increased $1.75 or 3.1% and average tariff revenue per passenger increased $1.11 or 9.4% compared to the prior year. The increase in average tariff revenues in fiscal 2015 reflected the price cap increases authorized by the Commissioner. It also reflected the Province's reduction in passenger fare discounts for BC seniors travelling Mondays through Thursdays from 100% to 50%, effectively resulting in BC seniors paying a portion of their fares on these days. During this period, there was no discount for BC seniors travelling Friday through Sunday. Higher average fares and higher traffic resulted in an increase in tariff revenue of $26.2 million.

Fuel surcharges collected were $8.8 million higher than in the prior year. Fuel surcharges of 3.5% on average were in place for approximately nine months of fiscal 2015, while in fiscal 2014, surcharges of 3.5% on average were in place for less than three months. Surcharges were removed December 17, 2014 due to declining fuel prices and successfully locking in pricing for a significant portion of our forecast fuel consumption to the end of fiscal 2016. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts.

Catering and on-board sales increased 2.0% in fiscal 2015 compared to the prior year reflecting higher average sales per passenger and higher passenger traffic levels. Sales of travel accessories increased 25.9%, giftware increased 3.6% and quality apparel increased 1.8%. Sales of books, magazines and newspapers declined 6.8% compared to the prior year, following industry trends.

The $5.8 million reduction in social program fees consists of a $6.3 million reduction as a result of 15% fewer BC seniors travelling under the program, partially offset by an increase in the number of people using the MTAP program and higher fares in fiscal 2015 compared to the prior year. The reduction in BC seniors travelling under the program began in April 2014, when we implemented the Province's decision to amend its program to reduce the passenger fare discount for BC seniors travelling Mondays through Thursdays from 100% to 50%. There continued to be no discount for BC seniors travelling Friday through Sunday.

Reservation fee revenue increased $1.0 million or 7.8% in fiscal 2015 compared to the prior year, mainly as a result of a greater percentage of customers reserving space.

Revenue from parking increased $0.4 million or 8.3% in fiscal 2015 compared to the prior year as a result of higher passenger traffic levels and a higher percentage of passengers using our parking facilities.

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

Ferry transportation fees remained at a similar level to the prior year. For the purpose of rate regulation, the funds related to the import duty remission are applied to our deferred fuel cost accounts.

Northern Routes

Operational Statistics	2015	2014	Increase (Decrease)
Vehicle traffic	26,642	28,366	(1,724)
6.1% (decrease)			
Passenger traffic	75,108	81,100	(5,992)
7.4% (decrease)			
On-time performance	90.0%	91.6%	(1.6%)
Number of round trips	227	348	(121.0)
Capacity provided (AEQs)	61,870	83,450	(21,580)
AEQs carried	32,741	34,238	(1,497)
Capacity utilization	52.9%	41.0%	11.9%

Prior to fiscal 2015, our Northern Routes consisted of three regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island. Effective April 1, 2014, the shortest of these routes, which only operated during the summer months, was eliminated and service to the mid-coast destinations was significantly adjusted.

Revenue ($ thousands)	**Years ended March 31**			
	2015	**2014**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	7,505	8,126	(621)	(7.6%)
Passenger tariff	6,265	6,859	(594)	(8.7%)
Catering & on-board	1,927	2,064	(137)	(6.6%)
Social program fees	1,052	1,181	(129)	(10.9%)
Stateroom rental	1,289	1,259	30	2.4%
Hostling & other	235	227	8	3.5%
Total Direct Route Revenue	18,273	19,716	(1,443)	(7.3%)
Indirect Route Revenue				
Ferry transportation fees	57,426	58,039	(613)	(1.1%)
Federal-Provincial subsidy	7,275	7,280	(5)	(0.1%)
Total Route Revenue	82,974	85,035	(2,061)	(2.4%)

In fiscal 2015, average tariff revenue per vehicle decreased $4.77 or 1.7% and average tariff revenue per passenger decreased $1.16 or 1.4% compared to the prior year. Average tariff revenues reflected the price cap increases implemented April 1, 2014. We believe the reduction in average tariff was partially due to a higher proportionate share of traffic on the route with lower fares, primarily in the second quarter. The reduction in traffic levels and decrease in average fares resulted in a total tariff revenue decrease of $1.2 million during fiscal 2015 compared to the prior year.

There were no fuel surcharges or rebates in place on our Northern Routes during fiscal 2015 or fiscal 2014.

Northern Routes cont'd

Reimbursements from the Province for social program fees decreased primarily as a result of lower usage of the MTAP program and fewer students and fewer BC 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 by 6.6%, mainly as a result of lower traffic levels.

Stateroom rental increased by 2.4% primarily due to higher usage as a result of changes to the schedule, which contained a higher number of night sailings when our staterooms are in higher demand.

Hostling and other revenues increased as a result of increased use of hostling services.

Ferry transportation fees received from the Province were $0.6 million lower than the prior year as a result of the following:

- $3.8 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; and
- $0.5 million decrease in fees related to the price of fuel;

partially offset by:

- $3.7 million increase in ferry transportation fees to mitigate the impact of fewer BC seniors on the Major and Other Routes utilizing the Province's discount program for seniors. The Province provided a maximum increase in ferry transportation fees to what would have been paid if there had been no change in the level of senior discounts on the Major and Other Routes. To the extent these funds were not required for the reimbursement of discounts provided BC seniors, they were directed to the ferry transportation fees and allocated to the Northern and regulated Other Routes.

The Federal-Provincial subsidy decreased marginally as a result of a decrease in the annual CPI (Vancouver).

Other Routes

Operational Statistics	2015	2014	Increase (Decrease)
Vehicle traffic	3,060,524	3,059,139	1,385
0.0% increase			
Passenger traffic	6,901,951	6,906,879	(4,928)
0.1% (decrease)			
On-time performance	93.2%	92.9%	0.3%
Number of round trips	64,664	71,081	(6,417)
Capacity provided (AEQs)	7,759,822	8,311,507	(551,685)
AEQs carried	3,269,223	3,260,603	8,620
Capacity utilization	42.1%	39.2%	2.9%

In fiscal 2015, vehicle traffic remained flat and passenger traffic decreased 0.1% compared to the prior year. In fiscal 2015, traffic levels were negatively impacted by a reduction in BC seniors travel related to the lower passenger fare discount for BC seniors travelling Mondays to Thursdays and decreases in student travel as a result of the teachers' labour dispute during the first two quarters of fiscal 2015.

In the last two months of the year, vehicle traffic was 9.0% higher and passenger traffic was 9.3% higher than the same period in the prior year. We believe this increase was partially due to favourable weather in February and March 2015, lower gas prices and unfavourable weather in the same period in the prior year. The lower Canadian dollar and a general increase in tourism and economic activity may also have had a positive impact towards the latter part of the year.

Revenue ($ thousands)	Years ended March 31			
	2015	**2014**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle tariff	43,817	41,879	1,938	4.6%
Passenger tariff	32,132	28,382	3,750	13.2%
Fuel surcharges	2,161	422	1,739	412.1%
Social program fees	9,246	10,559	(1,313)	(12.4%)
Catering & on-board	4,212	3,941	271	6.9%
Reservation fees	249	228	21	9.2%
Parking & other	302	100	202	202.0%
Total Direct Route Revenue	92,119	85,511	6,608	7.7%
Indirect Route Revenue				
Ferry transportation fees	94,053	90,298	3,755	4.2%
Federal-Provincial subsidy	21,080	21,093	(13)	(0.1%)
Total Route Revenue	207,252	196,902	10,350	5.3%

Other Routes cont'd

In fiscal 2015, average tariff revenue per vehicle increased $0.63 or 4.6% and average tariff revenue per passenger increased $0.55 or 13.4% compared to the prior year. On the majority of these routes, the average tariff per vehicle and passenger is calculated on a round trip basis. The increase in average tariff revenues reflected the price cap increases authorized by the Commissioner and the Province's reduction of the passenger fare discount for BC seniors travelling Monday through Thursday from 100% to 50%, resulting in BC seniors paying a portion of their fares. During this period, there continued to be no discount for BC seniors travelling Friday through Sunday. The increase in average fares and the changes in traffic resulted in a total tariff revenue increase of $5.7 million.

Fuel surcharges collected were $1.7 million higher than in the prior year. Fuel surcharges of 3.5% on average were in place for approximately nine months of fiscal 2015 while in fiscal 2014, surcharges of 3.5% on average were in place for less than three months. Surcharges were removed December 17, 2014 due to declining fuel prices and successfully locking in pricing for a significant portion of our forecast fuel consumption to the end of fiscal 2016.

On April 1, 2014, we implemented the Province's decision to amend its program to reduce the passenger fare discount for BC seniors travelling Mondays through Thursdays from 100% to 50%. In fiscal 2015, 8% fewer BC seniors used the program compared to the prior year. The $1.3 million reduction in social program fees in fiscal 2015 consisted of a $1.7 million reduction as a result of fewer BC seniors travelling under the program, partially offset by an increase in the number of people using the MTAP program and higher fares. To mitigate the impact of the loss in the number of BC seniors travelling under the program, the Province provided a maximum increase in ferry transportation fees to what would have been paid if there had been no change in the level of senior discounts available on the Major and Other Routes. To the extent these funds are not required for the reimbursement of discounts provided BC seniors, they are directed to the ferry transportation fees and allocated to the Northern and regulated Other Routes. These actions together have increased our total revenues, which reduced some pressure on future fares.

Increases in revenue from catering and on-board services reflected the higher average spending per passenger and, to a lesser extent, the inflation impact on the cost of food and certain other retail goods.

Reservation fee revenue increased as a result of a greater percentage of customers reserving space.

Parking and other revenues were higher in fiscal 2015 than in the prior year, mainly due to charter fees, commissions from new vendors at two of our terminal locations, parking and dock rental fees.

Ferry transportation fees received from the Province increased $3.8 million in fiscal 2015 compared to the prior year as a result of the following:

- $6.0 million increase in ferry transportation fees in respect of senior discounts;

partially offset by:

- $2.2 million decrease 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 decreased marginally as a result of a decrease in the annual CPI (Vancouver).

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

Operating expenses ($ millions)	Years ended March 31		
	2016	**2015**	**2014**
Operations	449.6	447.2	451.7
Maintenance	79.4	68.1	63.2
Administration	34.5	32.0	31.6
Total operations, maintenance & administration	563.5	547.3	546.5
% increase	*3.0%*	*0.1%*	*1.9%*
Cost of retail goods sold	35.2	32.4	30.9
Depreciation and amortization	145.5	142.8	136.9
Total operating expenses	744.2	722.5	714.3

We continue to take proactive measures to contain, reduce and optimize expenses while operating a sustainable, safe and reliable service. Our fiscal 2016 total operations, maintenance and administration expenses increased $17.0 million or 3.1% from fiscal 2014, for an average annual increase of 1.6% over the last two years.

In fiscal 2016, wages and benefits and fuel costs totaled $426.5 million or 75.7% of total operations, maintenance and administration. These costs are primarily variable operational costs, driven by the level of service. We continuously review all operational costs for efficiencies without compromising safety. The remaining $137.0 million of costs are discretionary and to some extent, more controllable.

The cost of retail goods sold continues to increase, reflecting the steady growth in catering and on-board sales and, to a lesser extent, the inflation impact on the cost of food and certain other retail goods.

Depreciation and amortization increased $2.7 million in fiscal 2016 compared to the prior year. Increases resulting from new or upgraded capital assets that have entered service was partially offset by a change in estimate of useful lives of our vessel hulls. 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 resulted in a decrease in depreciation expense of approximately $1.9 million for fiscal 2016.

Net finance and other expenses ($ millions)			
	Years ended March 31		
	2016	**2015**	**2014**
Finance expense			
Bond interest	58.0	59.6	64.0
KfW bank group ("KfW") loans	5.7	6.7	7.5
Interest on finance lease	1.9	2.0	2.0
Short-term debt	0.4	0.3	0.7
Structured Financing Facility ("SFF") program	-	(0.4)	-
Capitalized interest	(5.4)	(3.5)	(3.2)
Total finance expense	60.6	64.7	71.0
Less: finance income	(4.6)	(4.3)	(3.7)
Net finance expense	56.0	60.4	67.3
Loss on disposal and revaluation of property, plant and equipment, intangible assets and inventory	-	9.1	0.6
Total net finance and other expenses	56.0	69.5	67.9

Our fiscal 2016 net finance expense decreased $11.3 million or 16.8% from fiscal 2014. This is mainly a result of principal payments on long-term debt and KfW loans, lower interest rates, increased cash generated by operating activities and higher interest capitalized reflecting our investments in capital assets.

Year over year changes are described below:

Year to Year Comparison of Expenses 2016 – 2015

The $2.4 million increase in operations expenses from fiscal 2015 to fiscal 2016 consists of:

- $12.1 million increase in wages and benefits costs, mainly due to the bargaining unit wage rate increase of 2% effective April 1, 2015 in accordance with the Collective Agreement that expired October 31, 2015, payments relating to the new Collective Agreement that will end October 31, 2020 and an increase in overtime and in hours spent in training activities where backfill was required;
- $2.4 million increase in contracted services;
- $0.8 million increase in travel expenses, mainly as a result of training activities; and
- $2.5 million comprised of ITCs recoverable for the period April 2003 through October 2014 recorded as a recovery of expense in 2015, increases in parts and supplies, insurance claims and promotional advertising;

partially offset by:

- $15.4 million decrease in fuel expense, reflecting a decrease of $18.1 million or 15.0% due to lower fuel prices, partially offset by $2.7 million or 2.3% increase in fuel consumption primarily a result of additional round trips provided on the Major Routes. For purposes of rate regulation, in fiscal 2016 $11.0 million of fuel expenses was recorded in deferred fuel cost accounts to be settled through fuel rebates. In fiscal 2015, $9.1 million of our fuel expense was recorded in deferred fuel cost accounts for future recovery. (See "The Effect of Rate Regulation" for more detail.)

The $11.3 million increase in maintenance costs resulted from an increase in vessel maintenance costs, reflecting the variations in vessel refit scheduling, an increase in terminal maintenance costs and $2.6 million of ITCs recoverable for the period April 2003 through October 2014, reflecting the October 2014 Tax Court of Canada judgement recorded as a recovery of expense in fiscal 2015.

The $2.5 million increase in administration costs is mainly due to higher wages and benefits due to the filling of positions vacant in the prior year, computer software licencing costs, contracted services and $0.6 million of ITCs recoverable for the period April 2003 through October 2014, reflecting the October 2014 Tax Court of Canada judgement recorded in fiscal 2015.

The $2.8 million increase in cost of retail goods sold reflects the increase in overall sales, mainly from the impact of higher traffic levels and, to a lesser extent, the inflation impact on the cost of food and certain other retail goods. Cost of retail goods sold increased 8%, consistent with the increase in retail revenue.

Depreciation and amortization increased $2.7 million, reflecting higher depreciation resulting from the new capital assets that have entered service offset by lower depreciation resulting from extending our vessel lives from 40 years to 45 years. (See “Investing in our Capital Assets” below for details of capital asset expenditures in fiscal 2016.)

Net finance and other expenses decreased by $13.5 million from fiscal 2015 to fiscal 2016 mainly due to:

- $9.1 million decrease in loss on disposal and revaluation of property, plant and equipment and intangible assets, primarily due to asset impairment recorded in fiscal 2015;
- $1.9 million increase in interest capitalized;
- $1.6 million decrease in bond interest, reflecting the net effect of 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;
- $1.0 million decrease in interest on KfW loans, reflecting $24.0 million in principal repayments; and
- $0.3 million increase in finance income;

partially offset by:

- $0.4 million decrease in interest rate support received, reflecting the completion of the funding related to the purchase of the *Island Sky*. In previous years, funding had been received through the Structured Financing Facility (SFF) Program offered by the Government of Canada. As of March 31, 2013 this program was no longer accepting applications.

Year to Year Comparison of Expenses 2015 – 2014

The $4.5 million decrease in operations expenses from fiscal 2014 to fiscal 2015 consists of:

- $6.7 million decrease in fuel expense, reflecting a decrease of $2.7 million or 5.4% due to lower fuel prices and a $4.0 million or 3.2% decrease in fuel consumption mainly due to service level adjustments. For purposes of rate regulation, $9.1 million of our fuel expense for fiscal 2015 ($14.5 million for fiscal 2014) is recorded in deferred fuel cost accounts for future recovery;
- $1.4 million decrease in insurance claim costs; and
- $0.7 million of ITCs recoverable for the period April 2003 through October 2014, reflecting the October 2014 Tax Court of Canada judgement;

partially offset by:

- $1.3 million increase in wage and benefits costs, mainly due to collective agreement wage rate increases and higher benefit costs offset by reductions partially due to service level adjustments; and
- $3.0 million comprised of increases in promotional advertising costs, employee development program costs, credit card processing fees, telecommunications costs, insurance premiums, contracted services and materials and supplies.

The $4.9 million increase in maintenance costs resulted from an increase in vessel maintenance costs, reflecting the variations in vessel refit scheduling, and an increase in terminal maintenance costs, offset by $2.6 million of ITCs recoverable for the period April 2003 through October 2014, reflecting the October 2014 Tax Court of Canada judgement.

The $0.4 million increase in administration costs is mainly due to a $1.4 million increase in computer software fees, licenses, training supplies and contracted services, offset by a $0.4 million decrease in wages and benefits and $0.6 million of ITCs recoverable for the period April 2003 through October 2014, reflecting the October 2014 Tax Court of Canada judgement.

The $1.5 million increase in cost of retail goods sold primarily reflects the increase in overall sales and, to a lesser extent, the inflation impact on the cost of food and for certain select retail items. Cost of retail goods sold increased 5%, consistent with the increase in retail revenue.

Depreciation and amortization increased $5.9 million due to new capital assets placed in service during fiscal 2015, reflecting our continued investment in capital assets.

Net finance and other expenses increased by $1.6 million from fiscal 2014 to fiscal 2015 due to:

- $8.5 million increase in loss on disposal and revaluation of property, plant and equipment and intangible assets primarily due to asset impairments;

partially offset by:

- $4.4 million decrease in bond interest, reflecting a $50 million decrease in outstanding bonds ($200 million issued in April 2014 and $250 million redeemed in May 2015);
- $0.8 million decrease in interest on KfW loans, reflecting $9.0 million in principal repayments on the 2.95% KfW loan and $5.6 million in principal repayments on each of the KfW 12 Year loans; and
- $1.7 million mainly due to increases in finance income, interest rate support received through the SFF Program offered by the Government of Canada, reflecting the completion of the funding related to the purchase of the *Island Sky*, and interest capitalized.

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

Over the last five years, our capital expenditures averaged $136 million annually. Over the next five years, we expect the average to increase to approximately $250 million annually as we proceed with the replacement and upgrade of our aged vessels and make significant improvements at our terminals serving our Major Routes, as well as make investments in information technology. We expect 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 March 31, 2016, our unrestricted cash and cash equivalents and other short-term investments totalled $79 million and $61 million, respectively. Our unrestricted cash and cash equivalents include cash on hand and fixed rate instruments with a maturity of less than three months. Other short-term investments include fixed rate instruments with a maturity of more than three months.

Our $155 million credit facility was renewed on March 15, 2016 to extend the maturity date of the facility from April 2020 to April 2021. The facility is available to fund capital expenditures and other general corporate purposes. At March 31, 2016, 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 March 31, 2016 were “A” (DBRS) with a stable trend and “AA-” Standard & Poor’s ("S&P”) with a stable outlook.

On September 30, 2012, the Commissioner issued Order 12-02, which established price cap increases for the balance of PT3. 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 which is effectively a debt to total capitalization of 82.5% (“Leverage Ratio”) and a debt service ratio (“DSCR”) of 2.5 or greater.

At March 31, 2016, the end of PT3, we achieved a Leverage Ratio of 77.8% and a DSCR of 3.1.

On September 16, 2015, the Commissioner issued Order 15-03, which established price cap increases for PT4, which started April 1, 2016 and ends March 31, 2020. We believe that these price cap increases will be sufficient to enable us to meet our debt obligations and maintain access to borrowing rates and meet or exceed the Commissioner’s targeted Leverage Ratio and DSCR.

On November 12, 2015, we executed an export loan agreement with KfW IPEX-Bank GmbH, a German export credit bank. This loan agreement is secured under the MTI (May 2004) as described below and allows for three loans of up to $45 million each. These amortizing loans will be repaid over a 12-year term and bear an annual interest rate of 2.09%. The net proceeds will be used to partially finance the purchase of our three new Salish Class vessels and will coincide with the conditional acceptance of each of the vessels from the shipyard. No amounts have been drawn under the loan agreement.

Long-Term Debt

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

($ millions)	Effective interest rate	Amount outstanding as at March 31 2016	2015	2014
Senior Secured Bonds				
5.74%, due May 2014	5.92%	-	-	250
6.25%, due October 2034	6.41%	250	250	250
5.02%, due March 2037	5.06%	250	250	250
5.58%, due January 2038	5.62%	200	200	200
4.70%, due October 2043	4.75%	200	200	200
4.29%, due April 2044	4.45%	200	200	-
12 Year Loans				
Tranche A, due March 2020	5.17%	30	38	45
Tranche B, due March 2020	1.18%*	22	22	21
Tranche A, due June 2020	5.18%	32	39	47
Tranche B, due June 2020	1.18%*	23	23	20
2.95% Loan, due January 2021	3.08%	45	54	63
* Floating rate as at March 31, 2016		1,252	1,276	1,346

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

We are also party to a credit agreement with a syndicate of Canadian banks that is secured under the MTI. Under this agreement, we have available a revolving facility in the amount of $155 million, maturing April 2021. The facility is available to fund capital expenditures and other general corporate purposes. At March 31, 2016, March 31, 2015 and March 31, 2014 there were no draws on this credit facility.

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

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

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

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

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

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

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

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

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

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

Sources and uses of cash and cash equivalents for fiscal 2016 and 2015 are summarized in the table below:

	Years ended March 31		
($ millions)	**2016**	**2015**	**Increase (Decrease)**
Cash and cash equivalents, beginning of period	65.6	71.4	(5.8)
Cash from operating activities:			
Net earnings	69.6	49.1	20.5
Items not affecting cash	209.7	208.0	1.7
Changes in non-cash operating working capital	7.3	13.8	(6.5)
Net interest paid	(60.7)	(64.2)	3.5
Cash generated by operating activities	225.9	206.7	19.2
Cash used in financing activities	(31.3)	(86.4)	55.1
Cash used in investing activities	(181.1)	(126.1)	(55.0)
Net increase (decrease) in cash and cash equivalents	13.5	(5.8)	19.3
Cash and cash equivalents, end of period	79.1	65.6	13.5

For fiscal 2016, cash generated by operating activities increased by $19.2 million compared to the prior year, primarily due to an increase in net earnings reflecting the impact of increased traffic levels, higher revenues, lower financing costs and lower impairment costs, partially offset by higher asset depreciation and higher operating expenses.

Cash used in financing activities in fiscal 2016 was $31.3 million. This amount consisted of $24.0 million in repayment of KfW loans, $6.0 million in dividends paid on preferred shares and $1.3 million in repayment of finance lease obligations.

Cash used in financing activities in fiscal 2015 was $86.4 million. This amount consisted of $250 million repayment of our Series 04-1 bonds, $20.3 million in other long-term debt repayments; $7.7 million in hedge losses incurred on the settlement of interest rate forward contracts; $6.0 million in dividends paid on preferred shares; $1.3 million in bond financing costs; and $1.1 million repayment of finance lease obligations, partially offset by proceeds of $200 million from our April 2014 bond issuance.

Cash used in investing activities in fiscal 2016 increased by $55.0 million compared to the prior year, mainly due to a $18.3 million increase in cash used to purchase short-term investments, a $2.8 million change in debt service reserve requirements and a $33.9 million net increase in cash used for capital expenditures. (See “Investing in Our Capital Assets” below for detail of significant capital expenditures.)

FOURTH QUARTER RESULTS

The following provides an overview of our financial performance and selected operational statistics comparing the three months ended March 31, 2016 to the same period in the prior year.

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

Operational Statistics	**2016**	**2015**	**Increase (Decrease)**
Vehicle traffic	1,634,985	1,525,694	109,291
7.2% increase			
Passenger traffic	3,970,993	3,724,701	246,292
6.6% increase			
On-time performance	93.7%	96.0%	(2.3%)
Number of round trips	18,776	18,396	380
Capacity provided (AEQs)	3,912,061	3,845,266	66,795
AEQs carried	1,865,219	1,747,901	117,318
Capacity utilization	47.7%	45.5%	2.1%

Vehicle traffic increased 7.2% and passenger traffic increased 6.6% in the fourth quarter of fiscal 2016 compared to the same quarter in fiscal 2015. Traffic was favourably impacted by lower fuel prices, the lower Canadian dollar, a general increase in tourism and economic activity in BC and our 30% passenger fare discount on under-utilized sailings for approximately three weeks in March which covered spring break and the Easter long weekend.

On-time performance in the fourth quarter of fiscal 2016 dropped 2.3% compared to the same period in the prior year primarily due to the impact of the significant traffic increase.

Capacity utilization in the three months ended March 31, 2016 increased by 2.1% over the same period in the prior year, mainly as a result of an increase in total AEQs carried due to the higher traffic levels, partially offset by an increase in capacity provided as a result of additional round trips.

	Three months ended March 31			
			Variance	
($ millions)	**2016**	**2015**	**$**	**%**
Total revenue	173.0	161.4	11.6	7.2%
Operating expenses	189.2	173.2	(16.0)	(9.2%)
Operating loss	(16.2)	(11.8)	(4.4)	(37.3%)
Net finance and other	13.8	23.3	9.5	40.8%
Net loss	(30.0)	(35.1)	5.1	14.5%
Other comprehensive (loss) income	(12.0)	2.7	(14.7)	(544.4%)
Total comprehensive loss	(42.0)	(32.4)	(9.6)	(29.6%)

Our total comprehensive loss in the three months ended March 31, 2016 was $9.6 million higher and our net loss was $5.1 million lower than in the same quarter of fiscal 2015. The other comprehensive loss of $12.0 million in the fourth quarter of fiscal 2016 reflects the change in unrealized hedge losses of $12.4 million on fuel forward contracts, offset by the gain of $0.4 million on the revaluation of land at March 31, 2016. The other comprehensive loss in fiscal 2015 reflects the change in unrealized hedge losses of $2.9 million at March 31, 2015 on fuel forward contracts, offset by the loss of $0.2 million on the revaluation of land at March 31, 2015. The better performance in the last quarter of fiscal 2016, compared to the same period in the prior year, reflects increased traffic levels, increased fares, and lower finance expenses, partially offset by an increase in net operating expenses and higher fuel rebates.

Revenue

Our total revenues for the fourth quarter of fiscal 2016 increased by $11.6 million or 7.2% compared to the same quarter in the prior year, as shown in the following table:

Revenue	**Three months ended March 31**			
($ millions)			**Increase (Decrease)**	
	2016	**2015**	**$**	**%**
Direct Route Revenue				
Vehicle tariff	68.2	61.1	7.1	11.6%
Passenger tariff	40.1	36.8	3.3	9.0%
Fuel (rebates)	(1.3)	-	(1.3)	-
Catering & on-board	15.5	13.9	1.6	11.5%
Social program fees	5.5	5.3	0.2	3.8%
Reservation fees	3.1	2.0	1.1	55.0%
Other revenue	2.3	2.2	0.1	4.5%
Total Direct Route Revenue	133.4	121.3	12.1	10.0%
Indirect Route Revenue				
Ferry transportation fees	32.0	32.5	(0.5)	(1.5%)
Federal-Provincial subsidy	7.2	7.1	0.1	1.4%
Total Route Revenue	172.6	160.9	11.7	7.3%
Other general revenue	0.4	0.5	(0.1)	(20.0%)
Total Revenue	173.0	161.4	11.6	7.2%

Average tariff revenue per vehicle increased $1.62 or 4.0% in the quarter compared to the same period in the prior year and average tariff revenue per passenger increased $0.24 or 2.4%. The increase in average tariff revenues reflects the price cap increases authorized by the Commissioner, partially offset by the impact of our 30% passenger fare discount for approximately three weeks in March which covered spring break and the Easter long weekend. The increase in traffic levels and in average tariffs resulted in a $10.4 million increase in tariff revenue.

In the three months ended March 31, 2016, fuel rebates were $1.3 million. No fuel rebates or surcharges were in place during the three months ended March 31, 2015.

Catering and on-board sales increased $1.6 million or 11.5% in the quarter compared to the same period in the prior year, reflecting higher average sales per passenger and higher passenger traffic levels.

Social program fees increased by $0.2 million in the quarter compared to the same period in the prior year mainly as a result of an increase in the number of people using the MTAP program as well as more seniors and students travelling.

Reservation fee revenue increased mainly as a result of higher traffic levels and a greater percentage of customers reserving space.

Ferry transportation fees were lower in the quarter compared to the same period in the prior year primarily as a result of changes in funding received from the Province under the CFSC.

Expenses

Our operating and net finance and other expenses for the fourth quarter of fiscal 2016 and fiscal 2015 are shown in the following tables:

Operating expenses ($ millions)	**Three months ended March 31**			
			(Increase) Decrease	
	2016	**2015**	**$**	**%**
Operations	107.3	101.7	(5.6)	(5.5%)
Maintenance	26.7	19.8	(6.9)	(34.8%)
Administration	9.8	9.0	(0.8)	(8.9%)
Total operations, maintenance & administration	143.8	130.5	(13.3)	(10.2%)
Cost of retail goods sold	6.7	6.1	(0.6)	(9.8%)
Depreciation and amortization	38.7	36.6	(2.1)	(5.7%)
Total operating expenses	189.2	173.2	(16.0)	(9.2%)

The increase in operations costs for the three months ended March 31, 2016 compared to the same period in the prior year is due to:

- $4.8 million increase in wages and benefits mainly due to bargaining unit wage rate increases in accordance with the Collective Agreement;
- $0.7 million of ITCs recoverable for the period April 2003 through October 2014 recorded in fiscal 2015 as a recovery of expenses;
- $0.7 million increase in contracted services, $0.6 million in travel expense; and
- $0.8 million increase in insurance claims, promotional advertising, and parts and supplies;

partially offset by:

- $1.7 million decrease in fuel costs ($2.7 million in lower fuel prices partially offset by $1.0 million in higher fuel usage). (For purposes of rate regulation, $3.5 million of fuel expenses in the quarter were recorded in deferred fuel cost accounts to be settled through fuel rebates.); and
- $0.3 million decrease in credit card fees and various other operating costs.

The increase in maintenance costs of $6.9 million reflects increases in terminal maintenance costs, vessel maintenance costs resulting from variations in refit scheduling and $2.6 million of ITCs recoverable for the period April 2003 through October 2014 recorded in fiscal 2015.

The increase in administration costs of $0.8 million is mainly due to $0.6 million of ITCs recoverable for the period April 2003 through October 2014 recorded in fiscal 2015 and higher wages and benefits due to the filling of positions vacant in the prior year.

The increase in cost of retail goods sold reflects the increase in overall sales and rising food costs. Cost of retail goods sold increased 10%, consistent with the 11% increase in retail revenue.

Depreciation and amortization was $2.1 million higher in the quarter compared to the same period in the prior year reflecting higher depreciation resulting from the new capital assets that have entered service, offset by lower depreciation resulting from extending our vessel lives from 40 years to 45 years.

Net finance and other expenses	**Three months ended March 31**			
($ millions)			**(Increase) Decrease**	
	2016	**2015**	**$**	**%**
Finance expense				
Bond interest	14.4	14.3	(0.1)	(0.7%)
KfW bank group (KfW) loans	1.4	1.6	0.2	12.5%
Interest on finance lease	0.4	0.5	0.1	20.0%
Short-term debt	0.2	0.1	(0.1)	(100.0%)
Capitalized interest	(1.4)	(1.1)	0.3	27.3%
Total finance expense	15.0	15.4	0.4	2.6%
Less: finance income	(1.2)	(1.2)	-	-
Net finance expense	13.8	14.2	0.4	2.8%
Loss on disposal and revaluation of property, plant and equipment, intangible assets and inventory	-	9.1	9.1	100.0%
Total net finance and other expenses	13.8	23.3	9.5	40.8%

Net finance expense in the quarter was $0.4 million lower compared to the same period in the prior year, primarily due to $0.3 million higher interest capitalized.

Loss on disposal and revaluation of property, plant and equipment and intangible assets decreased by $9.1 million, primarily due to asset impairment in the prior year.

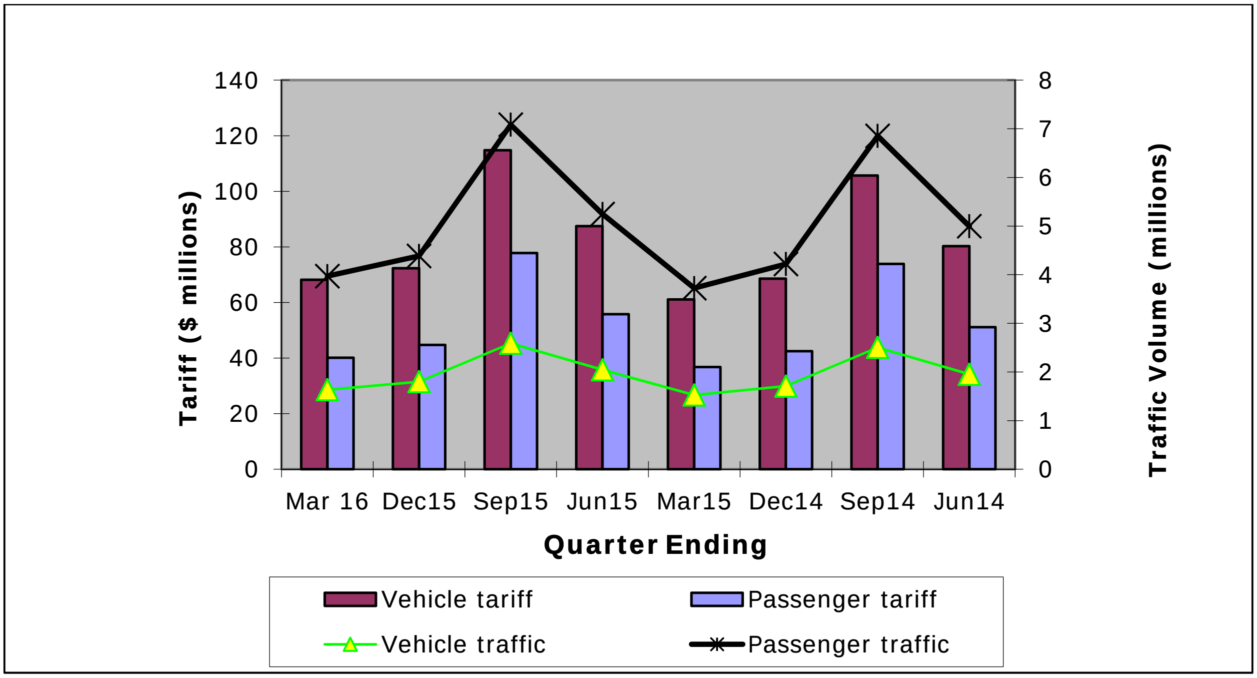
SUMMARY OF QUARTERLY RESULTS

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

($ millions)	Quarter Ended (unaudited)							
	Mar 16	**Dec 15**	**Sep 15**	**Jun 15**	**Mar 15**	**Dec 14**	**Sep 14**	**Jun 14**
Total revenue	173.0	186.6	292.5	217.7	161.4	182.4	284.2	213.1
Operating (loss) profit	(16.2)	10.2	98.5	33.1	(11.8)	8.2	91.6	30.6
Net (loss) earnings	(30.0)	(3.7)	84.5	18.8	(35.1)	(6.1)	76.4	13.9
Other comprehensive (loss) income	(12.0)	(11.7)	(3.6)	3.5	2.7	(7.4)	(2.9)	(2.4)
Total comprehensive (loss) income	(42.0)	(15.4)	80.9	22.3	(32.4)	(13.5)	73.5	11.5

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:



INVESTING IN OUR CAPITAL ASSETS

We have established a formal project management framework and guidelines to ensure that capital investments meet our functional and business needs. This framework is the structure under which capital projects are identified, managed, monitored and delivered as effectively and efficiently as possible. It ensures we take a disciplined approach by outlining the key principles, techniques and tools for managing and monitoring capital projects through the various stages of the project lifecycle.

Our capital asset planning is supported with formal business cases for all capital projects, project management principles and clear assignment of accountabilities to project managers, project owners and project sponsors. We require regular project reporting to monitor scope, schedule, budget and project risks at an individual project level and report against the capital expenditure budget. This regular reporting is used to prepare a summary report which is presented to a capital planning and budget committee on a monthly basis and for the Board of Directors on a quarterly basis.

Capital Expenditures

Capital expenditures in the three and twelve months ended March 31, 2016 totalled $70.3 million and $181.2 million, respectively.

($ millions)	**March 31, 2016**	
	3 months	**12 months**
Vessels	54.0	114.2
Information technology	8.9	31.9
Terminal marine structures	4.9	24.3
Terminal and building upgrades and equipment	2.5	10.8
Total capital expenditures	70.3	181.2

Vessels

Capital expenditures for new vessels, vessel upgrades and vessel modifications in the three and twelve months ended March 31, 2016 comprised the following:

($ millions)	**March 31, 2016**	
	3 months	**12 months**
Major overhauls and inspections	15.4	33.6
New Salish Class vessels	5.0	22.6
Spirit Class mid-life upgrade	15.9	16.9
Queen of Cumberland mid-life upgrade	6.5	10.9
Queen of Oak Bay ¾-life upgrade	4.1	10.1
Baynes Sound Connector	1.1	5.8
Queen of Surrey ¾-life upgrade	3.8	4.2
Navigational equipment upgrades	0.5	2.8
Queen of Coquitlam betterment	0.1	2.5
Queen of Capilano mid-life upgrade	-	1.3
Other projects	1.6	3.5
	54.0	114.2

The $33.6 million in major overhauls and inspections of components of hull, propulsion and generators completed in the twelve months ended March 31, 2016 or currently underway include:

- $6.1 million for the *Queen of Surrey*;
- $4.6 million for the *Queen of Cumberland*;
- $4.3 million for the *Queen of Coquitlam*;
- $3.0 million for the *Queen of Nanaimo*;
- $2.7 million for the *Northern Expedition*;
- $2.7 million for the *Spirit of British Columbia*;
- $2.0 million for the *Coastal Inspiration*;
- $1.8 million for the *Howe Sound Queen*;
- $1.8 million for the *Queen of New Westminster*;
- $1.4 million for the *Klitsa*;
- $1.1 million for the *Nimpkish;* and
- $2.1 million for the *Coastal Renaissance*; the *Queen of Capilano;* the *Spirit of Vancouver Island* and the *Queen of Oak Bay*

In July 2014, we entered into contracts with Remontowa Shipbuilding S.A. of Gdansk, Poland to build three new Salish (intermediate) Class vessels. The contracts, with a total value of $165 million, form the majority of the total project budget of $206 million. The original project budget of $252 million has been reduced by $46 million reflecting the elimination of tariffs to import the vessels into Canada. On July 28, 2015, we announced the names of these three new vessels: the *Salish Orca*, the *Salish Eagle* and the *Salish Raven*. On June 2, 2016, the *Salish Eagle,* and the *Salish Raven,* and on November 24, 2015, the *Salish Orca,* were launched and christened at Remontowa Shipbuilding S.A. The new vessels will be dual-fuel capable, designed to run primarily on LNG with marine diesel fuel as a backup. The *Salish Orca* is scheduled for delivery in the third quarter of fiscal 2017, and the *Salish Eagle* and *Salish Raven* are scheduled for delivery in the fourth quarter of fiscal 2017. The *Salish Orca* and the *Salish Eagle* will replace the 51-year old *Queen of Burnaby* on the Comox – Powell River route and the 52-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 24, 2016, we announced the award of a contract totalling $140 million to Remontowa Ship Repair Yard S.A. to conduct the mid-life upgrades, including conversion to dual-fuel, of our two largest vessels, the *Spirit of Vancouver Island* and the *Spirit of British Columbia*. In fiscal 2016, expenditures of $16.9 million mainly consisted of the first milestone payment in accordance with the contract payment schedule for each vessel. The mid-life upgrade of the *Spirit of British Columbia* is expected to be completed during the spring of 2018 and the mid-life upgrade of the *Spirit of Vancouver Island* is expected to be completed the following year. We expect the conversion of these vessels to result in substantial savings, as LNG costs considerably less than marine diesel. It also has significant environmental benefits such as reducing CO2 emissions by 12,000 tonnes annually which is the equivalent of taking approximately 2,500 vehicles off the road per year.

An $18 million major upgrade and refit to the *Queen of Cumberland* included $14 million for a mid-life upgrade to the propulsion system, passenger accommodation improvements, bridge standardization and safety improvements. The project is now complete.

An $18 million project for a three-quarter life upgrade of the *Queen of Oak Bay* included 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, at a total cost of $6 million. Phase 2, completed in the last quarter of fiscal 2016, replaced the steering gear system, upgraded the bridge and the passenger accommodations.

On February 9, 2016, our new cable ferry, the *Baynes Sound Connector*, commenced regularly scheduled service between Buckley Bay on Vancouver Island and Denman Island following extensive crew training and familiarization and Transport Canada certification. The *Baynes Sound Connector* accommodates 50 vehicles and 150 passengers and crew.

A $6 million project for a three-quarter life upgrade of the *Queen of Surrey* includes upgrades to the electrical system, the fire protection system, the elevator and the propulsion, improvements to the pet area and replacement of the emergency generator. This project is expected to complete in the first quarter of fiscal 2017.

Fiscal 2016 was the last year of a four year program to upgrade vessels with new navigational equipment. This year we spent nearly $3 million on upgrading the radar equipment and gyro compasses on several vessels to improve navigational safety. This takes us further towards bridge standardization.

A $5 million project for an upgrade of the *Queen of Coquitlam* included the first phase of upgrading the elevator, the passenger accommodations and the electrical distribution and lighting system, which was completed in November 2015. Remaining to be completed in the second phase, is reconfiguring the gift shop and installing hydraulic actuated fuel oil shut off valves. The remaining tasks are expected to complete in the fall of 2016.

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.

Other projects include a power management system and life-saving equipment for the *Northern Adventure,* a gearbox for the *Bowen Queen,* and upgrades to the mechanical and electrical equipment and standardization of the bridge for the *Queen of Cowichan*.

Information Technology

Capital expenditures for information technology in the three and twelve months ended March 31, 2016 comprised the following:

($ millions)	**March 31, 2016**	
	3 months	**12 months**
Customer service program	2.0	12.0
Hardware upgrades	4.0	7.2
Payroll system replacement	1.6	6.1
Payment card process enhancement	0.5	1.1
Oracle eBusiness upgrade	-	1.0
Other projects	0.8	4.5
	8.9	31.9

Our customer service program will replace our aged point of sale, website, e-commerce platform 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 with the installation of the customer relationship management application in 2015. We believe this program will significantly improve our transaction processing and enhance our ability to efficiently respond to the changing needs of our customers.

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

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

Our payment card process enhancement project includes designing and implementing an integrated solution for data processing streams of each application that accepts payments. The first phase was completed in the fall of 2015 and the second phase of our customer payment solution is scheduled to complete in the fall of 2017.

Our Oracle financial system upgrade, which included configuration changes to obtain process efficiencies, completed in the first quarter of fiscal 2016.

Our operation centre system upgrade includes replacing the hardware and upgrading the software applications which collect and disseminate information to allow operations to manage service interruptions and security incidents and is expected to complete in the third quarter of fiscal 2017.

Our Fare Flexibility and Digital Experience Initiative will introduce a new system to manage fares and provide customers with a modernized e-commerce platform with greater online functionality and booking options.

Other projects include software to automate the management of our server environments, software tools to provide application performance monitoring, software to improve our telecommunication systems, software to manage fares and provide greater online functionality and booking options, upgrading our safety management system and upgrading our catering and retail inventory management system.

Terminal Marine Structures

Capital expenditures for terminal marine structures in the three and twelve months ended March 31, 2016 comprised the following:

($ millions)		**March 31, 2016**	
Terminal	Description	**3 months**	**12 months**
Tsawwassen	Berth rebuild	4.3	8.0
Departure Bay	Replace dolphin and gangways	-	5.2
Sointula	Berth rebuild	0.1	5.1
Denman Island and Buckley Bay	Modifications to accommodate the new cable ferry	0.2	2.2
Quathiaski Cove	Trestle and floating lead upgrade	-	0.4
Various	Other projects	0.3	3.4
		4.9	24.3

At Tsawwassen terminal, a $14 million project to replace a tower, abutment, ramp, dolphins, and wingwalls is underway. This project is expected to complete by the end of the second quarter of fiscal 2017.

At Departure Bay terminal, a $4 million project to replace a dolphin with a multi-pile turning dolphin and a $4 million project to install active lift gangways completed in the third quarter of fiscal 2016.

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 completed in the second quarter of fiscal 2016.

Modifications at Denman Island and Buckley Bay terminals, as part of the project for our new cable ferry service, included 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 were completed and the *Baynes Sound Connector* commenced regularly scheduled service on February 9, 2016.

At Quathiaski Cove terminal, a project to extend the life of the trestle and floating leads by replacing and bracing timber piles completed in the third quarter of fiscal 2016.
Other projects currently in progress include upgrades at Chemanius, Otter Bay, Long Harbour, Prince Rupert and Langdale terminals.

Terminal and Building Upgrades and Equipment
Capital expenditures for terminal and building upgrades and equipment in the three and twelve months ended March 31, 2016 comprised the following:

($ millions)	**March 31, 2016**	
	3 months	**12 months**
Drainage system and holding compound upgrade at Prince Rupert terminal	0.1	3.5
Vehicles and other equipment	1.0	2.2
Asphalt resurfacing, signage and security at Tsawwassen terminal	0.2	1.5
Signage standardization	0.7	1.3
Other terminal projects	0.5	2.3
	2.5	10.8

A $4 million dollar project at Prince Rupert terminal to install an engineered drainage system and a concrete head wall to reduce overflow, and to repave the holding compound, completed in the third quarter of fiscal 2016.

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

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.

Several signage standardization projects are in progress, including way-finding signage at Duke Point, Departure Bay and various minor terminals.

Other projects currently in progress include upgrades at Langdale and Hornby terminals and at our Richmond maintenance facility.

Financial

Traffic Levels

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

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

Vehicle Traffic by fiscal year						
(thousands)	**2016**	**2015**	**2014**	**2013**	**2012**	**2011**
Major Routes	4,848.7	4,603.7	4,556.8	4,600.6	4,637.9	4,811.0
Other Routes	3,191.7	3,060.5	3,059.1	3,120.3	3,172.4	3,279.2
Northern Routes	29.1	26.7	28.4	27.8	27.6	29.3
Total	8,069.5	7,690.9	7,644.3	7,748.7	7,837.9	8,119.5
Increase (decrease)	*4.9%*	*0.6%*	*(1.3%)*	*(1.1%)*	*(3.5%)*	*(1.6%)*

Passenger Traffic by fiscal year						
(thousands)	**2016**	**2015**	**2014**	**2013**	**2012**	**2011**
Major Routes	13,449.3	12,818.9	12,708.7	12,777.2	12,920.8	13,309.7
Other Routes	7,158.9	6,902.0	6,906.9	7,061.0	7,168.5	7,350.5
Northern Routes	80.9	75.1	81.1	80.9	80.7	86.0
Total	20,689.1	19,796.0	19,696.7	19,919.1	20,170.0	20,746.2
Increase (decrease)	*4.5%*	*0.5%*	*(1.1%)*	*(1.2%)*	*(2.8%)*	*(1.4%)*

In fiscal 2016, vehicle traffic increased 4.9% while passenger traffic increased 4.5% compared to the prior year. Traffic was favourably impacted by lower fuel prices, the lower Canadian dollar, two Easter holiday weekends in the fiscal year, a general increase in tourism and economic activity in BC and our promotional fare incentives. Throughout fiscal 2016 we offered a variety of pricing promotions. We believe that these pricing promotions played a part in shifting some discretionary traffic to off-peak sailings, resulting in higher capacity utilization and contributed, to a small degree, to an increase in traffic compared to the prior year.

We believe the US economy and the outlook for the travel and tourism industry will continue to improve. With the lower value of the Canadian dollar versus the US dollar and the lower cost of fuel, we believe that passenger and vehicle traffic will remain strong in the near term, sustaining the improved discretionary traffic levels we are experiencing.

Market Opportunities

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

In May 2010, we opened our vacations centre, which is conveniently located in the tourist sector of downtown Vancouver. Through the use of our travel centre and an integrated marketing approach, we are able to leverage our core business to drive incremental ferry traffic as well as generate commissions from the related services. Using a 37-foot long interactive media wall display, customers are able to view route maps, vessel schematics, and destination images to help them choose from a variety of travel package options. Packaged vacations is the fastest growing segment of our market. In fiscal 2016, the number of vacation packages sold generated $5.7 million in revenue, an increase of 31.9% over the prior year and in fiscal 2015, the revenue from packages sold increased 29.1% over fiscal 2014. As the economy strengthens, we expect to see continuing growth, leading to increased traffic volumes as well as incremental non-tariff revenue.

Our drop-trailer service, launched in March 2009, operates on two of our Major Routes. Our commercial customers on these routes can drop their trailers off at one terminal and pick them up at another with our drivers loading and unloading the commercial trailers on and off the ferry with a hostling unit. This drop-trailer service revenue has increased over the past three years by 6%, 14%, and 15%, respectively. The service also improves our overall productivity by utilizing otherwise unused capacity. We will continue monitor demand and provide dependable service.

We also have opportunities for continued growth with our retail services which include food service and gift shops. Our retail revenue is approximately 10% of our total annual revenues and has increased in fiscal 2016, fiscal 2015 and fiscal 2014 by 8%, 2% and 3%, respectively.

Service Delivery Model

We provide frequent year-round transportation service on 24 routes which are regulated. We also manage ferry transportation services on other remote routes through contracts with independent operators. In an effort to reduce costs on our regulated routes, and consistent with section 69 of the Act, from time to time we test the market to determine if another operator, under contract to us, could provide safe, reliable and high quality service that is more cost effective.

Financial Summary

We expect positive net earnings in fiscal 2017, reflecting continued increases in discretionary traffic due to the low Canadian dollar, offset by a slight decrease in traffic primarily due to the timing of Easter, increases to average fares in accordance with the Commissioner's Order 15-03 and continued cost management, coupled with ongoing expenditure reductions realized from the Province's adjustments to service levels and to obtain our efficiency targets.

We expect an increase in total revenue in fiscal 2017, reflecting the impact of the April 1, 2016 tariff increases, higher traffic levels, higher catering and on-board revenues, and higher ferry transportation fees, partially offset by higher fuel rebate and the net cost of pricing promotions.

We are considering future pricing promotions. These promotions give us the opportunity to test variable pricing and will provide information on traffic trends, customer responses and impacts to operations for the Fare Flexibility and Digital Experience Initiative. This initiative is expected to commence in fiscal 2018 and will change the way we price fares. It will give customers an opportunity to purchase travel in advance at discounted rates, on select off-peak sailings on reservable routes. We expect it will help shift traffic to sailings that typically run with low capacity utilization.

The Commissioner established price caps for PT3 which incorporated efficiency targets of $54.2 million, over and above the benefits associated with any service level adjustments, to be achieved by us over the four years of PT3. We exceeded this target by $41.0 million. The total efficiency target for PT4 is $27.6 million.

We expect a modest increase in total expenses in fiscal 2017, reflecting higher wage and benefit costs resulting from the implementation of the new Collective Agreement and introduction of new assets, partially offset by lower fuel costs, lower vessel maintenance costs, cost savings from the introduction of our new cable ferry and other operational related costs. We continue to manage our costs prudently without compromising safe operations.

Asset Renewal Program

We have a twelve year capital plan, covering fiscal 2015 through fiscal 2026, to invest $3 billion to replace 14 aged vessels, execute mid-life upgrades for the Spirit Class vessels, make significant improvements at our terminals, and renew our information technology infrastructure. A portion of this investment is expected to come from funds from operations, which will maintain our regulated financial covenants. Total capital expenditures during fiscal 2011 through fiscal 2016 are shown in the table below:

Capital expenditures by fiscal year

($ millions)	2016	2015	2014	2013	2012	2011
Vessel upgrades & modifications	85.8	43.8	64.9	39.9	47.6	43.8
Terminal marine structures	24.3	47.6	43.6	27.5	44.0	41.6
Information technology	31.9	23.5	16.9	20.6	18.6	17.2
Terminal & building upgrades & equipment	10.8	9.7	3.9	7.2	11.1	24.5
Total (without new vessels)	152.8	124.6	129.3	95.2	121.3	127.1
New vessels	28.4	25.2	0.6	1.4	0.9	1.6
Total (including new vessels)	181.2	149.8	129.9	96.6	122.2	128.7

Vessels and Terminals

We have one of the largest ferry fleets in the world. The average age of our assets was among the oldest of major ferry operators worldwide. The first phase of our vessel renewal program involved upgrading and replacing a large share of our major vessels and terminal assets, with the most significant portion of this program completed during fiscal 2008 and 2009.

The next phase of vessel renewals began in fiscal 2010 with the commencement of design for new minor and intermediate sized vessels. The typical life span of vessels is 40 to 45 years and our minor and intermediate sized vessels currently have an average age of 39 years. As the identified replacement dates approach, we are reviewing these vessels to determine potential candidates for life extension rather than replacement. In our twelve year capital plan, our expectation is that we will need to replace or extend the life of 14 of these vessels.

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

Both LNG and the marine diesel we currently use meet all domestic and international emissions regulations. We believe that a move to LNG would reduce costs and emissions. At this time, even with the current drop in diesel oil prices, LNG is forecast to remain 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 below, our three new Salish Class vessels will have the capability to run on it. We also analyze LNG as an option for existing vessels undergoing major retrofits (such as our Spirit Class vessels as discussed below) and intend to pursue the option where it is economically and technically feasible. FortisBC has provided us with up to a total of $16 million in incentive funding to help offset incremental capital costs associated with the use of LNG, $6 million for the Salish class vessels and up to $10 million for the Spirit Class vessels.

The first new minor vessel was the *Baynes Sound Connector*. When this cable ferry was placed into service, it allowed us to retire and dispose of the 52 year-old *Tenaka.*

Three Salish Class (intermediate) vessels are currently under construction and will be dual-fuel capable. When two of these vessels are placed into service, it will allow us to retire and dispose of the 51-year old *Queen of Burnaby* and the 52-year old *Queen of Nanaimo*. The third vessel will augment service during the peak and shoulder season and provide relief when other vessels are in refit.

We are very early in the planning stage for the potential replacement of two intermediate and three minor vessels, following construction of the Salish Class vessels. The vessels being considered for replacement have an average age of 51 years and are currently undergoing condition assessment and propulsion studies.

Cable Ferry

On February 9, 2016, our new cable ferry, the *Baynes Sound Connector*, commenced regularly scheduled service between Buckley Bay on Vancouver Island and Denman Island following extensive crew training and familiarization and Transport Canada certification. The cable ferry accommodates 50 vehicles and 150 passengers and crew and replaced the 39 year old *Quinitsa* on this route.

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

Compared to the service provided by the *Quinitsa*, it is projected that, over 40 years, the cable ferry will provide significant cost savings and 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.

Salish Class

In July 2014, we entered into contracts with Remontowa Shipbuilding S.A. in Gdansk, Poland to build three new intermediate class vessels. Each vessel will have the capacity to carry 145 vehicles and be designed to operate as 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 life-saving equipment moving us to a higher safety standard and improving interoperability. The Remontowa contracts, with a total value of $165 million, form the majority of the total project budget of $206 million. The original project budget of $252 million has been reduced by $46 million reflecting the elimination of tariffs to import the vessels into Canada. 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 *Salish Orca* is scheduled for delivery in the third quarter of fiscal 2017, and the *Salish Eagle* and *Salish Raven* are scheduled for delivery in the fourth quarter of fiscal 2017. FortisBC has provided us with $6 million in incentive funding for the new vessels to help offset incremental capital costs associated with the use of LNG. The use of LNG will result in the reduction of an estimated 9,000 tonnes of carbon dioxide equivalent per year.

Spirit Class Mid-life Upgrades

On March 24, 2016, we announced the award of a contract totalling $140 million to Remontowa Ship Repair Yard S.A. of Gdansk, Poland to conduct the mid-life upgrades, including conversion to dual-fuel, of our two largest vessels, the *Spirit of Vancouver Island* and the *Spirit of British Columbia*. The upgrade of the *Spirit of British Columbia* is expected to be completed during the spring of 2018 and the upgrade of the *Spirit of Vancouver Island* is expected to be completed the following year. The conversion of these vessels is expected to result in substantial savings, as LNG costs considerably less than marine diesel. It also has significant environmental impacts such as reducing CO_2 emissions by 12,000 tonnes annually, which is the equivalent of taking approximately 2,500 vehicles off the road per year. FortisBC has provided us with up to $10 million in incentive funding to help offset incremental capital costs associated with the use of LNG.

Terminals

In fiscal 2016, we completed construction of Buckley Bay and Denman Island West cable ferry berths. This included the installation of two concrete floating pontoons and the construction of two berths, expansion of Denman West holding compound and all associated upland development.

Over the next 10 years, an estimated capital investment of $0.5 billion is expected to be required, at the terminals serving the Major Routes, including over $200 million at the Horseshoe Bay terminal and approximately $50 million at each of the Swartz Bay and the Tsawwassen terminals. Careful consideration, extensive detailed design and consultation with stakeholders will be done before these projects proceed.

Information Technology

Automated Customer Experience Program

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 flexible pricing initiatives.

Fare Flexibility and Digital Experience Initiative

We believe our information technology systems must be significantly improved to evolve our business model. The rigid technology systems we currently use limit our ability to design attractive and relevant pricing at a sailing level. The Fare Flexibility and Digital Experience Initiative will introduce a new system to manage fares at a sailing level, improve operational efficiency through better capacity management, provide customers with greater online functionality and booking options, and provide better access for mobile, tablet and desktop channels.

Vehicle Classification System

We successfully completed a pilot project at our Horseshoe Bay terminal testing a system that automatically measures vehicle length, height and ground clearance as vehicles approach the ticket booth. We believe the system will improve customer service with faster throughput and less waiting in line-ups, provide more reliability in measured vehicle lengths and greater safety and comfort for employees. This system will be considered for future implementation at our other major terminals.

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

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

Credit Risk

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

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

Our credit risk from trade customers is limited by having a large and diversified customer base and is managed through the review of third-party credit reports, utilizing pre-authorized payment plans, monitoring of aging of receivables, and collecting deposits and adjusting credit terms for higher risk customers. Amounts due from the Province and the Government of Canada are considered low credit risk. At March 31, 2016, 43% of our trade and other receivables were comprised of amounts due from the Province and the Government of Canada and 99% of our trade and other receivables were current.

Vendor Risk

Non-performance by strategic suppliers could adversely impact our financial results. We are in part, dependant on small suppliers or suppliers with specific knowledge.

Risk mitigation: We mitigate this risk, to the extent possible, through effective contract negotiations, vendor monitoring and diversification of our vendor base.

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

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

Risk mitigation: We manage liquidity risk through daily monitoring of cash balances, the use of long-term forecasting models and the maintenance of a credit facility and debt service reserves. Our credit ratings at March 31, 2016, were "A" (DBRS) with a stable trend and "AA-" (S&P) with a stable outlook.

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

Risk mitigation: To manage this risk, we maintain between 70% and 100% of our debt portfolio in fixed rate debt, in aggregate. In addition, we may enter into interest rate agreements to manage our exposure on debt instruments. A 50 basis point change in interest rates would not have had a significant effect on our fiscal 2016 earnings.

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

Risk mitigation: To manage exposure on future purchase commitments, we review our foreign currency denominated commitments and hedge through derivative instruments as necessary. With the possible exception of fuel prices (see discussion below), a 10% change in the US dollar or Euro foreign exchange rates would not have had a significant effect on our fiscal 2016 earnings.

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

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

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

We may enter into hedging instruments in order to reduce fuel price volatility and add a fixed component to the inherent floating nature of fuel prices. Fuel price hedging instruments are used solely for the purpose of reducing fuel price risk, not for generating trading profits. Pursuant to our Financial Risk Management Policy, the term of the contracts is not to extend beyond the greater of three years or the end of PT4. This policy limits hedging to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period, 90% of anticipated monthly fuel consumption for the 12 month period thereafter, 85% of anticipated monthly fuel consumption for the remaining 12 month period and if the end of PT4 is beyond 36 months, a maximum of 70% of anticipated monthly fuel consumption for the period between 36 months and the end of PT4. Fuel forward contracts are only entered into when there is a reasonable likelihood that the hedge will result in a net procurement cost per litre less than or equal to the set price per litre established by the Commissioner. At March 31, 2016, we had $78.4 million in fuel forward contracts. Realized gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs.

Derivatives
We hedge our exposure to fluctuations in fuel prices, foreign currency exchange rates and interest rates from time to time through the use of derivative instruments. At March 31, 2016 we held six foreign exchange forward contracts with a carrying and fair value liability of $11 thousand while at March 31, 2015 we held five such contracts with a carrying and fair value receivable of $21 thousand. There were no interest rate forward contracts in place at March 31, 2016 or at March 31, 2015.

At March 31, 2016 we held fuel forward contracts with a carrying and fair value liability of $17.9 million and at March 31, 2015, we held fuel forward contracts with a carrying and fair value liability of $4.5 million. At March 31, 2016, with the application of hedge accounting, the unrealized loss of $24.2 million was recognized in other comprehensive income. The fair value of commodity derivatives would reflect only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel.

The fair values would reflect the estimated amounts that we would receive or pay should the derivative contracts be terminated at the stated dates. For regulatory purposes, any realized gains or losses related to fuel commodity swaps would be charged to our deferred fuel cost accounts. (See “The Effect of Rate Regulation” for more detail.)

Non-Derivative Financial Instruments
The carrying and fair values of non-derivative financial instruments at March 31, 2016, and 2015 are as follows:

($ millions)	2016 Carrying Value	2016 Fair Value	2015 Carrying Value	2015 Fair Value
Financial Assets				
Cash and cash equivalents	79.1	79.1	65.6	65.6
Restricted short-term investments	32.0	32.0	32.5	32.5
Other short-term investments	61.5	61.5	62.1	62.1
Trade and other receivables	16.2	16.2	19.5	19.5
Long-term loan receivable	24.5	24.5	24.5	24.5
	213.3	213.3	204.2	204.2
Financial Liabilities				
Accounts payable and accrued liabilities	53.6	53.6	57.4	57.4
Interest payable on long-term debt	18.3	18.3	18.3	18.3
Long-term liability	1.5	1.5	1.5	1.5
Long-term debt, including current portion	1,242.1	1,529.2	1,265.7	1,622.6
	1,315.5	1,602.6	1,342.9	1,699.8

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

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

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

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

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

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

There will always be inherent risk resulting from our business operations and we minimize the risk, to the extent possible, with our mitigation plans. 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.

The following is a list of our principal business risks:

Vessel Repair Facilities

We have a vessel repair facility in Richmond where we perform maintenance and refit work on our vessels; however, our facility does not have a dry-dock. There are only two shipyards with dry-docks in British Columbia that can accommodate large vessels. One of these shipyards dominates the vessel repair market, especially for large vessels.

The overall demand for ship repair and ship building facilities is expected to increase with the federal ship procurement strategy. As a result, ship repair labour and dry-docking availability may become over-subscribed in the coming years.

The inability to acquire timely and cost effective ship repair services has the potential to cause operational disruption which in turn has the potential to have an adverse effect on results of operations, cash flow and financial results.

Risk mitigation: We plan our vessel maintenance to minimize the number of out-of-service periods and to maximize the maintenance performed by our own staff. We have also established long-range maintenance plans for all vessels which enable us to plan and reserve space with ship repair facilities well in advance. Further, when regulations permit, in-water surveys are performed on vessels, potentially eliminating the requirement for dry-docking. Also, alternatives to using local facilities are explored.

Major Capital Projects
We have several major capital projects underway, including the Salish Class ferries, the mid-life upgrades of the *Spirit of British Columbia* and the *Spirit of Vancouver Island*, the Fare Flexibility and Digital Experience Initiative and the Automated Customer Experience Program. Risks associated with the cost, schedule and the technical scope of major projects, as well as the implementation and sustainment of them, could cause critical systems or assets to be unavailable for use.

Risk mitigation: A project management framework is in place to govern all corporate projects. Also in place to monitor projects is a quality assurance framework which includes policies, standards and metrics.

We ensure each project has executive sponsorship, a project owner and a project analyst. As well, each major project has a steering committee and associated governance to ensure business alignment with desired outcomes.

We require regular project reporting to monitor scope, schedule, budget and project risks at an individual project level and report against the capital expenditure budget. This regular reporting is used to prepare a summary report which is presented to a capital planning and budget committee on a monthly basis and to the Board of Directors on a quarterly basis.

We require major projects to maintain a risk register. The risk register identifies the risks, rates the risks in terms of likelihood and consequences, reviews the effectiveness and appropriateness of the control, and determines any actions needed to mitigate the risk.

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

Risk mitigation: Security initiatives are in place to counter intentional attacks and we are in regular contact with government security agencies to ensure we have the latest information. Our 24-hour operations and security centre provides enhanced situational awareness and assessments, increased security monitoring, and a coordinated response during any incidents.

We continue to make improvements in the security on our vessels and at our terminals and maintenance facilities.

We have relocated our prime data centre facility to the interior of British Columbia to mitigate risk in the event of a major incident such as an earthquake. Our current infrastructure site has been expanded to house our pre-production infrastructure and serve as our production environment for disaster recovery in the unlikely event that the interior data centre production services are interrupted.

We have an internal control framework with defined control objectives for information and related technology which guides our governance and control processes. This assists us in ensuring the security, confidentiality and integrity of our information.

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

Safety

The safety of the public and our employees is our highest priority. Ineffectiveness of policy and procedures, equipment, maintenance, training, supervision, facility design and security measures may increase the risk to passenger and employee safety and/or property damage.

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

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

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

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

We adhere to a program of internal and external safety audits designed to verify our compliance with our safety management system. In fiscal 2014, we participated in the BC Maritime Employers Association's Certificate of Recognition Program which takes participating companies beyond basic safety compliance and sets an industry standard for developing a safety management system. As a result, in fiscal 2015, we received our first ever COR resulting from an audit of our Health & Safety Management and our Injury Management which sampled fifteen worksites and interviewed approximately 250 employees. In fiscal 2016, the COR audit resulted in a 96% score in Health and Safety and 92% in Injury Management for a combined score of 95.7% and provided us with 24 recommendations, reduced from the 31 we received in fiscal 2015. We are reviewing the recommendations, with a view toward continual improvement.

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

Customer Demand

Our vehicle and passenger traffic levels in fiscal 2016, as compared to the prior year, increased 4.9% and 4.5%, respectively. Traffic was favourably impacted by lower fuel prices, the lower Canadian dollar, two Easter holiday weekends in the fiscal year, general increase in tourism and economic activity in BC and our promotional fare incentives.

Many factors affect customer demand, including current economic conditions, the value of the Canadian dollar, levels of tourism, emerging transportation choices, consumer sentiment, threats to health and safety from outbreak of disease or security risks, demographics and population growth. The cost of transportation, including the price of fuel at the pump and ferry fares (including the implementation and removal of fuel surcharges or rebates), disposable personal income and weather conditions may have an effect on discretionary travel and levels of tourism.

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

Risk mitigation: We are constrained by the CFSC, which stipulates, among other things, the minimum number of round trips that must be provided for each regulated ferry route. Recognizing our ability to reduce capacity is constrained by the CFSC, we continually monitor traffic demand and leading indicators to meet requirements in an efficient and effective manner.

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

Security of Information

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

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

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

Regulations – Other

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

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

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

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

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

Economic Regulatory Environment
We cannot predict what changes the Province may make to the Act or to other legislation, nor can we predict how the Commissioner's interpretation and administration of the Act may change over time. Such changes may impact our profitability.

The Commissioner issued Order 15-03 which established final price cap increases of 1.9% for each of the four years of PT4, being the four year period ending on March 31, 2020. There remains uncertainty in the Commissioner's future price cap rulings.

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

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

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

Risk mitigation: We target a strong investment grade credit rating to maintain capital market access at reasonable interest rates. We monitor the capital markets although we do not foresee a need to access the capital markets in the near term. We continue to strive to communicate to our stakeholders the importance of our financial viability within our economic regulatory framework and our commitment to maintaining financial strength, in order to access these important markets.

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

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

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

Risk mitigation: We will continue to comply with environmental laws and regulations and actively search for ways to improve our environmental performance to help us become an industry leader in environmental management. We have renewed our environmental policy to provide a framework for setting environmental targets and to encourage best practices.
We have training programs in place that include training our staff in environmental awareness and first response to an oil spill and we conduct regularly scheduled oil spill drills on our vessels and at our terminals. We have received certification from Green Marine which is an environmental program where the intent is for participants to reduce their environmental footprint by undertaking concrete and measurable actions.

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

We are also actively pursuing LNG options for new vessels and vessels undergoing major retrofits because we believe that a move to this fuel source would reduce emissions as well as costs. Our three Salish Class ferries, expected to be in service by the summer of 2017, will be dual-fuel capable and will be operated as much as possible on LNG. This use of LNG will result in the reduction of an estimated 9,000 tonnes of carbon dioxide equivalent per year. The mid-life upgrade, including conversion to dual-fuel, of the *Spirit of British Columbia* and the *Spirit of Vancouver Island* could result in significant environmental benefits such as reducing CO_2 emissions by 12,000 tonnes annually. Both LNG and the marine diesel we currently use meet all current domestic and international emissions regulations.

We have programs in place to protect the environment and reduce GHG. Besides using biodegradable hydraulic oils, we recycle beverage containers, cardboard, newsprint, plastics, wood, metal, spent fluorescent tubes, batteries, aerosol spray cans, old upholstery foam and used cooking oil. We continue to expand our composting program and to replace chemical products with more environmentally friendly solutions. We have replaced gasoline powered terminal vehicles with electric vehicles and gasoline powered baggage vans with propane powered tugger units. We also reduce GHG levels by transferring vessels to shore-power while berthed overnight at several of our terminals, promoting anti-idling and increasing waste diversion. We are currently expanding our shore-power program to additional terminals by upgrading the current shore power installations and adding new shore-power installations where necessary to provide sufficient capacity to provide power to the vessels.

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

We actively work with Oceans Network Canada and provide three of our vessels as platforms for instrumentation to monitor meteorological and sea-surface properties in the Salish Sea.

We participate in the Enhancing Cetacean Habitat Observation (ECHO) Program, established by Port Metro Vancouver, in collaboration with government agencies, First Nations, marine industry users, non-government organizations and scientific experts, to better understand and manage the potential impacts to cetaceans (whales, porpoises and dolphins) from commercial vessel activities.

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

Performance Risk

Our failure to mitigate or manage the risks detailed above could result in default under the CFSC.

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

Risk mitigation: We mitigate performance risk by monitoring and managing all other risks and ensuring we have mitigation plans for them.

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

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

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

Taxes

We received an advance income tax ruling from the CRA that, provided the facts and other statements set out therein are accurate, we are a "Tax Exempt Corporation" described in paragraph 149(1)(d.1) of the *Income Tax Act*. There can be no additional assurance that we are and will continue to be a Tax Exempt Corporation.

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

First Nation Issues

First Nation issues normally arise in British Columbia when a company seeks governmental approvals for its activities. Canadian courts have said that governments must consult with First Nations before making any decision that could potentially affect Aboriginal interests even when the extent and nature of those interests has not been formally proved in court or recognized in a treaty. Potential Aboriginal rights are especially significant in British Columbia because most of the Province is subject to far-reaching claims of Aboriginal rights and title, including in coastal areas where we operate. These claims could have importance if we seek new property rights or approvals from government.

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

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

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

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

Retirement Liability
We sponsor a plan that provides a post-retirement benefit for eligible long service employees. The valuation of this plan is estimated based on complex actuarial calculations using several assumptions. These assumptions are determined by management with significant input from our actuary. The valuation of the obligation depends on such assumptions as discount rate, projected salary increases, retirement age and termination rates. An actuarial valuation of the plan at March 31, 2014, was obtained and the accrued benefit obligation estimated at $17.0 million. The retirement liability was increased and the actuarial loss of $2.9 million was recognized in other comprehensive income during fiscal 2015. The main driver of the increase in the liability was a lower employee turnover rate than previously estimated. The liability included in accrued employee future benefits in our financial statements at March 31, 2016, was $17.7 million ($17.4 million at March 31, 2015).

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

We annually review asset lives in conjunction with our longer term asset deployment, replacement and upgrade strategies. When we determine that asset lives do not reflect the expected remaining period of benefit, we make prospective changes to the remaining period over which they are depreciated or amortized. Estimates of useful life are monitored routinely through maintenance and refit programs, ongoing long-term fleet management and comparable vessels in use internally and externally. In fiscal 2016, 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 resulted in a decrease in depreciation expense of approximately $1.9 million for the year ended March 31, 2016.

Salvage value for vessels is monitored through secondary markets. Our expectation is that decommissioned vessels will be sold at a nominal salvage price into world markets to buyers who will keep them in active service.

There are a number of uncertainties inherent in estimating our asset lives and residual value and changes in these assumptions could result in material adjustments to our financial statements.

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

For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows that are largely independent of the cash flows from other assets or groups of assets. We define this level as a route group. If the carrying value of a group of assets is greater than the recoverable amount, the excess is charged to net earnings. Impairment losses are evaluated for potential reversals and are only reversed to the extent an asset's carrying amount does not exceed the carrying amount that would have been determined had no impairment been recognized.

Price caps for each route group, as defined in the CFSC with the Province are set by the Commissioner based on the principle that the costs necessary to provide the service system-wide are recovered.

Hedging Relationships

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

When applying hedge accounting, we document all relationships between hedging instruments and hedged items, as well as our risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the statement of financial position or to specific firm commitments or forecast transactions. We also assess, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. When derivatives are designated in a cash flow hedging relationship, the effective portion of changes in the fair value of the derivatives is recognized in other comprehensive income. Gains or losses on derivatives used in cash flow hedges of forecast purchases of non-financial assets are reclassified from equity (accumulated other comprehensive income) and are included in the initial carrying amount of the non-financial asset acquired. Gains or losses on derivatives for hedging relationships related to other cash flow hedges are reclassified from other comprehensive income to net earnings or loss when the hedged item affects net earnings or loss. Realized and unrealized gains or losses associated with derivative instruments which have been terminated or cease to be effective prior to maturity are recognized in net earnings in the period in which they have been terminated or cease to be effective.

Asset Retirement Obligations

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

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

No amount has been recorded for asset retirement obligations relating to these assets as it is not possible to make a reasonable estimate of the fair value of any such liability due to the indeterminate magnitude, likelihood, or financial impact, if any, of this issue. In addition, there is a reasonable expectation that retired assets may be sold to a responsible secondary market at a nominal salvage price, and furthermore because we are a regulated entity, any significant asset retirement costs that cannot be mitigated by the responsible sale of the retired asset, would be recoverable through future tariffs.

Adoption of New Accounting Standards
There are no relevant changes in accounting standards applicable to our fiscal year beginning April 1, 2015.

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.

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.

The IASB published amendments to IAS 7 *Statement of Cash Flows*. These amendments require a disclosure of changes in liabilities arising from financing activities, including changes arising from cash flows and non-cash changes. The mandatory effective date for us will be April 1, 2017. Early adoption is permitted. We do not expect the application of these amendments to have any significant 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 will be effective for us April 1, 2018. Earlier application is permitted. We are in the process of assessing the financial reporting impact of the adoption of this standard.

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 are in the process of assessing the financial reporting impact of the adoption of this standard.

IFRS 16 *Leases* introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all assets with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. This standard will be effective for us April 1, 2019. Early adoption is permitted if IFRS 15 *Revenue from Contracts with Customers* has also been applied. We are in the process of assessing the financial reporting impact of the adoption of this standard.

CORPORATE STRUCTURE AND GOVERNANCE

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

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, fares, fuel prices, and fiscal 2017 net earnings; our expectations of the rebate we expect to receive from WorkSafeBC on our 2015 assessed premiums; our short-term and long-range business plans, capital expenditure levels, asset renewal programs for vessels and terminals, our customer service program, Fare Flexibility and Digital Experience Initiative, pricing promotions, payroll system replacement initiative, vehicle classification system, Salish Class vessels, the loan agreement with KFW IPEX-Bank GmbH, the agreement with FortisBC Energy Inc. regarding incentive funding, the New Building Canada Fund, the *Baynes Sound Connector*, LNG plans, Spirit Class mid-life upgrades, decommissioned vessels, and safety and training projects; our expectations regarding vacation package sales growth, customer service, 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, IFRS 15, and IFRS 16 and amendments to IAS 1, IAS 7, 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.

NON-IFRS MEASURES

In addition to providing measures prepared in accordance with IFRS, we present certain financial measures that do not have any standardized meanings prescribed by IFRS and therefore are unlikely to be comparable to similar measures presented by other companies. These include, but are not limited to, total comprehensive income adjusted for the effect of rate regulation and average tariff revenue per vehicle and per passenger. These supplemental financial 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.

Corporate Structure and Governance
Board of Directors

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

During the fiscal year ended March 31, 2016, the board was composed of the following directors:

Chair: Donald P. Hayes
Members: Jane M. Bird, Bruce A. Chan, John A. Horning, Brian G. Kenning, Gordon M. Kukec, Gordon R. Larkin, and P. Geoffrey Plant (vice chair)

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

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

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

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

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

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

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

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

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

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

Jane M. Bird:	Director, IBI Group Inc.
	Director, Western Forest Products Inc.
Brian G. Kenning:	Director, MacDonald Dettwiler & Associates Inc.

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

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

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

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

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

a Corporate Communications Policy, both of which are also posted on the Company's intranet and internet sites.

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

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

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

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

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

Nomination of Directors

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

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

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

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

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

Executive Compensation

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

Executive Compensation Plan

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

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

With the assistance of the independent, third-party compensation expert, the Human Resources & Compensation Committee periodically reviews the remuneration limits set by the executive compensation plan in conjunction with market data from appropriate comparator organizations and, when warranted, provides advice to the board on possible changes to the plan for recommendation to the Authority.

The executive compensation plan applies to the executives of the Company, as that term is defined in the CFA, and includes the individuals holding the positions or acting in a similar capacity or performing similar functions to the President & Chief Executive Officer (CEO) or an Executive Vice President. Pursuant to *Miscellaneous Statutes Amendment Act No. 3 - 2010* (Bill 20), the individuals who held such positions on the date Bill 20 received first reading are excluded from the provisions of an executive compensation plan for so long as that individual remains in that executive position with BC Ferries.

Through March 31, 2015, in accordance with the CFA and Bill 20, the executive compensation plan governed the remuneration the Company provided to its President & CEO, but not the remuneration provided to any other executive officer. Effective April 8, 2015, a new Chief Financial Officer (CFO) of the Company was appointed to succeed the incumbent, who stepped down from the position on March 31, 2015 to take on a new role with the Company. The remuneration of the new CFO is governed by the executive compensation plan, and has been set by the Company in accordance with it.

Executive Compensation Process

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

On an annual basis, the board, led by the Human Resources & Compensation Committee, sets the performance requirements for the President & CEO and evaluates his performance against those requirements. Similarly, the Human Resources & Compensation Committee leads the board in an annual evaluation of the performance of each of the other executive officers with respect to their achievement of performance objectives set by the President & CEO. The amount, if any, of the salary holdback earned by the President & CEO and the other executive officers is determined based on the evaluation results and, where applicable, the available room under the total remuneration limit set for the position in the executive compensation plan. Changes, if any, to the compensation of the executive officers are made in consideration of the individuals' performance, leadership skills, retention risk, and value to achieving corporate strategy, and in conjunction with market compensation data from appropriate comparator organizations. All changes in compensation are made in accordance with the executive compensation plan, as applicable.

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

Director Compensation

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

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

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

Protocol Agreement

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

Board Committees

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

Audit & Finance Committee:
Members during the fiscal year ended March 31, 2016:
Chair: Brian G. Kenning
Members: Bruce A. Chan, John A. Horning, P. Geoffrey Plant and Donald P. Hayes (ex-officio)

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

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

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

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

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

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

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

	Year ended March 31	
External Auditor billings ($ thousands)	**2016**	**2015**
Audit and audit related	187.2	183.5
Tax services	2.3	2.2
Accounting advisory	2.0	4.7
	191.5	190.4

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

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

***Safety, Health, Environment & Security Committee*:**
Members during the fiscal year ended March 31, 2016:
Chair: Jane M. Bird
Members: Bruce A. Chan, Gordon R. Larkin and Donald P. Hayes (ex-officio)

The Safety, Health, Environment & Security Committee is appointed by the board to assist the board in fulfilling its oversight responsibilities in matters related to safety, health, environment and security. The committee has the mandate to:

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

Governance & Nominating Committee:
Members during the fiscal year ended March 31, 2016:
Chair: P. Geoffrey Plant
Members: Jane M. Bird, Gordon M. Kukec and Donald P. Hayes (ex-officio)

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

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

Human Resources & Compensation Committee:
Members during the fiscal year ended March 31, 2016:
Chair: John A. Horning
Members: Brian G. Kenning, Gordon M. Kukec, Gordon R. Larkin and Donald P. Hayes (ex-officio)

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

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

Strategic Projects Committee:
Members during the fiscal year ended March 31, 2016:
Chair: Gordon M. Kukec
Members: Bruce A. Chan, John A. Horning and Donald P. Hayes (ex-officio)

The Strategic Projects Committee is appointed by the board to assist the board in fulfilling its oversight responsibilities with respect to specific capital projects of BC Ferries as designated by the board from time to time. For the projects under its purview, the committee has the mandate to:

- in respect to projects which have not yet been approved by the board, review and provide advice to the Audit & Finance Committee and the board on whether the Company should proceed with the projects and, where approval to proceed is recommended, provide advice on the schedule, scope and budget for the projects;
- in respect of projects which have been approved by the board:
  - review the governance structure for the projects;
  - regularly review and monitor progress against scope and budget, as well as material changes in the schedule and risk profile of the projects;
  - review and recommend to the Audit & Finance Committee and the board any changes in authorized scope and budget of the projects; and
  - upon project completion, ascertain whether the projects have met their objectives.

Assessments
As part of its dedication to best governance practices, the board is committed to regular assessments of the effectiveness of the board, the board chair, committees, committee chairs, and individual directors. The board, on the recommendation of the Governance & Nominating Committee, has implemented a process for the assessments consisting of a review facilitated by an independent consultant every second year. The process aims to ensure that the individual directors continue to contribute effectively to the board's performance, and that the board and its committees continue to function effectively.

The last facilitated review was completed in February 2015. The consultant engaged by the board to conduct the review obtained the directors' views on matters related to the effectiveness of the board through the use of questionnaires and individual discussions with each director. The evaluation included an assessment of the performance of the board as a whole with respect to best practices in board governance, as well as a director self-assessment and peer review related to best practices for board directors. The peer review results for each director were shared with the respective director and the chairs of the board and the Governance & Nominating Committee, and discussions on the results were held between the individual directors and the board chair. The results of the board evaluation were provided to the board, together with the consultant's recommendations for action. The results and the recommendations arising from the board evaluation have and will continue to inform the deliberations and decisions of the board.

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