



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

For the three months ended
June 30, 2017

Dated August 17, 2017

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**Management's Discussion & Analysis
of Financial Condition and Financial Performance
For the three months ended June 30, 2017
Dated August 17, 2017**

The following is our discussion and analysis of the financial condition and financial performance for British Columbia Ferry Services Inc. ("BC Ferries") for the three months ended June 30, 2017 and has been prepared with information available as of August 17, 2017. This discussion and analysis should be read in conjunction with our unaudited interim consolidated financial statements and related notes for the three months ended June 30, 2017 and 2016, and our audited consolidated financial statements and related notes for the years ended March 31, 2017 ("fiscal 2017") and March 31, 2016 ("fiscal 2016"), together with our Management's Discussion & Analysis for fiscal 2017. These documents are available on our investor webpage at http://www.bcferrries.com/investors/financial_reports.html and on SEDAR at www.sedar.com.

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

BUSINESS OVERVIEW

British Columbia Ferry Services Inc. is an independent company providing passenger and vehicle ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world. We provide frequent year-round transportation service with 35 vessels operating on 24 routes out of 47 terminals spread over 1,600 kilometres of coastline. We also manage ferry transportation service on other remote routes through contracts with independent operators.

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

We provide a wide range of ferry services for our customers. During the three months ended June 30, 2017 (the first quarter of fiscal 2018), we provided over 43,000 sailings (522 more than the same period in the prior year), carrying over five million passengers and two million vehicles. During the three months ended June 30, 2017, passenger traffic increased 3.8% and vehicle traffic increased 4.4% compared to the same quarter in the prior year, resulting in higher revenue which contributed favourably towards our net earnings. Passenger traffic levels were the highest we have experienced in 20 years and vehicle traffic levels were the highest we have ever experienced as compared to the same quarter in prior years. For a more detailed discussion of our traffic levels, see "Financial and Operational Overview" below.

Significant events during or subsequent to the first quarter of fiscal 2018 include the following:

Tariff

- On April 1, 2017, we applied average fare increases below those allowed by the BC Ferries Commissioner (the "Commissioner"). No passenger or vehicle fare increases were implemented on any routes with the exception of the three Major Routes connecting Metro Vancouver with mid and southern Vancouver Island. Average vehicle fare increases of 1.9% were implemented on these three Major Routes which enabled us to provide promotional fares with significant discounts on many sailings. No increase in passenger fares were implemented on these routes. Also on April 1, 2017, we implemented reductions in reservation fees.

Vessels

- On April 7, 2017, we finalized an agreement to acquire a 75-metre vessel with ownership to transfer in August 2017. The vessel, built in 2000, will accommodate approximately 35 vehicles and 150 passenger and crew and will be deployed on the mid-coast. On April 5, 2017, in response to our application, the Commissioner issued Order 17-03, in which he confirmed his determination that the capital expenditure for the acquisition and modification of a used vessel to be used to provide mid-coast service, including a new seasonal direct ferry service between Port Hardy and Bella Coola, as well as the necessary terminal modifications, is reasonably required. On April 5, 2017, after the Order was issued, the Province contributed an initial \$15 million towards the provision of this service, and on March 21, 2017, the Government of Canada approved funding of up to \$15.1 million under the New Building Canada Fund.
- On April 13, 2017, we entered into design and build contracts totalling \$60 million for the construction of two minor class vessels. On March 14, 2017, the Government of Canada approved funding of up to \$28.3 million under the New Building Canada Fund toward the purchase of two minor vessels. These vessels will each have a capacity of up to 300 passengers and approximately 44 vehicles. When these new vessels are placed into service, we will be able to retire the 59-year old *North Island Princess* and the 53-year old *Howe Sound Queen*. We intend to deploy the first new vessel to provide service from Powell River to Texada Island and the second new vessel to provide service from Port McNeill to Alert Bay and to Sointula.
- On April 26, 2017, we received \$1.5 million from FortisBC Energy Inc., the third payment towards a total contribution of \$6 million as part of the Natural Gas for Transportation ("NGT") incentive funding. We previously received \$2.3 million on March 7, 2017 and \$1.5 million in fiscal 2015. The last payment of \$0.7 million is expected to be received during fiscal 2018. The contribution is dependent upon the purchase of at least 3 million gigajoules of liquefied natural gas ("LNG") over a 10-year period. The NGT incentive funding will be applied towards the purchase of the three new Salish Class vessels. These vessels are dual-fuel capable and will run predominantly on LNG with marine diesel as a backup. We believe this will result in the reduction of carbon dioxide emissions and operating cost savings.
- On May 16, 2017, our first Salish Class vessel, the *Salish Orca*, commenced regularly scheduled service between Comox and Powell River. The *Salish Orca* replaced the 52-year old *Queen of Burnaby*.
- On June 1, 2017, we entered into a five-year supply agreement with Point Hope Maritime Ltd. of Victoria, BC for the maintenance of eight of our minor vessels. We have approximately 20 scheduled dry-dockings for the minor vessels over the next five years and this strategic partnership ensures a local and secure supply of services.

- On June 21, 2017 and on August 3, 2017, our second and third Salish Class vessels, the *Salish Eagle* and the *Salish Raven*, respectively, commenced regularly scheduled service in the Southern Gulf Islands. Introduction of these vessels will enable the retirement of the 53-year old *Queen of Nanaimo*.

Financing

- On April 28, 2017 and on May 4, 2017, we drew the third and final \$45 million under our export loan agreement with KfW IPEX-Bank GmbH, to coincide with the contract payment schedule for the *Salish Raven*. The net proceeds from the loan were used to partially finance the purchase of the *Salish Raven*. (See "Liquidity and Capital Resources" below for more detail.)

General

- On April 1, 2017, Mark Collins assumed the role of President and CEO. A senior marine executive for the past 20 years, Mr. Collins' experience includes roles as the President of Rolls Royce Marine Brazil and Italy and Vice President of Global Technical Services, CSL Group. Mr. Collins was previously Vice President of Strategic Planning & Community Engagement at BC Ferries, and was the Vice President, Engineering between 2004 and 2012.
- On June 23, 2017, our former Chief Financial Officer, Dennis Dodo, departed the company, and subsequently Alana Gallagher was appointed Chief Financial Officer. Ms. Gallagher has been Treasurer at BC Ferries for 18 years.

FINANCIAL AND OPERATIONAL OVERVIEW

This section provides an overview of our financial and operational performance for the three month periods ended June 30, 2017 and 2016.

(\$ millions)	Three months ended June 30			
	2017	2016	Variance	
			\$	%
Total revenue	225.9	219.2	6.7	3.1%
Operating expenses	194.4	178.6	(15.8)	(8.8%)
Operating profit	31.5	40.6	(9.1)	(22.4%)
Net finance and other	14.2	13.6	(0.6)	(4.4%)
Net earnings	17.3	27.0	(9.7)	(35.9%)
Other comprehensive (loss) income	(5.7)	10.3	(16.0)	(155.3%)
Total comprehensive income	11.6	37.3	(25.7)	(68.9%)

Our net earnings in the three months ended June 30, 2017 were \$9.7 million lower and total comprehensive income was \$25.7 million lower than in the three months ended June 30, 2016.

In the first quarter of fiscal 2018, revenues increased by 3.1% compared to the first quarter of the previous fiscal year, primarily as a result of the increased traffic volumes while the average tariff revenue per passenger remained unchanged and the average tariff revenue per vehicle decreased across the system. On April 1, 2017 we implemented a modest increase in vehicle fares on the Major Routes, which allowed us to provide promotional fares with significant discounts on many sailings.

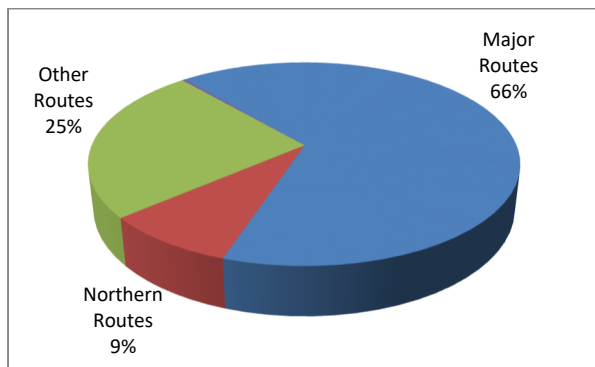
In the first quarter of fiscal 2018, operating expenses increased by 8.8% compared to the first quarter of the previous fiscal year. To improve our customer experience and to accommodate the higher traffic volumes, we provided 311 additional round trips and prepared for the introduction of three new vessels. Our actions resulted in an increase in fuel consumption, labour and training related costs.

The decrease in other comprehensive income from a gain of \$10.3 million in the first quarter of fiscal 2017 to a loss of \$5.7 million in the first quarter of fiscal 2018 reflects the \$16.0 million change in the fair value of our fuel swap contracts.

In the first quarter of fiscal 2018, vehicle traffic increased 4.4% and passenger traffic increased 3.8% compared to the same quarter in the prior year. We experienced growth in vehicle and passenger traffic system-wide. Passenger traffic levels were the highest we have experienced in 20 years and vehicle traffic levels were the highest we have ever experienced, as compared to the same quarter in prior years. Overall, commercial traffic increased by 0.4% in the quarter, while drop-trailer traffic, a component of commercial traffic, increased by 3.2% in the same period.

Revenue and Operational Statistics

The following discussions of revenue are based on IFRS results, with reference to the impacts of rate regulation (See "Accounting Practices – The Effect of Rate Regulation"). Our Major Routes, which are our four busiest routes, consist of three regulated routes connecting Metro Vancouver with mid and southern Vancouver Island and one regulated route connecting Horseshoe Bay and Langdale. Our Northern Routes consist of two regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island. Our Other Routes consist of 18 regulated routes and 8 unregulated routes primarily serving the northern and southern Gulf Islands and the northern Sunshine Coast.



In the three months ended June 30, 2017, the greatest portion of our revenues (66%) was earned on our Major Routes. Revenue from the Northern Routes contributed 9% and revenue from Other Routes contributed 25%.

Select operational statistics and total revenues for the three months ended June 30, 2017 compared to the same period in the prior year are shown in the tables below.

Operational Statistics	Three months ended June 30	
	2017	2016
Vehicle traffic	2,242,499	2,148,116
Passenger traffic	5,588,994	5,383,124
On-time performance	86.4%	88.0%
Number of round trips	19,535	19,224
Capacity provided (AEQs)	3,822,217	3,767,838
AEQs carried	2,552,637	2,455,327
Capacity utilization	66.8%	65.2%

In the three months ended June 30, 2017, vehicle traffic increased 4.4% and passenger traffic increased 3.8% compared to the same quarter in the prior year. Overall, we believe traffic during the first quarter of fiscal 2018 continued to be favourably impacted by the lower Canadian dollar, increases in tourism and other economic activity in British Columbia. We believe our passenger and vehicle fare pricing promotion also had a positive impact on both passenger and vehicle traffic.

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.

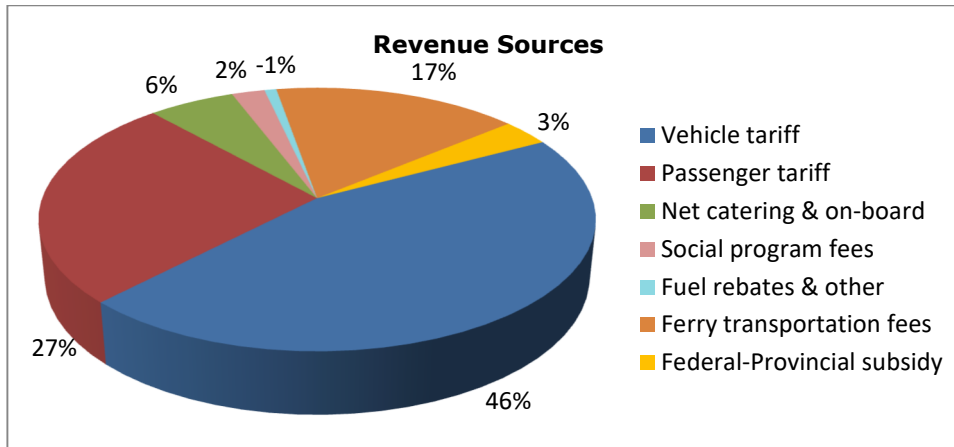
Meeting customer service expectations in a safe and reliable manner is an important factor in our focus on on-time performance. Our initiatives to improve on-time performance include adjusting and/or expanding sailing schedules, adjusting crewing schedules and refining vehicle loading processes during peak periods. While on-time performance on the Major Routes improved, that improvement was somewhat offset by a decline in on-time performance on the Northern and Other Routes, primarily due to the impact from increased traffic demand and delays due to weather.

An automobile equivalent ("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 vehicles types (the relative number of buses, commercial vehicles, and passenger vehicles), and actual size of vehicles carried.

Vehicle capacity provided, measured in AEQs, is the available vehicle deck space on a vessel multiplied by the number of round trips. The Coastal Ferry Services Contract ("CFSC") between BC Ferries and the Province stipulates, among other things, the minimum number of round trips to be provided for each regulated ferry service route in exchange for ferry transportation fees. 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. In the three months ended June 30, 2017, we provided 311 additional round trips compared to the same period in the prior year, resulting in an increase in capacity provided.

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 size of the vessels utilized and the number of round trips in each period. Capacity utilization increased to 66.8% from 65.2% for the three months ended June 30, 2017, compared to the same quarter in 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.

Revenue (\$ millions)	Three months ended June 30			
	2017	2016	Increase (Decrease)	
			\$	%
Direct Route Revenue				
Vehicle tariff	102.6	100.3	2.3	2.3%
Passenger tariff	60.5	58.1	2.4	4.1%
Fuel rebates	(4.9)	(4.7)	(0.2)	(4.3%)
Net retail	14.3	13.1	1.2	9.2%
Social program fees	4.9	5.0	(0.1)	(2.0%)
Other revenue	2.5	2.3	0.2	8.7%
Total Direct Route Revenue	179.9	174.1	5.8	3.3%
Indirect Route Revenue				
Ferry transportation fees	38.0	37.2	0.8	2.2%
Federal-Provincial subsidy	7.5	7.3	0.2	2.7%
Total Route Revenue	225.4	218.6	6.8	3.1%
Other general revenue	0.5	0.6	(0.1)	(16.7%)
Total Revenue	225.9	219.2	6.7	3.1%



Vehicle tariffs (which include reservation fee revenue) and passenger tariffs account for the majority of our revenues. Our year-over-year tariff revenues may be impacted by such things as changes in overall traffic levels, tariff rates and the proportion of total traffic on routes with higher versus lower fares. Catering, retail and other on-board service is our second highest source of direct revenue and provides a gross margin of approximately 60% which contributes favourably to our net earnings and helps to keep fares affordable. Catering, retail and other on-board services are impacted by traffic, price, service quality and product offerings.

On April 1, 2017, we implemented fare increases as permitted by the Commissioner's Order 15-03 dated September 16, 2015 by which the price cap increases for the four years ended March 31, 2020 ("PT4") were established. Average fare increases were below those allowed by the Commissioner. Average vehicle fares were increased by 1.9% on three of the Major Routes: Tsawwassen to Swartz Bay, Tsawwassen to Duke Point and Horseshoe Bay to Departure Bay. No increase in passenger fares was implemented on these routes. No increases in vehicle fares or passenger fares were implemented on the regulated Other Routes, the Northern Routes or the Horseshoe Bay to Langdale route. Also on April 1, 2017, we implemented reductions in reservation fees.

Surcharges and/or rebates are implemented as a direct result of rising and declining fuel prices. On April 1, 2016, due to lower fuel prices, coupled with the fact that we had, through our fuel hedging program, locked in pricing for a significant portion of our forecast fuel consumption to the end of 2017, we implemented a fuel rebate of 1.9% on the Northern Routes and increased fuel rebates from 1% to 2.9% on our Major and regulated Other Routes. These fuel rebates continued during the three months ended June 30, 2017. Prior to April 1, 2016, no rebates or surcharges were in place on our Northern Routes. For the purpose of rate regulation, these amounts are applied to our deferred fuel cost accounts. (See "Accounting Practices - The Effect of Rate Regulation" below for more detail.)

From time to time, we utilize promotional fares designed to stimulate growth in traffic or to direct traffic towards our less busy sailings while ensuring compliance with approved price cap orders. In calculating the price cap, vehicle and passenger tariffs, as well as reservation revenue, is combined. The utilization of promotional fare incentives may cause the average vehicle and passenger fares to be under or over the allowed increase in any one period; however, under the terms of the *Coastal Ferry Act* (the "Act") we cannot be over price cap for more than four consecutive quarters.

Year-to-year changes in operational statistics and revenue for the three months ended June 30, 2017 and 2016 for the Major, Northern and Other Routes are discussed separately below.

Major Routes

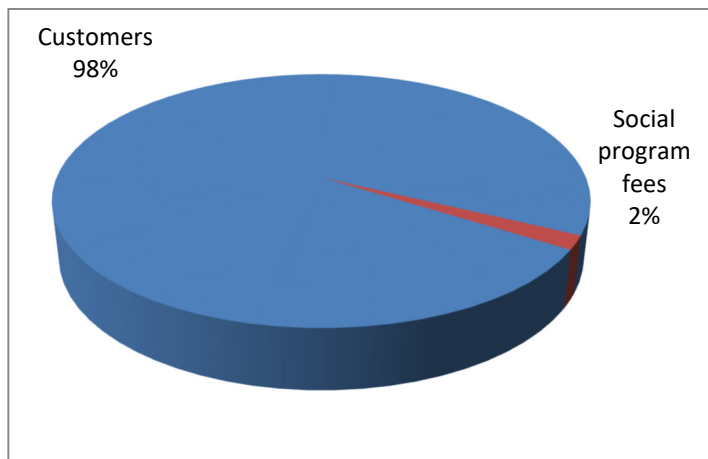
Our Major Routes are our four busiest routes, carrying approximately 60% of our vehicle traffic and 64% of our passenger traffic during the three month periods ended June 30, 2017 and 2016.

Operational Statistics	Three months ended June 30	
	2017	2016
Vehicle traffic	1,330,193	1,282,364
Passenger traffic	3,604,138	3,471,058
On-time performance	78.0%	73.4%
Number of round trips	3,306.5	3,184.0
Capacity provided (AEQs)	2,070,372	2,014,036
AEQs carried	1,573,758	1,527,843
Capacity utilization	76.0%	75.9%

In the three months ended June 30, 2017, vehicle traffic increased 3.7% and passenger traffic increased 3.8% compared to the same period in the prior year. Overall, commercial traffic decreased 0.5% in the quarter, while drop-trailer traffic, a component of total commercial traffic, increased 3.2% in the same period. We believe traffic during the first quarter of fiscal 2018 continued to be favourably impacted by the lower Canadian dollar, increases in tourism and other economic activity in British Columbia. We believe our passenger and vehicle fare pricing promotion also had a positive impact on both passenger and vehicle traffic.

During the first quarter of fiscal 2018, on-time performance on the Major Routes improved 4.6% compared to the same period in the prior period. On-time performance on all of the Major Routes improved with the exception of the route connecting Horseshoe Bay and Langdale which declined 5.7%. We face particular on-time challenges on the routes using Horseshoe Bay terminal. The configuration of the terminal limits our operational flexibility, particularly during periods of high traffic. Our initiatives to continue to improve on-time performance have included adjusting and/or expanding sailing schedules, adjusting crewing schedules, changing operational procedures and refining vehicle loading processes during peak periods.

Capacity utilization on these routes during the three months ended June 30, 2017 was comparable to the same period in the prior year, mainly as a result of a higher number of AEQs carried due to higher traffic levels, mainly offset by an increase in capacity provided from additional round trips.



In the three months ended June 30, 2017, revenue from our Major Routes consisted of 98% from customers and 2% from the Province.

Major Routes cont'd

Revenue (\$ thousands)	Three months ended June 30			
	2017	2016	Increase (Decrease)	
Direct Route Revenue				
Vehicle tariff	86,681	85,133	1,548	1.8%
Passenger tariff	49,210	47,327	1,883	4.0%
Fuel rebates	(3,982)	(3,854)	(128)	(3.3%)
Net retail	12,849	11,788	1,061	9.0%
Social program fees	2,501	2,551	(50)	(2.0%)
Parking	1,300	1,267	33	2.6%
Other revenue	1,021	984	37	3.8%
Total Direct Route Revenue	149,580	145,196	4,384	3.0%
Indirect Route Revenue	-	-	-	-
Total Route Revenue	149,580	145,196	4,384	3.0%

In the three months ended June 30, 2017, average tariff revenue (tariff revenue divided by traffic volume) per vehicle decreased \$1.22 or 1.8% compared to the same period in the prior year. On April 1, 2017 we implemented a modest increase in vehicle fares, which allowed us to provide promotional fares with significant discounts on many sailings. No passenger fare increases were implemented at April 1, 2017, resulting in average tariff revenue per passenger in the three months ended June 30, 2017 remaining at the same level as the three months ended June 30, 2016. The increase in traffic levels and the change in average tariff revenue during the first quarter of fiscal 2017 resulted in a tariff revenue increase of \$3.4 million compared to the same period in the prior year.

As discussed above, a fuel rebate of 2.9% was in place on our Major Routes during the three months ended June 30, 2017 and June 30, 2016.

All vessels that provide service on our Major Routes have a gift shop and options for food service. In the three months ended June 30, 2017, net retail sales increased 9.0% compared to the same period in the prior year as a result of both higher passenger traffic and higher average sales per passenger. Food sales remain strong, providing approximately 72% of the total retail revenue. Sales of quality apparel continue to grow and now comprise over 10% of total retail revenue. Cost of goods sold is approximately 40% of total sales.

Social program fees are reimbursements from the Province of discounts provided on fares for students travelling to and from school, persons with disabilities and persons travelling under the Ministry of Health Travel Assistance Program ("MTAP"). Social program fees for the three months ended June 30, 2017 decreased slightly compared to the same period in the prior year, mainly as a result of fewer students travelling under the program.

Revenue from parking increased as a result of higher traffic levels and proportionately higher usage.

Northern Routes

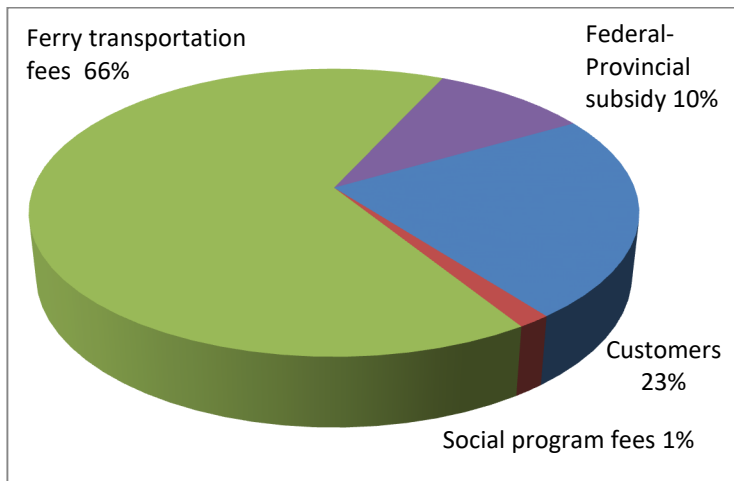
Our Northern Routes consist of two regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island.

Operational Statistics	Three months ended June 30	
	2017	2016
Vehicle traffic	7,574	7,102
Passenger traffic	20,373	18,995
On-time performance	85.3%	90.3%
Number of round trips	58.5	54.0
Capacity provided (AEQs)	11,787	11,064
AEQs carried	9,485	8,799
Capacity utilization	80.5%	79.5%

In the three months ended June 30, 2017, vehicle traffic increased 6.6% and passenger traffic increased 7.3% compared to the same period in the prior year.

On-time performance in the three months ended June 30, 2017 decreased from 90.3% to 85.3% over the same period in the prior year, primarily due to the additional loading and unloading time required to manage the increased traffic demand.

Capacity utilization on these routes during the three months ended June 30, 2017 was 1.0% higher than the same period in the prior year, primarily as a result of a higher number of AEQs carried mainly offset by increased capacity provided due to an increase in the number of round trips.



In the three months ended June 30, 2017, revenue from our Northern Routes consisted of 23% from customers and 77% from the Province (1% social program fees, 66% ferry transportation fees, and 10% from payments under the Federal-Provincial subsidy agreement).

Northern Routes cont'd

Revenue (\$ thousands)	Three months ended June 30			
	2017	2016	Increase (Decrease)	
Direct Route Revenue				
Vehicle tariff	2,173	2,001	172	8.6%
Passenger tariff	1,635	1,550	85	5.5%
Fuel (rebates) surcharges	(80)	(75)	(5)	(6.7%)
Net retail	245	217	28	12.9%
Social program fees	295	317	(22)	(6.9%)
Stateroom rental	415	374	41	11.0%
Hostling & other	78	63	15	23.8%
Total Direct Route Revenue	4,761	4,447	314	7.1%
Indirect Route Revenue				
Ferry transportation fees	12,826	12,535	291	2.3%
Federal-Provincial subsidy	1,910	1,870	40	2.1%
Total Route Revenue	19,497	18,852	645	3.4%

In the three months ended June 30, 2017, average tariff revenue (tariff revenue divided by traffic volume) per vehicle increased \$5.15 or 1.8% compared to the same period in the prior year. There were no vehicle fare or passenger fare increases implemented at April 1, 2017. Average tariff revenue per passenger during the same period decreased \$1.35 or 1.7%. Average tariff revenues reflect a change in the proportion of traffic on routes with higher versus lower tariffs. The increase in traffic levels and changes in average tariff revenue, during the first quarter of fiscal 2017 resulted in a total tariff revenue increase of \$0.3 million compared to the same period in the prior year.

As discussed above, a fuel rebate of 1.9% was in place on our Northern Routes during the three months ended June 30, 2017 and June 30, 2016.

Reimbursements from the Province for social program fees decreased compared to the same period in the prior year, mainly as a result of a decrease in the usage of the MTAP program.

Revenue from net retail services increased in the quarter compared to the same period in the prior year, mainly as a result of higher passenger levels.

Stateroom rental revenue increased due to higher passenger levels and increased utilization.

Ferry transportation fees received from the Province increased \$0.3 million in the quarter compared to the same period in the prior year, mainly as a result of differences in the monthly schedule of round trips.

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

Other Routes

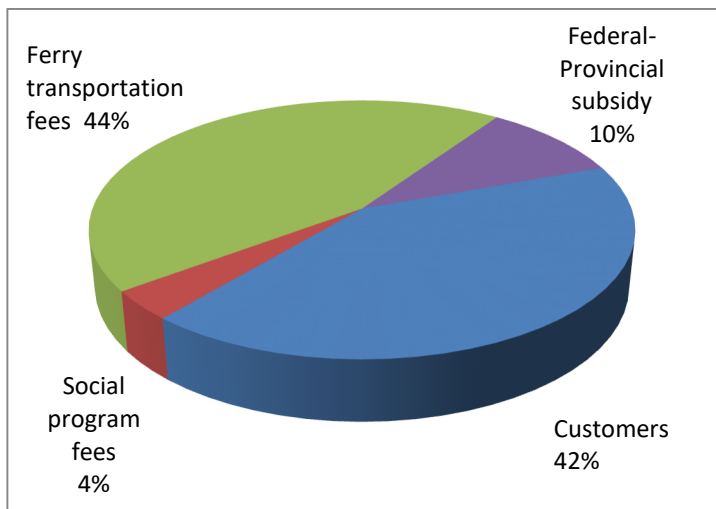
Our Other Routes primarily serve the northern and southern Gulf Islands and the northern Sunshine Coast. One of the regulated routes and all of the unregulated routes are operated under contract by alternative service providers. We receive fees from the Province for the provision of contracted services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

Operational Statistics	Three months ended June 30	
	2017	2016
Vehicle traffic	904,732	858,650
Passenger traffic	1,964,483	1,893,071
On-time performance	88.0%	90.5%
Number of round trips	16,170.0	15,986.0
Capacity provided (AEQs)	1,740,058	1,742,738
AEQs carried	969,394	918,685
Capacity utilization	55.7%	52.7%

In the three months ended June 30, 2017, vehicle traffic increased 5.4% and passenger traffic increased 3.8% compared to the same period in the prior year.

On-time performance in the three months ended June 30, 2017 decreased from 90.5% to 88.0% over the same period in the prior year, primarily due to the impact from increased traffic demand, vessel substitutions and delays due to weather.

Capacity utilization on these routes during the three months ended June 30, 2017 was higher compared to the same period in the prior year, primarily due to a higher number of AEQs carried and a decrease in capacity provided due to vessel substitutions.



In the three months ended June 30, 2017, revenue from our Other Routes consisted of 42% from customers and 58% from the Province (4% social program fees, 44% ferry transportation fees, and 10% from payments under the Federal-Provincial subsidy agreement).

Other Routes cont'd

Revenue (\$ thousands)	Three months ended June 30			
	2017	2016	Increase (Decrease)	
Direct Route Revenue				
Vehicle tariff	13,791	13,099	692	5.3%
Passenger tariff	9,630	9,254	376	4.1%
Fuel (rebates) surcharges	(806)	(770)	(36)	(4.7%)
Social program fees	2,080	2,122	(42)	(2.0%)
Net retail	806	742	64	8.6%
Parking & other	89	68	21	30.9%
Total Direct Route Revenue	25,590	24,515	1,075	4.4%
Indirect Route Revenue				
Ferry transportation fees	25,197	24,631	566	2.3%
Federal-Provincial subsidy	5,535	5,419	116	2.1%
Total Route Revenue	56,322	54,565	1,757	3.2%

In the three months ended June 30, 2017, average tariff revenue per vehicle (tariff revenue divided by traffic volume) and average tariff revenue per passenger remained at a similar level, reflecting the fact that no fare increases for these routes were implemented at April 1, 2017. The total tariff revenue increase of \$1.1 million compared to the same period in the prior year was mainly as a result of higher traffic levels.

As discussed above, a fuel rebate of 2.9% was in place on our regulated Other Routes during the three months ended June 30, 2017 and June 30, 2016.

In the three months ended June 30, 2017, social program fees decreased compared to the same period in the prior year, mainly as a result of fewer students travelling and a decrease in the number of people using the MTAP program.

Revenue from net retail services increased in the quarter compared to the same period in the prior year as a result of both higher passenger traffic and higher average sales per passenger.

Ferry transportation fees received from the Province increased \$0.6 million in the quarter compared to the same period in the prior year as a result differences in the monthly schedule of round trips.

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

Expenses

Expenses for the three month periods ended June 30, 2017 and 2016 are summarized in the table below:

Operating expenses (\$ millions)	Three months ended June 30			
	2017	2016	Increase (Decrease)	
			\$	%
Operations	124.9	112.7	12.2	10.8%
Maintenance	20.9	21.1	(0.2)	(0.9%)
Administration	10.0	8.0	2.0	25.0%
Total operations, maintenance & administration	155.8	141.8	14.0	9.9%
Depreciation and amortization	38.6	36.8	1.8	4.9%
Total operating expenses	194.4	178.6	15.8	8.8%

To improve our customer experience and to accommodate the higher traffic volumes, we provided 311 additional round trips and prepared to introduce three new vessels. Our actions resulted in an increase in fuel consumption, labour and training related costs. We continue to take proactive measures to contain, reduce and optimize expenses while operating a sustainable, safe and reliable service.

In the three months ended June 30, 2017, operations expenses increased \$12.2 million compared to the same period in the prior year mainly due to:

- \$6.1 million increase in wages and benefits costs, mainly due to staffing for the additional round trips provided, a wage rate increase of 1.5% effective April 1, 2017 in accordance with the Collective Agreement with the BC Ferry & Marine Workers' Union, an increase in overtime and an increase in hours spent in training activities where backfill was required;
- \$1.8 million increase in fuel expense, reflecting a \$1.1 million or 4.5% increase in fuel prices and a \$0.7 million or 2.9% increase in fuel consumption primarily from additional round trips provided. For purposes of rate regulation, in the three months ended June 30, 2017, \$2.6 million would be recorded in deferred fuel cost accounts. (See "Accounting Practices - The Effect of Rate Regulation" below for more detail.);
- \$1.7 million increase in costs primarily due to a hydraulic issue with a controllable pitch propeller on the *Spirit of Vancouver Island* which resulted in emergency drydocking;
- \$1.2 million increase in materials, supplies and contracted services mainly resulting from increased traffic volumes; and
- \$1.4 million increase in training related expenses, utilities, computer licences, credit card fees and promotional costs.

Maintenance costs were \$0.2 million lower in the three months ended June 30, 2017 compared to the same period in the prior year as a result of variations in vessel refit scheduling and in the timing of repairs to our terminals.

Administration costs were \$2.0 million higher in the three months ended June 30, 2017 compared to the same period in the prior year, mainly due to higher wages and benefits, computer licences and legal costs.

Depreciation and amortization increased \$1.8 million compared to the same period in the prior year reflecting higher depreciation resulting from the new capital assets that have entered service. (See "Investing in our Capital Assets" below for details of significant capital asset expenditures.)

Net finance and other expenses (\$ millions)	Three months ended June 30			
	2017	2016	Increase (Decrease)	
			\$	%
Finance expense				
Bond interest	14.6	14.4	0.2	1.4%
KfW bank group (KfW) loans	1.6	1.3	0.3	23.1%
Interest on finance lease	0.5	0.5	-	-
Short-term debt	0.2	0.1	0.1	100.0%
Capitalized interest	(1.7)	(1.9)	0.2	10.5%
Total finance expense	<u>15.2</u>	<u>14.4</u>	<u>0.8</u>	<u>5.6%</u>
Less: finance income	<u>(1.1)</u>	<u>(1.0)</u>	<u>(0.1)</u>	<u>(10.0%)</u>
Net finance expense	14.1	13.4	0.7	5.2%
Loss on disposal and revaluation of property, plant and equipment, intangible assets and inventory	0.1	0.2	(0.1)	(50.0%)
Total net finance and other expenses	<u><u>14.2</u></u>	<u><u>13.6</u></u>	<u><u>0.6</u></u>	<u><u>4.4%</u></u>

In the three months ended June 30, 2017, net finance and other expenses increased \$0.6 million compared to the same periods in the prior year mainly due to:

- \$0.2 million decrease in capitalized interest in the quarter; and
- \$0.3 million increase in interest on KfW loans, reflecting interest on the additional KfW loans for the Salish Class vessels.

LIQUIDITY AND CAPITAL RESOURCES

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.

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 a Master Trust Indenture and allows for three loans of up to \$45 million each. These amortizing loans will be repaid over a 12-year term and bear interest at 2.09% per annum. In November 2016, we drew down a total of \$45 million, to coincide with the contract payment schedule for the purchase of the *Salish Orca*. In February 2017, we drew down an additional \$45 million, to coincide with the contract payment schedule for the purchase of the *Salish Eagle*. During the quarter ended June 30, 2017, we drew down the third and final \$45 million, to coincide with the contract payment schedule for the *Salish Raven*. The net proceeds were used to partially finance the purchase of these vessels.

On April 5, 2017, in response to our application, the Commissioner issued Order 17-03, in which he confirmed his determination that the capital expenditure for the acquisition and modification of a used vessel to be used to provide mid-coast service, including a new seasonal direct ferry service between Port Hardy and Bella Coola, as well as the necessary terminal modifications, is reasonably required. On April 5, 2017, after the Order was issued, the Province contributed an initial \$15 million towards the provision of this service, and on March 21, 2017, the Government of Canada approved funding of up to \$15.1 million under the New Building Canada Fund.

We expect our cash requirements, in the near term, will be met through operating cash flows, funding under government programs and by accessing our credit facility from time to time. At June 30, 2017, our unrestricted cash and cash equivalents and other short-term investments totalled \$72 million and \$116 million, respectively.

Our \$155 million credit facility was renewed on March 10, 2017 to extend the maturity date of the facility from April 2021 to April 2022. The facility is available to fund capital expenditures and for other general corporate purposes. At June 30, 2017, there were no draws on this credit facility.

We target maintaining a strong investment-grade credit rating to allow capital market access at reasonable interest rates. Our credit ratings at June 30, 2017 were "A" (DBRS) with a positive trend and "AA-" (Standard & Poor's) with a stable outlook.

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. At June 30, 2017 we achieved a leverage ratio of 74.1% and a debt service ratio of 3.01.

Sources & Uses of Cash

Sources and uses of cash and cash equivalents for the three months ended June 30, 2017 and 2016 are summarized in the table below:

(\$ millions)	Three months ended June 30		
	2017	2016	Increase (Decrease)
Cash and cash equivalents, beginning of period	72.0	79.1	(7.1)
Cash from operating activities:			
Net earnings	17.3	27.0	(9.7)
Items not affecting cash	54.4	51.7	2.7
Changes in non-cash operating working capital	6.9	(20.0)	26.9
Net interest paid	(17.9)	(17.6)	(0.3)
Cash generated by operating activities	60.7	41.1	19.6
Cash generated by (used in) financing activities	36.8	(4.1)	40.9
Cash used in investing activities	(97.4)	(38.0)	(59.4)
Net increase in cash and cash equivalents	0.1	(1.0)	1.1
Cash and cash equivalents, end of period	72.1	78.1	(6.0)

For the three months ended June 30, 2017, cash generated by operating activities increased by \$19.6 million compared to the same period in the prior year, primarily due to changes in non-cash working capital (prepaid expenses and deferred revenue) partially offset by a decrease in net earnings. Net earnings reflect the impact of higher operating and finance expenses partially offset by increased traffic levels and higher revenues.

Cash generated by financing activities in the three months ended June 30, 2017 was \$36.8 million. This amount consisted of our new \$45.3 million loan from KfW IPEX-Bank GmbH partially offset by \$7.0 million in repayment of KfW loans and finance lease obligations and \$1.5 million in deferred financing costs.

Cash used in financing activities in the three months ended June 30, 2016 was \$4.1 million consisting of repayments of KfW loans and finance lease obligations.

Cash used in investing activities in the three months ended June 30, 2017 increased by \$59.4 million compared to the same period in the prior year, due to a \$55.2 million increase in cash used for capital expenditures, a \$3.7 million decrease in the amount provided by short-term investments and a \$0.5 million change in debt service reserves. (See "Investing in Our Capital Assets" below for detail of significant capital expenditures.)

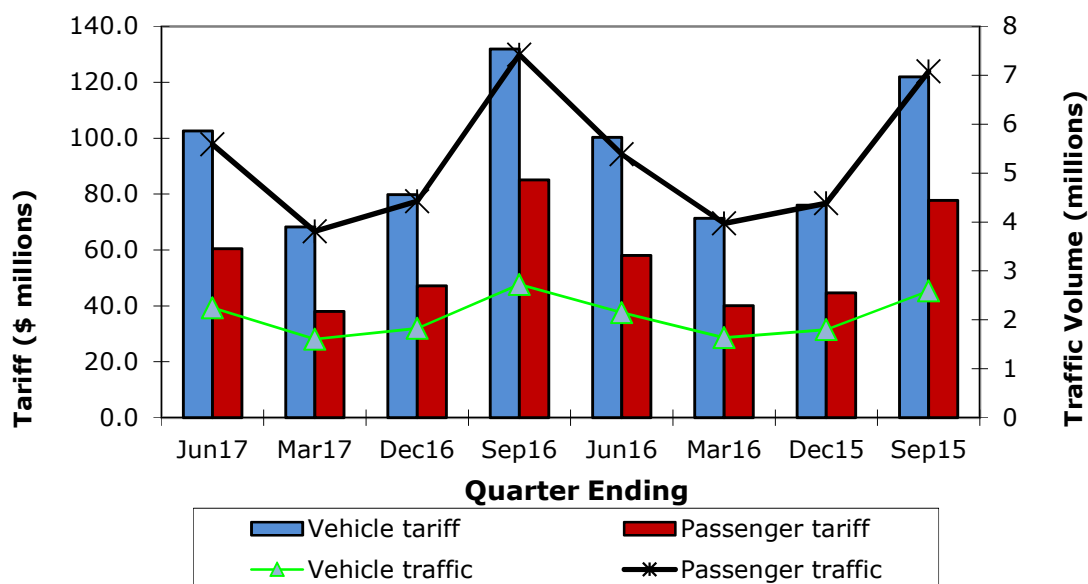
SUMMARY OF QUARTERLY RESULTS

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

(\$ millions)	Quarter Ended (unaudited)							
	Jun 17	Mar 17	Dec 16	Sep 16	Jun 16	Mar 16	Dec 15	Sep 15
Total revenue	225.9	157.5	183.7	298.9	219.2	166.3	178.7	280.6
Operating profit (loss)	31.5	(25.8)	9.8	108.5	40.6	(16.2)	10.2	98.5
Net earnings (loss)	17.3	(40.8)	(4.0)	95.2	27.0	(30.0)	(3.7)	84.5
Other comprehensive (loss) income	(5.7)	(1.0)	6.3	(1.0)	10.3	(12.0)	(11.7)	(3.6)
Total comprehensive income (loss)	11.6	(41.8)	2.3	94.2	37.3	(42.0)	(15.4)	80.9

Quarterly results are affected by the seasonality of leisure travel patterns. The second quarter, covering the summer period, experiences the highest traffic levels and the highest net earnings. The third and fourth quarters reflect a seasonal reduction in traffic. We utilize these periods to perform upgrades and major maintenance and refit programs, as well as to undertake mandatory inspections on the majority of our vessels.

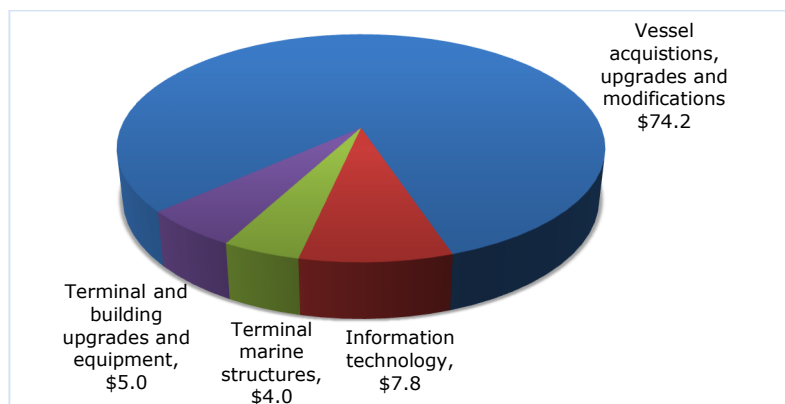
The following graph demonstrates the seasonality of our revenue and shows the relationship of traffic volume and tariff revenue over the most recent eight quarters:



INVESTING IN OUR CAPITAL ASSETS

Capital Expenditures

Capital expenditures in the three months ended June 30, 2017 totalled \$91.0 million.



In fiscal 2017, the Government of Canada approved funding under the New Building Canada Fund, towards the purchase of two new minor class vessels, a major upgrade of our Langdale terminal, improvements at several other terminals and the purchase and refurbishment of a used vessel to be used to provide mid-coast service, including a new seasonal direct ferry service between Port Hardy and Bella Coola. In total, up to \$60 million in funding under the New Building Canada Fund has been approved.

Capital expenditures in the three months ended June 30, 2017, included the following:

(\$ millions)	June 30, 2017
	3 months
New Salish Class vessels	53.6
New Minor Class vessels	9.4
Major overhauls and inspections	8.7
Customer service program	2.5
Spirit Class mid-life upgrades	1.2
Various other projects	15.6
	<u>91.0</u>

New Salish Class vessels

In July 2014, we entered into contracts with Remontowa Shipbuilding S.A. of Gdansk, Poland to build three new Salish Class vessels. The contracts, with a total value of \$165 million, form the majority of the total project budget of \$206 million. In the three months ended June 30, 2017, \$53.6 million in capital expenditures was primarily related to the payment made, based on the contract milestones, for the third vessel. The new vessels are dual-fuel capable, designed to run primarily 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. On May 16, 2017, the *Salish Orca* replaced the 52-year old *Queen of Burnaby* and commenced regularly-scheduled service between Comox and Powell River. On June 21, 2017 and on August 3, 2017, the *Salish Eagle* and the *Salish Raven*, respectively, commenced regularly scheduled service in the Southern Gulf Islands. Introduction of these vessels will enable the retirement of the 53-year old *Queen of Nanaimo*. FortisBC has committed to provide us with up to \$6 million in incentive funding to help offset incremental capital costs associated with the Salish Class vessels.

Minor Class Vessel Replacements

On April 13, 2017, we entered into design and build contracts with Damen Shipyard Group of Netherlands, totalling \$60 million for the construction of two minor class vessels. In the three months ended June 30, 2017, \$9.4 million in capital expenditures primarily consisted of the first installment payments made based on the contract. These vessels will each have a capacity of up to 300 passengers and approximately 44 vehicles. When these new vessels are placed into service, it will allow us to retire the 59-year old *North Island Princess* and the 53-year old *Howe Sound Queen*. We intend to deploy the first new vessel to provide service from Powell River to Texada Island and the second new vessel to provide service from Port McNeill to Alert Bay and to Sointula.

Major overhauls and inspections

In the quarter ended June 30, 2017, we had capital expenditures of \$8.7 million in respect of major overhauls and inspections of components of hull, propulsion and generators for eight vessels that were completed or underway.

Customer service program

Our customer service program, which includes the Fare Flexibility and Digital Experience Initiative, will replace our aged website, reservation systems and e-commerce platform and upgrade our point-of-sale. This program will give customers an opportunity to purchase travel in advance at discounted rates, on select sailings on reservable routes and allow us to respond in a more timely fashion to changing business needs. Our customer service program will introduce improved transaction processing and online booking with more choices in fares. The main elements of this multi-year program will be implemented in stages over the next few years.

Spirit Class mid-life upgrades

In March 2016, we awarded contracts 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*. 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. We also expect the conversion to result in significant environmental benefits, such as reducing carbon dioxide emissions from our vessels. FortisBC has committed to provide us with up to \$10 million in incentive funding to help offset incremental capital costs associated with the conversion of the Spirit Class vessels to utilize LNG.

OUTLOOK

Financial

We expect positive net earnings in fiscal 2018, primarily reflecting increases in discretionary traffic due to favourable economic conditions including the low Canadian dollar, fuel prices, tourism and the timing of Easter.

We expect an increase in total revenue in fiscal 2018, reflecting higher traffic levels and higher net retail revenues. Fare increases were limited to vehicle fares on three of our Major Routes and were mainly offset by a reduction in reservation fees. Due to the volatility of fuel costs, we expect that fuel rebates in place at April 1, 2017 may need to be reduced somewhat during fiscal 2018.

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 will change the way we price fares and will give customers an opportunity to purchase travel in advance at discounted rates, on select sailings on reservable routes. We expect this initiative to help shift traffic to sailings that typically run with low capacity utilization.

The Commissioner established price caps for PT4 which incorporate an efficiency target of \$27.6 million, to be achieved by us over the four years of PT4. We expect to meet this target.

We expect an increase in total expenses in fiscal 2018, reflecting additional round trips provided, higher wage and benefit costs resulting from the implementation of the Collective Agreement and the introduction of new assets, higher vessel and terminal maintenance costs, and higher costs from growth in traffic partially offset by savings from the implementation of the Salish Class vessels. We continue to manage our costs prudently without compromising safe operations.

Major Investments

Our 12-year capital plan, covering fiscal 2015 through 2026, consists of \$3 billion to replace 14 aged vessels, execute mid-life upgrades for the Spirit Class vessels as well as upgrades and modifications for other vessels, make significant improvements at our terminals, and renew our information technology infrastructure. In fiscal 2018, our capital spending is projected to be \$344 million and includes the first of two mid-life upgrades on the Spirit Class vessels, other ongoing vessel replacement projects and the acquisition and upgrade of a used vessel and modifications to minor terminals for the new seasonal direct ferry service between Port Hardy and Bella Coola beginning in the summer of 2018.

On April 7, 2017, we finalized an agreement to acquire a 75-metre used vessel with ownership transferring in August 2017. In fiscal 2018, it will undergo major upgrades and mechanical modifications to be ready for service in the summer of 2018. While several smaller terminals will require modification, our major northern berths are already able to accommodate the new vessel. On April 5, 2017, the Province contributed an initial \$15 million towards the provision of this service, and on March 21, 2017, the Government of Canada approved funding of up to \$15.1 million under the New Building Canada Fund.

Summary

We continue to pursue strategies to provide a customer focussed, affordable and sustainable ferry system by optimizing our service on routes, standardizing our vessels, optimizing our fuel consumption, and reducing our environmental impact. We also continue to look for ways to diversify our revenue sources, increase operational efficiencies, and leverage opportunities for federal infrastructure funding and provincial incentive funding to renew our fleet and terminals.

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.

There is a fair amount of uncertainty in the market and mixed opinions regarding the impact the new US administration will have on the Canadian economy. We remain confident that as long as the Canadian dollar and oil prices continue at current levels, the fundamentals impacting our traffic will remain favourable, and we should continue to see traffic growth and positive earnings in the near-term.

FINANCIAL RISKS

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

A discussion of financial risks can be found on pages 59 through 62 of our fiscal 2017 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2017. Our 2017 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

BUSINESS RISK MANAGEMENT

Understanding and managing operational risk is an important part of our business. We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business. A discussion of enterprise wide risk management can be found on pages 63 through 70 of our fiscal 2017 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2017. Our 2017 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

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

ACCOUNTING PRACTICES

Critical Accounting Policies and Estimates

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

Our significant accounting policies are contained in note 1 to our March 31, 2017 audited consolidated financial statements and our June 30, 2017 interim consolidated financial statements. Certain of these policies involve critical accounting estimates because they require us to make particularly subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts could be reported under different conditions or using different assumptions. These judgements, estimates and assumptions are subject to change as new events occur, as more experience is acquired, as additional information is obtained and as the general operating environment changes.

Discussion of the most critical accounting policies and estimates that we have used in the preparation of our consolidated financial statements can be found on pages 71 and 72 of our fiscal 2017 Management's Discussion & Analysis. The following describes the changes to critical accounting policies we have used in the preparation of our consolidated financial statements for the three months ended June 30, 2017, or expect to use in the future.

Adoption of New Accounting Standards

No new accounting standards were adopted effective April 1, 2017.

Future Accounting Changes

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

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 analyzing our revenues and assessing the financial reporting impact of the adoption of this standard. Although we have made progress in our analysis using the IFRS 15 five-step model as the basis to recognize revenue, we have not yet quantified the impact of the new standard on our consolidated financial statements.

IFRS 9 *Financial Instruments* (2014) introduces a new expected credit loss model for calculating impairment, and incorporates guidance on the classification and measurement of financial assets and the final general hedge accounting requirements originally published in IFRS 9 (2013). Mandatory adoption of IFRS 9 (2014) for us will be April 1, 2018. We adopted *IFRS 9 Financial Instruments* (2013) in fiscal 2015 and as such will only be impacted by the expected credit loss model when we adopt IFRS 9 (2014). This model applies to our trade receivables and long-term loan receivable. We have determined that we will need to establish an expected credit loss for our trade receivables. We do not expect the application of IFRS 9 to have a significant impact on our consolidated financial statements, other than additional disclosure, as we have an existing provision for impairment.

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. We are in the process of reviewing our leases and assessing the financial reporting impact of the adoption of this standard. We do not expect the application of IFRS 16 to have a significant impact on our consolidated financial statements.

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, 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 June 30, 2017 will be settled in the future. These regulatory liabilities are considered supplemental disclosures and are detailed in note 15 to our June 30, 2017 unaudited interim 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 three month periods ended June 30, 2017 and 2016 would be as follows:

(\$ millions)	Three months ended June 30		
	2017	2016	
Net earnings	17.3	27.0	
Changes in net earnings:			
Regulatory asset or liability			
Deferred fuel costs (a)			
Fuel costs under set price	Operations expense	(2.6)	(3.2)
Fuel rebates	Fuel rebates	4.9	4.7
Payments from the Province	Ferry service fees	0.1	0.1
Increase in total net earnings	2.4	1.6	
Adjusted net earnings	19.7	28.6	

(a) Deferred fuel costs: As prescribed by regulatory order, we defer differences between actual fuel costs and regulated fuel costs which were used to develop the regulated price caps. The difference between actual fuel costs (including fuel hedge gains and losses) and the regulated fuel costs (set price) is deferred for settlement in future tariffs. Also, as prescribed by regulatory order, we collect fuel surcharges or provide fuel rebates from time to time which are applied against deferred fuel cost account balances. We may also receive payments from the Province to be applied against deferred fuel cost account balances.

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 U.S. Dollar, fuel costs, construction costs, the state of the local economy, fluctuating financial markets, demographics, tax changes, and the requirements of the CFSC.

Forward looking statements included in this document include statements with respect to: economic conditions, traffic levels, fuel prices, and fiscal 2018 net earnings; our short-term and long-range business plans, capital expenditure levels, and asset renewal programs for vessels and terminals; our customer service program, Fare Flexibility and Digital Experience Initiative, and pricing promotions; our Salish Class vessels, the seasonal direct ferry service between Port Hardy and Bella Coola, the minor class vessel replacements, the supply agreement with Point Hope Maritime Ltd., the loan agreement with KfW IPEX-Bank GmbH, the agreements with FortisBC Energy Inc. regarding incentive funding, the New Building Canada Fund, LNG plans, and Spirit Class mid-life upgrades; our expectations regarding food sales and sales of quality apparel; total revenue and expense projections, and how our cash requirements will be met in the near term; and our expectations regarding the impacts of IFRS 9, IFRS 15, and IFRS 16 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 Nations 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, net earnings 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.