

Interim Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Nine months ended December 31, 2015 and 2014

(unaudited)

BRITISH COLUMBIA FERRY SERVICES INC.

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

	As at	
	December 31, 2015	March 31, 2015
Assets		
Current assets		
Cash and cash equivalents	95,408	65,574
Restricted short-term investments (note 3 (b))	32,146	32,496
Other short-term investments	100,510	62,098
Trade and other receivables	12,614	19,490
Prepaid expenses	8,688	6,177
Inventories	25,032	25,393
	274,398	211,228
Non-current assets		
Loan receivable	24,515	24,515
Land lease	30,802	31,146
Property, plant and equipment (note 5)	1,516,727	1,524,692
Intangible assets (note 6)	77,215	65,031
	1,649,259	1,645,384
Total assets	1,923,657	1,856,612
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	39,776	57,401
Interest payable on long-term debt	16,346	18,329
Deferred revenue	15,947	16,957
Derivative liabilities (note 7)	16,278	4,433
Current portion of long-term debt (note 3)	24,000	24,000
Current portion of accrued employee future benefits	2,400	2,400
Current portion of obligations under finance lease	1,497	1,309
Provisions	52,602	48,065
	168,846	172,894
Non-current liabilities		
Accrued employee future benefits	18,482	18,800
Long-term debt (note 3)	1,226,257	1,241,699
Obligations under finance lease	42,385	43,514
Other liabilities	1,500	1,500
	1,288,624	1,305,513
Total liabilities	1,457,470	1,478,407
Equity		
Share capital	75,478	75,478
Contributed surplus	25,000	25,000
Retained earnings	388,796	289,177
Total equity before reserves	489,274	389,655
Reserves (note 9 (a))	(23,087)	(11,450)
Total equity including reserves	466,187	378,205
Total liabilities and equity	1,923,657	1,856,612
Commitments (note 5 (b))		

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statements of Comprehensive Income/(Loss) (unaudited)

(Expressed in thousands of Canadian dollars)

	Three months ended December 31		Nine months ended December 31	
	2015	2014	2015	2014
Revenue				
Vehicle and passenger fares	117,006	111,074	452,930	422,087
Ferry service fees	39,110	38,913	134,895	138,155
Retail	19,275	17,386	70,830	65,887
Federal-Provincial Subsidy Agreement	7,182	7,089	21,547	21,267
Fuel (rebates) surcharges	(1,350)	3,045	(5,102)	13,193
Regulated other income	3,686	2,979	14,993	12,500
Other income	1,674	1,899	6,674	6,572
Total revenue	186,583	182,385	696,767	679,661
Expenses				
Operations	105,681	105,074	342,353	345,457
Maintenance	18,512	19,188	52,673	48,305
Administration	8,445	7,364	24,665	22,997
Cost of retail goods sold	7,952	7,169	28,514	26,315
Depreciation and amortization	35,840	35,354	106,767	106,200
Total operating expenses	176,430	174,149	554,972	549,274
Operating profit	10,153	8,236	141,795	130,387
Net finance and other expenses				
Net finance expense (note 10)				
Finance income	1,048	1,056	3,401	3,092
Finance expenses	(15,119)	(15,432)	(45,609)	(49,268)
Net finance expense	(14,071)	(14,376)	(42,208)	(46,176)
Gain (loss) on disposal and revaluation of property, plant and equipment, intangible assets and inventory	233	(5)	32	(49)
Net finance and other expenses	(13,838)	(14,381)	(42,176)	(46,225)
Net earnings (loss)	(3,685)	(6,145)	99,619	84,162
Other comprehensive loss (note 9 (b))				
Items not to be reclassified to net earnings	-	-	-	(2,890)
Items to be reclassified to net earnings	(11,739)	(7,354)	(11,824)	(9,750)
Total other comprehensive loss	(11,739)	(7,354)	(11,824)	(12,640)
Total comprehensive income (loss)	(15,424)	(13,499)	87,795	71,522

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statements of Cash Flows (unaudited)

(Expressed in thousands of Canadian dollars)

	Nine months ended December 31	
	2015	2014
Cash flows from operating activities		
Net earnings	99,619	84,162
Items not affecting cash		
Net finance expense	42,208	46,176
Depreciation and amortization	106,767	106,200
(Gain) loss on disposal and revaluation of property, plant and equipment, intangible assets and inventory	(32)	49
Other non-cash adjustments to property, plant and equipment	(4)	(888)
Changes in		
Accrued employee future benefits	(318)	64
Derivative liabilities recognized in net earnings	21	(13)
Provisions	4,537	(3,661)
Long-term land lease	344	344
Accrued interest costs	(97)	55
Total non-cash items	153,426	148,326
Movements in operating working capital		
Trade and other receivables	6,876	5,770
Prepaid expenses	(2,511)	(1,920)
Inventories	361	(964)
Accounts payable and accrued liabilities	(17,625)	(12,681)
Deferred revenue	(1,010)	5
Change in non-cash working capital	(13,909)	(9,790)
Change attributable to capital asset acquisitions	9,417	4,229
Change in non-cash operating working capital	(4,492)	(5,561)
Cash generated from operating activities	248,553	226,927
Interest received	3,428	3,453
Interest paid	(51,065)	(54,639)
Net cash generated by operating activities	200,916	175,741

See accompanying notes to the interim consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statements of Cash Flows (unaudited)

(Expressed in thousands of Canadian dollars)

	Nine months ended December 31	
	2015	2014
Cash flows from financing activities		
Proceeds from issuance of bonds	-	200,000
Repayment of long-term debt	(15,750)	(262,000)
Repayment of finance lease obligations	(941)	(834)
Deferred financing costs incurred	-	(1,315)
Hedge losses on interest rate forward contracts	-	(7,652)
Net cash used in financing activities	(16,691)	(71,801)
Cash flows from investing activities		
Proceeds from disposal of property, plant and equipment	214	115
Purchase of property, plant and equipment and intangible assets	(116,543)	(100,237)
Changes in debt service reserves	350	3,141
Net (purchase of) proceeds from short-term investments	(38,412)	18,308
Net cash used in investing activities	(154,391)	(78,673)
Net increase in cash and cash equivalents	29,834	25,267
Cash and cash equivalents, beginning of period	65,574	71,365
Cash and cash equivalents, end of period	95,408	96,632

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statements of Changes in Equity (unaudited)

(Expressed in thousands of Canadian dollars)

	Share capital	Contributed surplus	Retained earnings	Total equity before reserves	Reserves (note 9 (a))	Total equity including reserves
Balance as at March 31, 2014	75,478	25,000	246,142	346,620	(1,691)	344,929
Net earnings for the nine months ended December 31, 2014	-	-	84,162	84,162	-	84,162
Other comprehensive loss for the nine months ended December 31, 2014	-	-	-	-	(12,640)	(12,640)
Hedge losses reclassified to net earnings	-	-	-	-	168	168
Balance as at December 31, 2014	75,478	25,000	330,304	430,782	(14,163)	416,619
Balance as at March 31, 2015	75,478	25,000	289,177	389,655	(11,450)	378,205
Net earnings for the nine months ended December 31, 2015	-	-	99,619	99,619	-	99,619
Other comprehensive loss for the nine months ended December 31, 2015	-	-	-	-	(11,824)	(11,824)
Hedge losses reclassified to net earnings	-	-	-	-	187	187
Balance as at December 31, 2015	75,478	25,000	388,796	489,274	(23,087)	466,187

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Nine months ended December 31, 2015 and 2014

(Tabular amounts expressed in thousands of Canadian dollars)

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:

Except as described in note 1(e), the same accounting policies and methods of computation are followed in the interim consolidated financial statements as compared with the annual consolidated financial statements for the year ended March 31, 2015.

(a) Basis of preparation:

British Columbia Ferry Services Inc. is domiciled in Canada. The address of the Company’s registered office is Suite 500, 1321 Blanshard Street, Victoria, BC Canada, V8W 0B7. These interim consolidated financial statements as at and for the nine months ended December 31, 2015 and 2014 comprise the Company and its subsidiaries (together referred to as the “Group”).

(b) Statement of compliance:

These 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 interim consolidated financial statements should be read in conjunction with the Group’s annual consolidated financial statements and the notes thereto for the year ended March 31, 2015.

These interim consolidated financial statements were approved by the Board of Directors on February 26, 2016.

(c) Basis of measurement:

These interim consolidated financial statements have been prepared using the historical cost method, with the exception of the following assets and liabilities which are measured at fair value: land, derivatives, and cash and cash equivalents.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Nine months ended December 31, 2015 and 2014

(Tabular amounts expressed in thousands of Canadian dollars)

1. Accounting policies (continued):

(d) Functional and presentation currency:

These interim consolidated financial statements are presented in Canadian dollars ("Cdn") which is the Group's functional currency. All tabular financial data is presented in Canadian dollars rounded to the nearest thousand.

(e) Property, plant and equipment:

Property, plant and equipment, excluding land assets, are valued at cost plus direct overhead and financing costs, less depreciation and impairment. The cost includes the initial estimate of retirement obligations. Land is valued at fair value at each year-end using the annual assessed values for property tax purposes as being representative of the fair values of these assets.

The cost of self-constructed assets includes expenditures on materials, direct labour, financing costs and an allocated proportion of project overheads. Major parts of an item of property, plant and equipment with materially different estimated useful lives are accounted for as separate items (major components) of property, plant and equipment. The cost of replacing an item of property, plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the item will flow to the Group, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of the item of property, plant and equipment and are recognized in net earnings or loss. The costs of the day-to-day servicing of items of property, plant and equipment are recognized in net earnings or loss as incurred.

Where major components of an asset have materially different estimated useful lives, depreciation is calculated on each separate component. Depreciation commences when an asset is available for use. Estimates of remaining useful lives and residual values are reviewed annually and adjusted if appropriate.

The Group revised its estimate of the useful lives of vessel hulls from 40 to 45 years. This change has been applied prospectively effective April 1, 2015, and will result in a decrease in depreciation expense of approximately \$1.9 million for the year ending March 31, 2016.

Property, plant and equipment, including assets under finance leases, are depreciated on a straight-line basis over the estimated useful lives of the assets at the following rates:

Asset class	Estimated useful life
Vessel hulls	3 to 45 years
Vessel propulsion and utility systems	3 to 30 years
Marine structures	20 to 40 years
Buildings	20 to 40 years
Equipment and other	3 to 20 years

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Nine months ended December 31, 2015 and 2014
(Tabular amounts expressed in thousands of Canadian dollars)

2. Future accounting changes:

IFRS 9 Financial Instruments (2014):

On July 24, 2014, the International Accounting Standards Board (IASB) issued the completed version of IFRS 9. 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 periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions. Early adoption is permitted. The Group does not expect the application of IFRS 9 (2014) to have a significant impact on its consolidated financial statements.

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 entities to provide users of financial statements with more informative and relevant disclosures. IFRS 15 was issued in May 2014 and the effective date is for annual periods beginning on or after January 1, 2017. Earlier application is permitted. On July 22, 2015, the IASB confirmed a one-year deferral of the effective date. The Group does not expect the application of IFRS 15 to have a significant impact on its consolidated financial statements.

Amendments to IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets:

The IASB has issued *Clarification of Acceptable Methods of Depreciation and Amortization*. The amendments clarify that a revenue-based depreciation method is not considered to be an appropriate manifestation of consumption because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset. The amendments apply prospectively and are effective for annual periods beginning on or after January 1, 2016. Early adoption is permitted. The application of these amendments will not have any impact on the Group's consolidated financial statements.

Disclosure Initiative (Amendments to IAS 1 Presentation of Financial Statements):

The IASB published clarification to IAS 1 *Presentation of Financial Statements*. The *Disclosure Initiative* comprises several smaller projects to improve presentation and disclosure requirements in existing International Financial Reporting Standards. The amendments are effective for periods beginning on or after January 1, 2016. Early adoption is permitted. The Group does not expect the application of these amendments to have a significant impact on its consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Nine months ended December 31, 2015 and 2014

(Tabular amounts expressed in thousands of Canadian dollars)

3. Loans:

Long-term debt:	As at	
	December 31, 2015	March 31, 2015
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%)	31,875	37,500
Tranche B (floating interest rate of 1.16% at December 31, 2015)	22,500	22,500
12 Year Loan, maturing June 2020		
Tranche A (effective interest rate of 5.18%)	33,750	39,375
Tranche B (floating interest rate of 1.17% at December 31, 2015)	22,500	22,500
2.95% Loan, maturing January 2021 (effective interest rate of 3.08%)	49,500	54,000
	1,260,125	1,275,875
Less: Unamortized deferred financing costs and bond discounts	(9,868)	(10,176)
Current portion	(24,000)	(24,000)
Total	1,226,257	1,241,699

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Nine months ended December 31, 2015 and 2014

(Tabular amounts expressed in thousands of Canadian dollars)

3. Loans (continued):

(a) Credit facility:

There were no draws on the \$155.0 million credit facility as at December 31, 2015 and as at March 31, 2015. There was no interest expense related to this facility during the nine months ended December 31, 2015 and December 31, 2014. Letters of credit outstanding against this facility at December 31, 2015 totalled \$0.3 million (March 31, 2015: \$0.3 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 principal payments, to be increased under certain conditions. As at December 31, 2015, debt service reserves of \$32.1 million were held in short-term investments and have been classified as restricted short-term investments on the statements of financial position (March 31, 2015: \$32.5 million).

(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. As at December 31, 2015, the debt service coverage ratio was 3.12.

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 December 31, 2015.

(d) KfW Loans:

On November 12, 2015, the Group entered into a loan agreement with KfW IPEX-Bank GmbH, 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. These amortizing loans will be repaid over a 12-year term and bear an interest rate of 2.09% per annum. Receipt of proceeds from the loans will coincide with the conditional acceptance of each of the three new Salish Class vessels from the shipyard and the net proceeds will be used to partially finance the Group's purchase of these vessels. As at December 31, 2015, no amounts were outstanding under the loan agreement.

4. Financial instruments:

The carrying values of the Group's financial instruments approximate fair value as at December 31, 2015 and March 31, 2015 for all financial instruments except for long-term debt:

	As at December 31, 2015		As at March 31, 2015	
	Carrying Value	Approx Fair Value	Carrying Value	Approx Fair Value
Long-term debt, including current portion ^{1,2,3}	1,250,257	1,493,136	1,265,699	1,622,645

¹ Carrying value is measured at amortized cost using the effective interest rate method.

² 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 statement of financial position, or by using available quoted market prices.

³ Classified in level 2 as the significant measurement inputs used in the valuation models are indirectly observable in active markets (derived from prices).

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Nine months ended December 31, 2015 and 2014

(Tabular amounts expressed in thousands of Canadian dollars)

4. Financial instruments (continued):

The following items shown in the consolidated statements of financial position at December 31, 2015 and March 31, 2015 are carried at fair value on a recurring basis using level 1 or 2 inputs. There were no financial assets and liabilities at December 31, 2015 and at March 31, 2015, valued using level 3 inputs.

	As at December 31, 2015		As at March 31, 2015	
	Level 1	Level 2	Level 1	Level 2
Asset (liability):				
Cash ¹	73,780	-	37,880	-
Cash equivalents ¹	6,576	-	2,508	-
Derivatives ²	-	(16,278)	-	(4,433)
	80,356	(16,278)	40,388	(4,433)

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 nine months ended December 31, 2015. Financial assets have been pledged as security for liabilities under the MTI.

As at December 31, 2015, all financial instruments measured at fair value (excluding derivatives) have been classified as level 1 in the fair value hierarchy with quoted prices in active markets.

During the nine months ended December 31, 2015, no profits resulting from the use of valuation techniques used to measure level 2 or 3 (i.e. those with no active market price) instruments in the fair value hierarchy have been recognized.

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.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
 Nine months ended December 31, 2015 and 2014
 (Tabular amounts expressed in thousands of Canadian dollars)

5. Property, plant and equipment:

(a) Continuity of property, plant and equipment:

	Vessels	Berths, buildings & equipment under finance lease	Berths, buildings & equipment	Land under finance lease	Land	Construction in progress	Total
Cost:							
Balance at March 31, 2015	1,227,689	599,099	80,537	5,559	15,895	65,585	1,994,364
Additions	-	-	-	-	-	93,284	93,284
Disposals	(9,414)	(898)	(582)	-	-	(139)	(11,033)
Impairment loss recovery	421	-	-	-	-	-	421
Transfers from construction in progress	34,316	22,109	8,067	-	(239)	(64,253)	-
Balance at December 31, 2015	1,253,012	620,310	88,022	5,559	15,656	94,477	2,077,036
Accumulated depreciation:							
Balance at March 31, 2015	341,377	95,528	32,767	-	-	-	469,672
Depreciation for the period	73,679	20,494	7,204	-	-	-	101,377
Disposals	(9,300)	(898)	(542)	-	-	-	(10,740)
Balance at December 31, 2015	405,756	115,124	39,429	-	-	-	560,309
Net carrying value:							
As at March 31, 2015	886,312	503,571	47,770	5,559	15,895	65,585	1,524,692
As at December 31, 2015	847,256	505,186	48,593	5,559	15,656	94,477	1,516,727

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Nine months ended December 31, 2015 and 2014
(Tabular amounts expressed in thousands of Canadian dollars)

5. Property, plant and equipment (continued):

(b) Other disclosures - property, plant and equipment:

During the nine months ended December 31, 2015, financing costs capitalized during construction amounted to \$2.4 million (December 31, 2014: \$1.1 million) with an average capitalization rate of 5.04% (December 31, 2014: 5.30%). In addition to the construction in progress referenced above, the contractual commitments at December 31, 2015 for assets to be constructed totalled \$173.1 million (March 31, 2015: \$184.6 million). These contractual commitments include \$137.4 million of the total contract value of \$165 million for construction of the three new Salish Class vessels.

During the three months ended December 31, 2015, the Group recognized a \$0.4 million reversal of an impairment loss recorded during the year ended March 31, 2015. The \$0.4 million reversal was reported under "Loss on disposal and revaluation of property, plant and equipment, intangible assets, and inventory" in the interim consolidated statements of comprehensive income.

The Government of Canada, through the Shore Power Technology for Ports Program, agreed to provide funding to help offset the costs of shore power upgrades at certain of the Group's terminals. The Group has received and recorded \$1.6 million as a reduction of the cost of property, plant and equipment, and expects to receive a total of \$2.0 million.

During the three months ended December 31, 2015, the Group received \$0.2 million (December 31, 2014: \$0.2 million) of rental income earned from buildings held for leasing purposes and during the nine months ended December 31, 2015, the Group received \$0.7 million (December 31, 2014: \$0.7 million). These buildings have a cost and accumulated depreciation of \$11.9 million and \$2.1 million respectively, as at December 31, 2015.

During the three months ended September 30, 2015, the *Queen of Chilliwack* (decommissioned during the year ended March 31, 2015), was sold.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
 Nine months ended December 31, 2015 and 2014
 (Tabular amounts expressed in thousands of Canadian dollars)

6. Intangible assets:

(a) Continuity of intangible assets:

	Acquired software, licenses & rights	Internally developed software & website	Construction in progress	Total
Cost:				
Balance at March 31, 2015	31,706	11,516	48,635	91,857
Additions	-	-	17,574	17,574
Transfers from construction in progress	5,420	932	(6,352)	-
Balance at December 31, 2015	37,126	12,448	59,857	109,431
Accumulated amortization:				
Balance at March 31, 2015	17,390	9,436	-	26,826
Amortization for the period	4,020	1,370	-	5,390
Balance at December 31, 2015	21,410	10,806	-	32,216
Net carrying value:				
As at March 31, 2015	14,316	2,080	48,635	65,031
As at December 31, 2015	15,716	1,642	59,857	77,215

(b) Other disclosures - intangible assets:

Capitalized financing costs during construction for intangible assets for the nine months ended December 31, 2015 totalled \$1.6 million (December 31, 2014: \$1.3 million) with an average capitalization rate of 5.04% (December 31, 2014: 5.30%).

During the nine months ended December 31, 2015, intangible assets totalling \$16.2 million (December 31, 2014: \$13.7 million) were acquired and \$1.4 million (December 31, 2014: \$nil) were internally developed.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Nine months ended December 31, 2015 and 2014

(Tabular amounts expressed in thousands of Canadian dollars)

7. Financial risk management:

Fuel price risk:

The Group is exposed to risks associated with changes in the market price of marine diesel 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 greater of three years or 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 end of the 36 month period; and to 70% of anticipated monthly fuel consumption for the period between 36 months and the end of the fourth performance term.

During the year ended March 31, 2015, the Group entered into Ultra-low Sulfur Diesel (ULSD) fuel swap contracts with a notional value of \$62.3 million, and during the nine months ended December 31, 2015 the Group entered into ULSD fuel swap contracts with a notional value of \$77.1 million to reduce its exposure to changes in the ULSD and foreign exchange risk components associated with forecast diesel fuel purchases and applied hedge accounting to these contracts. The notional value of the fuel swap contracts outstanding as at December 31, 2015 was \$87.8 million.

As at December 31, 2015, the unrealized hedge loss on these contracts was \$16.3 million (note 7 (a)). The effective portion of this unrealized loss of \$16.3 million has been recognized in other comprehensive income. A realized loss of \$6.5 million has been recognized in net earnings during the nine months ended December 31, 2015. There was no hedge ineffectiveness for the nine months ended December 31, 2015.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Nine months ended December 31, 2015 and 2014

(Tabular amounts expressed in thousands of Canadian dollars)

7. Financial risk management (continued):

	Fiscal 2016	Fiscal 2017	Fiscal 2018	Total
Cash flow hedges				
Fuel price risk				
Fuel contracts (litres in thousands)	16,380	76,200	55,000	147,580
Contract price range (\$/litre)	\$0.6324-\$0.6708	\$0.5797-\$0.6098	\$0.5510-\$0.5975	

- (a) As at December 31, 2015, the Group's derivative liabilities of \$16.3 million included foreign exchange forward contracts and fuel swap contracts.

Fuel swap contracts as at December 31, 2015:

				Fair value changes used for calculating hedge ineffectiveness		
	Notional amount of the hedging instrument	Carrying amount of the hedging instrument – (liability)	Item location	Cash flow hedge reserve	Hedging instruments	Hedged items
Cash flow hedges						
Fuel price risk	87,783	(16,278)	Included in derivative liabilities	16,278	16,278	16,362

- (b) Hedging losses:

	Three months ended December 31		Nine months ended December 31	
	2015	2014	2015	2014
Hedging losses recognized in cash flow hedge reserve:				
Interest rate forward contracts	-	-	-	(2,396)
Fuel swap contracts (note 9 (a))	(15,033)	(7,354)	(18,296)	(7,354)
	(15,033)	(7,354)	(18,296)	(9,750)
Hedging losses reclassified from cash flow hedge reserve:				
Interest rate forward contracts – amortization of hedge loss	63	62	187	168
Fuel swap contracts – loss recognized in net earnings (note 9 (a))	3,294	-	6,472	-
	3,357	62	6,659	168
Net change in cash flow hedge reserve	(11,676)	(7,292)	(11,637)	(9,582)

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Nine months ended December 31, 2015 and 2014

(Tabular amounts expressed in thousands of Canadian dollars)

8. Accrued employee future benefits:

During the three months ended December 31, 2015, the Group recognized total defined benefit costs of \$0.4 million (December 31, 2014: \$0.4 million) and during the nine months ended December 31, 2015, the Group recognized total defined benefit costs of \$1.2 million (December 31, 2014: \$1.2 million).

During the year ended March 31, 2015, a loss of \$2.9 million was recognized in other comprehensive income to reflect the actuarial valuation of the liability at March 31, 2014, for the retirement and death benefit plans.

9. Other comprehensive 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, 2015	2,997	(2,786)	(4,454)	(7,207)	(11,450)
Derivatives designated as cash flow hedges:					
Net change in fair value	-	-	(18,296)	-	(18,296)
Realized losses	-	-	6,472	-	6,472
Amortization of losses (note 7 (b))	-	-	-	187	187
	-	-	(11,824)	187	(11,637)
Balance at December 31, 2015	2,997	(2,786)	(16,278)	(7,020)	(23,087)

(b) Other comprehensive loss:

	Three months ended December 31		Nine months ended December 31	
	2015	2014	2015	2014
Items to be reclassified to net earnings:				
Hedge losses on interest rate forward contracts (note 7 (b))	-	-	-	(2,396)
Hedge losses on fuel swaps	(11,739)	(7,354)	(11,824)	(7,354)
Items not to be reclassified to net earnings:				
Actuarial losses on defined benefit plans (note 8)	-	-	-	(2,890)
Total other comprehensive loss	(11,739)	(7,354)	(11,824)	(12,640)

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Nine months ended December 31, 2015 and 2014

(Tabular amounts expressed in thousands of Canadian dollars)

10. Net finance expense:

	Three months ended December 31		Nine months ended December 31	
	2015	2014	2015	2014
Finance expenses				
Long-term debt	15,805	16,100	47,469	49,879
Short-term debt	67	67	226	221
Finance leases	482	499	1,456	1,495
Amortization of deferred financing costs and bond discounts	165	162	495	549
Interest capitalized in the cost of qualifying assets	(1,400)	(954)	(4,037)	(2,434)
Interest rate support	-	(442)	-	(442)
Total finance expenses	15,119	15,432	45,609	49,268
Finance income	(1,048)	(1,056)	(3,401)	(3,092)
Total	14,071	14,376	42,208	46,176

11. 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, under certain circumstances, 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's transition date to IFRS was 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. Regulatory liabilities represent obligations to customers which will be settled in the future. Management continually assesses whether the Group's regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes. Management believes the regulatory assets at December 31, 2015 detailed below are probable of future recovery and that the obligations represented by the regulatory liabilities will be settled in the future.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Nine months ended December 31, 2015 and 2014

(Tabular amounts expressed in thousands of Canadian dollars)

11. Economic effect of rate regulation (continued):

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

Regulatory accounts	As at	
	December 31, 2015	March 31, 2015
Deferred fuel costs:		
Balance – beginning of period	(448)	6,150
Fuel costs (under) over set price	(6,365)	9,107
Rebates (surcharges)	5,102	(13,195)
Fuel price risk recoveries payable to (receivable from) the Province	28	(1,200)
Other payments from the Province	(920)	(1,310)
Balance – end of period	(2,603)	(448)
Tariffs in excess of price cap (a)	-	(1,013)
Performance term submission costs	20	82
Total of regulatory accounts	(2,583)	(1,379)
Total regulatory (liabilities)	(2,583)	(1,379)
Current regulatory assets (liabilities)	20	(931)
Total long term regulatory (liabilities)	(2,603)	(448)

(a) Tariffs in excess of price cap:

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. Tariffs charged to customers were below established price caps at December 31, 2015.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Nine months ended December 31, 2015 and 2014

(Tabular amounts expressed in thousands of Canadian dollars)

11. 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, total comprehensive income for the three months ended December 31, 2015 would have been \$1.4 million lower (December 31, 2014: \$1.7 million lower) and during the nine months ended December 31, 2015, total comprehensive income would have been \$1.2 million lower (December 31, 2014: \$5.0 million lower) as detailed below:

	Three months ended December 31		Nine months ended December 31	
	2015	2014	2015	2014
Effect of rate regulation on total comprehensive income				
Regulatory accounts:				
Deferred fuel costs	(1,398)	(1,687)	(2,155)	(4,898)
Performance term submission costs	(21)	(21)	(62)	(61)
Tariffs in excess of price cap	-	-	1,013	-
Total decrease in total comprehensive income	(1,419)	(1,708)	(1,204)	(4,959)

12. 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 nine months ended December 31, 2015, the Group paid \$93,960 (December 31, 2014: \$91,943) of such expenses.

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