Condensed Interim Consolidated Financial Statements

BRITISH COLUMBIA FERRY SERVICES INC.

Six months ended September 30, 2017 and 2016
(Unaudited)

BRITISH COLUMBIA FERRY SERVICES INC.

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

	September 30, 2017	March 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 97,158	$ 72,032
Restricted short-term investments (note 6(b))	32,586	32,426
Other short-term investments	150,998	115,582
Trade and other receivables	22,700	15,319
Prepaid expenses	11,861	7,454
Inventories	29,113	28,257
Derivative assets (note 8)	3,119	1,604
	347,535	272,674
Non-current assets:		
Loan receivable	24,515	24,515
Land lease	30,000	30,230
Property, plant and equipment (note 3)	1,685,073	1,621,802
Intangible assets (note 4)	99,048	97,673
	1,838,636	1,774,220
Total assets	$ 2,186,171	$ 2,046,894
Liabilities		
Current liabilities:		
Accounts payable and accrued liabilities	$ 34,475	$ 55,173
Interest payable on long-term debt (note 5)	18,645	18,458
Deferred revenue	33,744	20,705
Derivative liabilities (note 8)	61	1,048
Current portion of long-term debt (note 5,6)	34,511	30,939
Current portion of accrued employee future benefits	1,400	1,400
Current portion of obligations under finance lease (note 5)	1,617	1,582
Provisions	57,443	55,711
	181,896	185,016
Non-current liabilities:		
Accrued employee future benefits	22,054	20,913
Long-term debt (note 5,6)	1,296,955	1,273,860
Obligations under finance lease (note 5)	39,605	40,423
Other liabilities	7,750	5,250
	1,366,364	1,340,446
Total liabilities	1,548,260	1,525,462
Equity		
Share capital	75,478	75,478
Contributed surplus	25,000	25,000
Retained earnings	539,771	424,020
Total equity before reserves	640,249	524,498
Reserves (note 9(a))	(2,338)	(3,066)
Total equity including reserves	637,911	521,432
Total liabilities and equity	$ 2,186,171	$ 2,046,894

Commitments (note 3)

See accompanying notes to the condensed interim consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

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

	Three months ended September 30		Six months ended September 30	
	2017	2016	2017	2016
Revenue:				
Vehicle and passenger fares	$ 225,307	$ 217,013	$ 388,426	$ 375,377
Ferry service fees	58,595	57,887	101,494	100,043
Net retail (note 10)	21,880	20,006	36,803	33,717
Federal-Provincial Subsidy Agreement	7,446	7,290	14,891	14,579
Fuel rebates (note 15)	(6,746)	(6,278)	(11,614)	(10,977)
Other income	3,128	2,995	5,498	5,373
Total revenue	309,610	298,913	535,498	518,112
Expenses (note 11):				
Operations	133,980	131,061	258,901	243,773
Maintenance	13,697	14,170	34,566	35,243
Administration	9,265	8,757	19,223	16,784
Depreciation and amortization	40,008	36,373	78,648	73,213
Total operating expenses	196,950	190,361	391,338	369,013
Operating profit	112,660	108,552	144,160	149,099
Net finance and other expenses (note 12):				
Finance income	1,365	1,148	2,428	2,183
Finance expenses	(15,420)	(14,533)	(30,588)	(28,945)
Net finance expense	(14,055)	(13,385)	(28,160)	(26,762)
(Loss) gain on disposal and revaluation of property, plant and equipment, intangible assets and inventory	(206)	32	(249)	(153)
Net finance and other expenses	(14,261)	(13,353)	(28,409)	(26,915)
NET EARNINGS	**98,399**	**95,199**	**115,751**	**122,184**
Other comprehensive income (loss) (note 9(b)):				
Items not to be reclassified to net earnings	(1,943)	(1,240)	(1,943)	(1,240)
Items to be reclassified to net earnings	6,526	208	810	10,536
Total other comprehensive income (loss)	4,583	(1,032)	(1,133)	9,296
Total comprehensive income	$ 102,982	$ 94,167	$ 114,618	$ 131,480

See accompanying notes to the condensed interim consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Cash Flows
(Expressed in thousands of Canadian dollars)
(Unaudited)

	Six months ended September 30 2017	2016
Cash flows from operating activities:		
Net earnings	$ 115,751	$ 122,184
Items not affecting cash:		
Net finance expense	28,160	26,762
Depreciation and amortization	78,648	73,213
Loss on disposal and revaluation of property, plant and equipment, intangible assets and inventory	249	153
Other non-cash changes to property, plant and equipment	37	(931)
Changes in:		
Accrued employee future benefits	(802)	161
Derivative liabilities (assets) recognized in net earnings	45	(20)
Provisions	1,732	1,672
Long-term land lease	230	229
Accrued financing costs	59	360
Total non-cash items	108,358	101,599
Movements in operating working capital:		
Trade and other receivables	(7,381)	(501)
Prepaid expenses	(4,407)	(3,614)
Inventories	(856)	(2,366)
Accounts payable and accrued liabilities	(20,698)	(5,998)
Deferred revenue	13,039	(1,890)
Change in non-cash working capital	(20,303)	(14,369)
Change attributable to capital asset acquisitions	12,418	1,565
Change in non-cash operating working capital	(7,885)	(12,804)
Cash generated from operating activities	216,224	210,979
Interest received	2,200	1,797
Interest paid	(32,776)	(32,281)
Net cash generated by operating activities	185,648	180,495
Cash flows from financing activities:		
Proceeds from long term debt	45,264	-
Repayment of long-term debt	(17,641)	(12,000)
Repayment of finance lease obligations	(783)	(748)
Deferred financing costs incurred	(1,470)	-
Net cash generated by (used in) financing activities	25,370	(12,748)
Cash flows from investing activities:		
Proceeds from disposal of property, plant and equipment	34	101
Purchase of property, plant and equipment and intangible assets	(150,350)	(67,241)
Changes in debt service reserve	(160)	250
Net purchase of short-term investments	(35,416)	(48,050)
Net cash used in investing activities	(185,892)	(114,940)
Net increase in cash and cash equivalents	25,126	52,807
Cash and cash equivalents, beginning of period	72,032	79,113
Cash and cash equivalents, end of period	**$ 97,158**	**$ 131,920**

See accompanying notes to the condensed interim consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Changes in Equity
Six months ended September 30, 2017 and 2016
(Expressed in thousands of Canadian dollars)
(Unaudited)

		Share capital	Contributed surplus	Retained earnings	Total equity before reserves	Reserves (note 9(a))	Total equity including reserves
Balance as at March 31, 2016	$	75,478	25,000	352,692	453,170	(24,223)	428,947
Net earnings		-	-	122,184	122,184	-	122,184
Other comprehensive income		-	-	-	-	9,296	9,296
Realized hedge losses recognized in fuel swaps		-	-	-	-	5,135	5,135
Hedge losses on interest rate forward contract reclassified to net earnings		-	-	-	-	124	124
Balance as at September 30, 2016	$	75,478	25,000	474,876	575,354	(9,668)	565,686
Balance as at March 31, 2017	$	75,478	25,000	424,020	524,498	(3,066)	521,432
Net earnings		-	-	115,751	115,751	-	115,751
Other comprehensive loss		-	-	-	-	(1,133)	(1,133)
Realized hedge losses recognized in fuel swaps		-	-	-	-	1,737	1,737
Hedge losses on interest rate forward contract reclassified to net earnings		-	-	-	-	124	124
Balance as at September 30, 2017	$	75,478	25,000	539,771	640,249	(2,338)	637,911

See accompanying notes to the condensed interim consolidated financial statements.

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

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

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

1. Accounting policies:

These condensed interim financial statements do not include all disclosures normally provided in annual financial statements and should be read in conjunction with the Company's audited consolidated financial statements and the related notes for the year ended March 31, 2017, as they follow the same accounting policies, unless otherwise indicated.

(a) Basis of preparation:

British Columbia Ferry Services Inc. is a company domiciled in Canada. The address of the Company's registered office is Suite 500, 1321 Blanshard Street, Victoria, BC Canada, V8W 0B7. These condensed interim consolidated financial statements as at and for the six months ended September 30, 2017 and 2016 comprise the Company and its subsidiaries (together referred to as the "Group").

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

These condensed interim consolidated financial statements were approved by the Board of Directors on November 24, 2017.

These condensed interim consolidated financial statements have been prepared using the historical cost method, except for land, land under finance lease, derivatives, and cash and cash equivalents, which are measured at fair value.

These condensed interim consolidated financial statements are presented in Canadian dollars ("CAD") which is the Group's functional currency. All tabular financial data is presented in thousands of Canadian dollars.

2. Adoption of new and amended standards and interpretations:

(a) Changes in accounting policies:

No new or amended standards or interpretations to existing standards were applied by the Group during the six months ended September 30, 2017.

(b) Future changes in accounting policies:

IFRS 15 *Revenue from Contracts with Customers*:

IFRS 15 *Revenue from Contracts with Customers* will replace IAS 11 *Construction Contracts* and IAS 18 *Revenue*. It provides a single, principles based five-step model to be applied to all contracts with customers. IFRS 15 also requires additional disclosures. The mandatory effective date of IFRS 15 is for annual reporting periods beginning on or after January 1, 2018. Earlier application is permitted. The Group is planning to apply IFRS 15 using the modified retrospective with cumulative effect method. The Group is currently assessing the potential effects of adopting IFRS 15 on its consolidated financial statements, including the impact of changes in its internal controls and to the disclosure requirements.

IFRS 9 *Financial Instruments (2014)*:

On July 24, 2014, the IASB issued the completed version of IFRS 9 and the Group adopted IFRS 9 (2013) in fiscal 2015. IFRS 9 (2014) introduces a new expected credit loss model for calculating impairment, and incorporates the guidance on the classification and measurement of financial assets and the final general hedge accounting requirements originally published in IFRS 9 (2013). The mandatory effective date of IFRS 9 (2014) is for annual reporting periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions. The Group has determined the need to establish an expected credit loss provision for trade receivables. The Group does not expect the application of IFRS 9 (2014) to have a significant impact on its consolidated financial statements, other than additional disclosure, as the Group has an existing provision for impairment.

IFRS 16 *Leases*:

On January 13, 2016, the IASB issued IFRS 16 *Leases*, which will replace IAS 17 *Leases*. The standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases 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. The standard is effective for annual periods beginning on or after January 1, 2019. Early adoption is permitted if IFRS 15 *Revenue from Contracts with Customers*, has also been applied. The Group is in the process of reviewing lease agreements.

2. Adoption of new and amended standards and interpretations (continued):

(b) Future changes in accounting policies (continued):

IFRS 16 *Leases* (continued):

The Group expects that IFRS 16 will result in:

- an increase in assets and liabilities with the recognition of right of use assets and additional lease liabilities,
- a decrease in lease expense and an increase in amortization and accretion expenses, and
- an increase in cash flow generated by operating activities as these lease payments will be recorded as financing outflows in the consolidated statements of cash flows.

The Group is currently analyzing the potential effects of adopting IFRS 16. The Group does not expect the application of this standard to have a significant impact on its consolidated financial statements.

(Tabular amounts expressed in thousands of Canadian dollars)

3. Property, plant and equipment:

Continuity of property, plant and equipment:

	Vessels	Berths, buildings and equipment under finance lease	Berths, buildings and equipment	Land under finance lease	Land	Construction in progress	Total
Cost:							
Balance at March 31, 2017	$1,305,845	642,436	104,332	6,824	18,433	212,467	2,290,337
Additions	-	-	-	-	-	134,979	134,979
Disposals	(8,674)	(1,032)	(422)	-	-	(59)	(10,187)
Transfers from construction in progress	208,481	21,127	5,352	-	-	(234,960)	-
Balance at September 30, 2017	**$1,505,652**	**662,531**	**109,262**	**6,824**	**18,433**	**112,427**	**2,415,129**
Accumulated depreciation:							
Balance at March 31, 2017	$ 467,454	149,958	51,123	-	-	-	668,535
Depreciation for the period	52,203	14,271	5,153	-	-	-	71,627
Disposals	(8,672)	(1,032)	(402)	-	-	-	(10,106)
Balance at September 30, 2017	**$ 510,985**	**163,197**	**55,874**	**-**	**-**	**-**	**730,056**
Net carrying value:							
As at March 31, 2017	**$ 838,391**	**492,478**	**53,209**	**6,824**	**18,433**	**212,467**	**1,621,802**
As at September 30, 2017	**994,667**	**499,334**	**53,388**	**6,824**	**18,433**	**112,427**	**1,685,073**

(Tabular amounts expressed in thousands of Canadian dollars)

3. Property, plant and equipment (continued):

Other disclosures - property, plant and equipment:

During the six months ended September 30, 2017, financing costs capitalized during construction amounted to $2.6 million (September 30, 2016: $2.1 million) with an average capitalization rate of 5.05% (September 30, 2016: 5.01%). In addition to the construction in progress referenced above, the contractual commitments as at September 30, 2017, for assets to be constructed totalled $176.8 million (March 31, 2017: $186.7 million). These contractual commitments include $86.9 million (March 31, 2017: $103.7 million) of the total contract value of $140 million for the mid-life upgrade and conversion to dual fuel of the two Spirit class vessels and $54.6 million (March 31, 2017: $nil) of the total contract value of $60 million for the construction of two minor class vessels.

During the six months ended September 30, 2017, the Group received $0.5 million (September 30, 2016: $0.5 million) of rental income earned from buildings held for leasing purposes. These buildings have a cost and accumulated depreciation of $11.9 million and $2.9 million, respectively, as at September 30, 2017.

During the six months ended September 30, 2017, the *Queen of Burnaby* and the *Queen of Nanaimo* were decommissioned. The *Queen of Burnaby* and the *Queen of Nanaimo* are classified as held for sale. Both vessels are fully depreciated and have no carrying value.

4. Intangible assets:

Continuity of intangible assets:

	Acquired software, licenses and rights	Internally developed software and website	Assets under development	Total
Cost:				
Balance at March 31, 2017	$ 103,249	13,324	24,646	141,219
Additions	-	-	8,599	8,599
Disposals	-	-	(203)	(203)
Transfers from assets under development	3,663	2,127	(5,790)	-
Balance at September 30, 2017	**$ 106,912**	**15,451**	**27,252**	**149,615**
Accumulated amortization:				
Balance at March 31, 2017	$ 31,895	11,651	-	43,546
Amortization for the period	6,748	273	-	7,021
Balance at September 30, 2017	**$ 38,643**	**11,924**	**-**	**50,567**
Net carrying value:				
As at March 31, 2017	**$ 71,354**	**1,673**	**24,646**	**97,673**
As at September 30, 2017	**68,269**	**3,527**	**27,252**	**99,048**

(Tabular amounts expressed in thousands of Canadian dollars)

4. Intangible assets (continued):

Other disclosures - intangible assets:

During the six months ended September 30, 2017, the Group recorded asset impairment of $0.2 million (September 30, 2016: $0.2 million). The impairment loss is reported under "Loss on disposal and revaluation of property, plant and equipment and intangible assets" in the consolidated statements of comprehensive income.

Capitalized financing costs during construction for intangible assets for the six months ended September 30, 2017 totalled $0.6 million (September 30, 2016: $1.6 million).

During the six months ended September 30, 2017, intangible assets totalling $4.6 million (September 30, 2016: $13.3 million) were acquired and $4.0 million (September 30, 2016: $2.8 million) were internally developed.

5. Liabilities arising from financing activities:

Continuity of liabilities arising from financing activities:

	Long-term debt	Obligations under finance lease	Interest payable on long-term debt
Balance at March 31, 2017			
Current	$ 30,939	$ 1,582	$ 18,458
Non-current	1,273,860	40,423	-
	1,304,799	42,005	18,458
Additions	45,264	-	31,928
Payments	(17,641)	(783)	(31,741)
Addition to debt issue costs	(1,470)	-	-
Amortization of debt issue costs	514	-	-
Balance at September 30, 2017	1,331,466	41,222	18,645
Current	34,511	1,617	18,645
Non-current	1,296,955	39,605	-
Balance at September 30, 2017	$ 1,331,466	$ 41,222	$ 18,645

(Tabular amounts expressed in thousands of Canadian dollars)

6. Loans:

	As at	
	September 30, 2017	March 31, 2017
Long-term debt:		
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (effective interest rate of 6.41%)	$ 250,000	$ 250,000
5.02% Senior Secured Bonds, Series 07-1, due March 2037 (effective interest rate of 5.06%)	250,000	250,000
5.58% Senior Secured Bonds, Series 08-1, due January 2038 (effective interest rate of 5.62%)	200,000	200,000
4.70% Senior Secured Bonds, Series 13-1, due October 2043 (effective interest rate of 4.75%)	200,000	200,000
4.29% Senior Secured Bonds, Series 14-1, due April 2044 (effective interest rate of 4.45%)	200,000	200,000
12 Year Loan, maturing March 2020:		
Tranche A (effective interest rate of 5.17%)	18,750	22,500
Tranche B (floating interest rate of 1.75% at September 30, 2017)	22,500	22,500
12 Year Loan, maturing June 2020:		
Tranche A (effective interest rate of 5.18%)	20,625	24,375
Tranche B (floating interest rate of 1.74% at September 30, 2017)	22,500	22,500
2.95% Loan, maturing January 2021 (effective interest rate of 3.08%)	31,500	36,000
2.09% Loan, maturing October 2028 (effective interest rate of 2.64%)	42,054	43,923
2.09% Loan, maturing January 2029 (effective interest rate of 2.63%)	43,378	45,264
2.09% Loan, maturing January 2029 (effective interest rate of 2.64%)	43,378	-
	1,344,685	1,317,062
Less:		
Unamortized deferred financing costs and bond discounts	(13,219)	(12,263)
Current portion	(34,511)	(30,939)
Total	$ 1,296,955	**$ 1,273,860**

6. Loans (continued):

(a) Credit facility:

The Group has a credit facility with a syndicate of Canadian banks, secured by pledged bonds. This revolving facility, in the amount of $155.0 million, was renewed on March 10, 2017 to extend the maturity date to April 20, 2022. There were no draws on this credit facility as at September 30, 2017 and as at March 31, 2017. There was no interest expensed during the six months ended September 30, 2017 and September 30, 2016. Letters of credit outstanding against this facility as at September 30, 2017 totalled $0.1 million (March 31, 2017: $0.1 million).

(b) Debt service reserves:

Long-term debt agreements require the Group to maintain debt service reserves equal to a minimum of six months of interest payments, to be increased under certain conditions. As at September 30, 2017, debt service reserves of $32.6 million (March 31, 2017: $32.4 million) were held in short-term investments and have been classified as restricted short-term investments on the statements of financial position.

(c) Debt service coverage:

Debt service coverage (earnings before interest, taxes, depreciation, amortization, and rent) is required to be at least 1.25 times the debt service cost under the credit facility agreement. As at September 30, 2017, the debt service coverage ratio was 2.99.

In addition, there are other covenants contained in the Master Trust Indenture (“MTI”) (May 2004) available at www.SEDAR.com. The Group was in compliance with all of its covenants at September 30, 2017 and at March 31, 2017.

(d) 2.09% Loan, maturing January 2029:

The Group has a loan agreement with KfW, a German export credit bank. This loan agreement is secured under the MTI and allows for three loans of up to $45.3 million each.

Proceeds of $45.3 million from the third and final loan were received in June 2017 to coincide with the contract payment schedule for the *Salish Raven* and applied toward the purchase of the vessel. This amortizing loan will be repaid over a 12-year term and bear an interest rate of 2.09% per annum. Quarterly principal payments plus interest are due in January, April, July and October each year of the term of the loan.

(Tabular amounts expressed in thousands of Canadian dollars)

7. Financial instruments:

The carrying values of the Group's financial instruments approximate fair value as at September 30, 2017 and March 31, 2017 for all financial instruments except for long-term debt.

	As at September 30, 2017		As at March 31, 2017	
	Carrying value	Approximate fair value	Carrying value	Approximate fair value
Long-term debt, including current portion [1]	$ 1,331,466	$ 1,598,125	$ 1,304,799	$ 1,597,761

[1] Classified in Level 2 as the significant measurement inputs used in the valuation models are indirectly observable in active markets.

Carrying value is measured at amortized cost using the effective interest rate method. Fair value is calculated by discounting the future cash flows of each debt issue at the estimated yield to maturity for the same or similar issues at the date of the statements of financial position, or by using available quoted market prices.

The following items shown in the consolidated statements of financial position as at September 30, 2017 and March 31, 2017 are carried at fair value on a recurring basis using Level 1 or 2 inputs. There were no financial assets and liabilities at September 30, 2017 or at March 31, 2017, valued using Level 3 inputs.

	As at September 30, 2017		As at March 31, 2017	
	Level 1	Level 2	Level 1	Level 2
Asset (liability):				
Cash [1]	$ 89,689	$ -	$ 66,093	$ -
Cash equivalents [1]	468	-	44	-
Derivatives [2]	-	3,058	-	556
	$ 90,157	**$ 3,058**	**$ 66,137**	**$ 556**

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

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

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

No amounts have been reclassified into or out of fair value classifications in the six months ended September 30, 2017. Financial assets have been pledged as security for liabilities under the MTI.

During the six months ended September 30, 2017, gains or losses related to Level 2 derivatives have been recorded in OCI. There were no Level 3 instruments outstanding during the period.

7. Financial instruments (continued):

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

8. Financial risk management:

Fuel price risk:

The Group is exposed to risks associated with changes in the market price of marine diesel fuel and natural gas (“NG”) fuel. In order to reduce price volatility and add a fixed component to the inherent floating nature of fuel prices, the Group may manage its exposure by entering into hedging instruments with certain financial intermediaries. Fuel price hedging instruments are used to reduce fuel price risk and to minimize fuel surcharges, not for generating trading profits. Gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs. Pursuant to the Group's Financial Risk Management Policy, the term of the contracts is not to extend beyond the end of the fourth performance term ending March 31, 2020. This policy also 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 period thereafter to the fourth performance term.

The Group is also allowed by regulatory order to use deferred fuel cost accounts to mitigate the impact of changes in fuel price on its earnings (note 15).

During the six months ended September 30, 2017, the Group entered into ultra-low sulfur diesel (“ULSD”) fuel swap contracts with a notional value of $29.2 million CAD. To reduce its exposure to changes in the ULSD and foreign exchange risk components associated with forecast diesel fuel purchases, the Group hedges using CAD denominated ULSD swaps. The notional value of all fuel swap contracts outstanding as at September 30, 2017 was $71.8 million CAD (March 31, 2017: $66.7 million). Hedge accounting was applied to these contracts. No NG swap contracts were entered into during the six months ended September 30, 2017.

An economic relationship exists between the hedged item and the hedging instruments as the fair values of both the hedged item and the hedging instrument move into opposite directions in response to the same risk. The inclusion of credit risk in the fair value of the hedging instrument which is not replicated in the hedged item is a potential source of ineffectiveness, however, the Group does not consider this risk to be material.

During the six months ended September 30, 2017, the total change in the value of fuel swap contracts was $2.5 million. The fair value change of $0.8 million was recognized in OCI. The realized hedging loss of $1.7 million was reclassified from equity (accumulated other comprehensive income) and included in the Group’s fuel expense during the six months ended September 30, 2017. There was no hedge ineffectiveness during the six months ended September 30, 2017.

8. Financial risk management (continued):

	Fiscal 2018	Fiscal 2019	Fiscal 2020	Total
Cash flow hedges:				
Fuel price risk:				
Fuel contracts (litres in thousands)	31,850	68,800	30,180	130,830
Contract price range ($/litre)	$0.4931-$0.5694	$0.5247-$0.5680	$0.5308-$0.5599	

(a) As at September 30, 2017, the Group's derivative assets of $3.1 million included foreign exchange forward contracts and fuel swap contracts and derivative liabilities of $0.1 million included foreign exchange forward contracts and fuel swap contracts.

Fuel swap contracts as at September 30, 2017:

				Fair value changes used for calculating hedge ineffectiveness		
	Notional amount of the hedging instrument	Carrying amount of the hedging instrument	Item location	Cash flow hedge reserve	Hedging instruments	Hedged items
Cash flow hedges:						
Fuel price risk	$ 71,823	$ 3,108	Derivative assets	$ 3,108	$ 3,108	$ 3,118

(b) Cash flow hedge reserve:

	Three months ended September 30, 2017	Three months ended September 30, 2016	Six months ended September 30, 2017	Six months ended September 30, 2016
Hedging gains recognized in cash flow hedge reserve:				
Fuel swap contracts (note 9(a))	6,526	208	810	10,536
Hedging losses reclassified from cash flow hedge reserve:				
Interest rate forward contract - amortization of hedge loss	62	62	124	124
Fuel swap contracts – loss recognized in net earnings (note 9(a))	942	2,816	1,737	5,135
Net change in cash flow hedge reserve	7,530	3,086	2,671	15,795

(Tabular amounts expressed in thousands of Canadian dollars)

9. Other comprehensive income (loss):

(a) Continuity of reserves:

	Land revaluation reserves	Employee future benefit revaluation reserves	Fuel swaps reserves	Interest rate forward contracts reserves	Total
Balance at March 31, 2017	**7,109**	**(4,026)**	**561**	**(6,710)**	**(3,066)**
Actuarial loss on defined benefit plans (note 13)	-	(1,943)	-	-	(1,943)
Derivatives designated as cash flow hedges (note 8(b)):					
Net change in fair value	-	-	810	-	810
Realized losses (note 8(b))	-	-	1,737	-	1,737
Amortization of losses (note 8(b))	-	-	-	124	124
Balance at September 30, 2017	**7,109**	**(5,969)**	**3,108**	**(6,586)**	**(2,338)**

(b) Other comprehensive income (loss):

	Three months ended September 30		Six months ended September 30	
	2017	2016	2017	2016
Items not to be reclassified to net earnings:				
Actuarial losses on defined benefit plans	(1,943)	(1,240)	(1,943)	(1,240)
Items to be reclassified to net earnings:				
Hedge gains on fuel swaps (note 8(b))	6,526	208	810	10,536
Total other comprehensive income (loss)	**4,583**	**(1,032)**	**(1,133)**	**9,296**

10. Net retail:

	Three months ended September 30		Six months ended September 30	
	2017	2016	2017	2016
Retail revenue	$ 34,993	$ 32,256	59,474	$ 54,994
Cost of goods sold	(13,113)	(12,250)	(22,671)	(21,277)
Net retail	$ **21,880**	**$ 20,006**	**36,803**	**$ 33,717**

(Tabular amounts expressed in thousands of Canadian dollars)

11. Operating expenses:

	Three months ended September 30		Six months ended September 30	
	2017	2016	2017	2016
Salaries, wages and benefits	$ 95,830	$ 91,338	$ 189,721	$ 177,341
Fuel	30,878	32,380	56,239	55,963
Materials, supplies and contracted services	13,872	15,060	34,389	33,423
Other operating expenses	16,362	15,210	32,341	29,073
Depreciation and amortization	40,008	36,373	78,648	73,213
Total operating expenses	**$ 196,950**	**$ 190,361**	**$ 391,338**	**$ 369,013**

12. Net finance expense:

	Three months ended September 30		Six months ended September 30	
	2017	2016	2017	2016
Finance expenses:				
Long-term debt	$ 16,046	$ 15,665	$ 31,939	$ 31,228
Short-term debt	47	63	283	148
Finance leases	452	469	908	943
Amortization of deferred financing costs and bond discounts	335	160	638	320
Interest capitalized in the cost of qualifying assets	(1,460)	(1,824)	(3,180)	(3,694)
Total finance expenses	15,420	14,533	30,588	28,945
Finance income	(1,365)	(1,148)	(2,428)	(2,183)
Net finance expense	**$ 14,055**	**$ 13,385**	**$ 28,160**	**$ 26,762**

13. Accrued employee future benefits:

During the six months ended September 30, 2017, the Group recognized total defined benefit costs of $1.0 million (September 30, 2016: $1.1 million).

During the three months ended September 30, 2017, the Group recognized a net loss of $1.9 million in other comprehensive income reflecting the actuarial valuation for the retirement and death defined benefit plans as at March 31, 2017.

14. Related party transactions:

In accordance with the Act, the Group is responsible for paying any expenses that are incurred by the Authority, without charge. During the six months ended September 30, 2017, the Group paid $82,342 (September 30, 2016: $62,606) of such expenses.

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

(Tabular amounts expressed in thousands of Canadian dollars)

15. Economic effect of rate regulation:

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

In January 2014 the IASB issued IFRS 14, *Regulatory Deferral Accounts*. IFRS 14 is an interim standard that addresses the accounting for regulatory deferral accounts; however, it does not allow the recognition of regulatory assets and regulatory liabilities that result from the regulated price cap setting process for entities that have already transitioned to IFRS. The Group transitioned to IFRS effective April 1, 2011. As a result, the Group is not permitted to recognize its regulatory assets and regulatory liabilities in its consolidated statements of financial position.

Regulatory assets generally represent incurred costs that have been deferred for purposes of rate regulation because they are probable of future recovery in tariffs or fuel surcharges. Regulatory liabilities represent obligations to customers which will be settled through future tariff reductions or fuel rebates. Management continually assesses whether the Group’s regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes. Management believes that the regulatory assets at September 30, 2017, are probable of future recovery in tariff or fuel surcharges.

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

	As at	
Regulatory accounts	September 30, 2017	March 31, 2017
Deferred fuel costs:		
Balance, beginning of period	$ 4,450	$ (6,132)
Fuel costs under set price	(6,274)	(7,625)
Rebates	11,614	18,068
Fuel price risk recoveries payable to the Province	291	139
Balance, end of period	10,081	4,450
Total long-term regulatory assets	**$ 10,081**	**$ 4,450**

The Act contains provisions which ensure that if tariffs charged by the Group exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. At September 30, 2017, tariffs charged to customers were below established price caps.

(Tabular amounts expressed in thousands of Canadian dollars)

15. Economic effect of rate regulation (continued):

If the Group was permitted under IFRS to recognize the effects of rate regulation and to record regulatory assets and regulatory liabilities, net earnings for the three months ended September 30, 2017 would have been $3.3 million higher (September 30, 2016: $5.4 million higher) and during the six months ended September 30, 2017, net earnings would have been $5.6 million higher (September 30, 2016: $7.1 million higher) as detailed below:

Effect of rate regulation on net earnings	Three months ended September 30		Six months ended September 30	
	2017	2016	2017	2016
Regulatory accounts:				
Deferred fuel costs	$ 3,271	$ 5,447	$ 5,631	$ 7,078
Total increase in net earnings	**$ 3,271**	**$ 5,447**	**$ 5,631**	**$ 7,078**