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

For the three and nine months ended December 31, 2017

Dated February 23, 2018

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Management's Discussion & Analysis
of Financial Condition and Financial Performance
For the three and nine months ended December 31, 2017
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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 and nine months ended December 31, 2017 and has been prepared with information available as of February 23, 2018. This discussion and analysis should be read in conjunction with our unaudited condensed interim financial statements and related notes for the nine month periods ended December 31, 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.bcferries.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 an average of 471 sailings per day for our customers. During the three months ended December 31, 2017 (the third quarter of fiscal 2018), we provided over 42,000 sailings (1,002 more than the same period in the prior year), carrying 4.6 million passengers and 1.9 million vehicles. During the three months ended December 31, 2017, passenger traffic increased 5.1% and vehicle traffic increased 5.2% compared to the same quarter in the prior year, resulting in higher revenue which contributed favourably towards our net earnings. Year-to-date, we have carried 18.0 million passengers and 7.0 million vehicles compared to 17.2 million passengers and 6.7 million vehicles in the same period in the prior year. Passenger and vehicle traffic levels in the third quarter were the highest we have experienced since the third quarter ended December 31, 2004. Year-to-date, passenger traffic levels were the highest we have experienced in 20 years and vehicle traffic levels were the highest we have ever experienced. For a more detailed discussion of our traffic levels, see "Financial and Operational Overview" below.

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

Vessels

- On October 21, 2017, one of our two largest vessels, the *Spirit of British Columbia,* arrived at Remontowa Ship Repair Yard S.A., in Gdansk, Poland, for its mid-life upgrade. The mid-life upgrade, which will enable the vessel to be in service for another 25 years, includes the conversion to dual-fuel so it can operate on liquefied natural gas or ultra-low sulphur marine diesel. The vessel is expected to return to service by the summer of 2018.

- On December 15, 2017, the *Northern Sea Wolf* arrived in British Columbia after a 10,097 nautical mile journey from Athens, Greece. The 75-metre used vessel is undergoing extensive upgrades at Esquimalt Drydock Company, a local shipyard, in preparation for regular service commencing in the summer of 2018.

General

- On October 16, 2017, Corrine Storey assumed the role of Vice President and Chief Operating Officer. Ms. Storey was previously Vice President of Customer Services and has been with BC Ferries for 13 years.

- In November 2017, the Commissioner released a Comparative Fare Analysis prepared by PricewaterhouseCoopers LLP, updating an earlier review conducted in 2012. The report indicates that fares at BC Ferries are generally comparable with similar ferry operators worldwide, and that BC Ferries' cost per nautical mile rankings with other ferry operators have not changed significantly since 2012. The Commissioner's reports are available on the Commissioner's website at www.bcferrycommission.ca.

- In December 2017, the new Provincial government announced a review of the Coastal Ferry Services Contract ("CFSC") and the provision of coastal ferry service in British Columbia to ensure that the model is operating in the public interest. The terms of reference for the review are available on the Province's website at www2.gov.bc.ca. The reviewer is to prepare and submit a report to the Minister of Transportation and Infrastructure for government's consideration by June 30, 2018 that will:
  - examine BC Ferries' operations, including operating and capital expenditures, business processes, practices and policies to assess whether the services are being provided for in a manner that supports the public interest in affordable fares;
  - consider what changes to the price cap and regulatory model would ensure the ferry system is working as efficiently and effectively as possible for all British Columbians and, in particular, ferry users and communities who depend on this essential service; and,
  - identify opportunities and recommend actions to enhance ferry service delivery and/or reduce costs without impacting existing service.

- On January 16, 2018, DBRS Limited ("DBRS") upgraded our Issuer Rating and Senior Secured Bonds Rating from "A" with a positive trend to "A (high)" with a stable trend. DBRS states that the upgrades "acknowledge the proven operating resilience and reliable management demonstrated by the Company, having weathered challenging macroeconomic conditions while maintaining satisfactory financial metrics and successfully returning to growth."

- On February 7, 2018, the British Columbia Ferries Commissioner (the "Commissioner") issued Order 18-01 in response to the findings of the review of BC Ferries' annual customer satisfaction tracking survey conducted for the Commissioner by MNP LLP. The order directs BC Ferries to augment our survey to include additional routes and to re-procure our contract with an external service provider to conduct the survey. Our plans to address the recommendations in MNP's report dated October 17, 2017, together with how we will communicate the actions we have taken in response, must be submitted to the Commissioner no later than June 1, 2018. The Commissioner's reports are available on the Commissioner's website at www.bcferrycommission.ca.

- On February 23, 2018, we reconfirmed our commitment to fare affordability with our contribution to the Province's fare initiatives which include freezing fares on the major routes, reducing fares by 15% on the minor and northern routes and reinstating the full seniors' passenger discount Monday through Thursday starting April 1, 2018. We are working with the Province to amend the CFSC to reflect these initiatives.

FINANCIAL AND OPERATIONAL OVERVIEW

This section provides an overview of our financial and operational performance for the three and nine month periods ended December 31, 2017 and 2016.

($millions)	Three months ended December 31			Nine months ended December 31		
	2017	**2016**	**Variance**	**2017**	**2016**	**Variance**
Total revenue	195.3	183.7	11.6	730.7	701.8	28.9
Operating expenses	195.3	173.9	(21.4)	586.6	542.9	(43.7)
Operating profit	-	9.8	(9.8)	144.1	158.9	(14.8)
Net finance and other	14.8	13.8	(1.0)	43.2	40.7	(2.5)
Net (loss) earnings	(14.8)	(4.0)	(10.8)	100.9	118.2	(17.3)
Other comprehensive income	9.7	6.3	3.4	8.6	15.6	(7.0)
Total comprehensive (loss) income	(5.1)	2.3	(7.4)	109.5	133.8	(24.3)

Quarterly results are affected by the seasonality of leisure travel patterns. Our third quarter results reflects a seasonal reduction in traffic. We utilize this period to perform upgrades and major maintenance and refit programs, as well as to undertake mandatory inspections on the majority of our vessels.

Our net loss in the three months ended December 31, 2017 was $10.8 million larger than in the three months ended December 31, 2016. Total comprehensive income of $2.3 million in the three months ended December 31, 2016 decreased by $7.4 million, to a loss of $5.1 million in the three months ended December 31, 2017. Year-to-date, our net earnings were $17.3 million lower and total comprehensive income was $24.3 million lower than in the same period in the prior year.

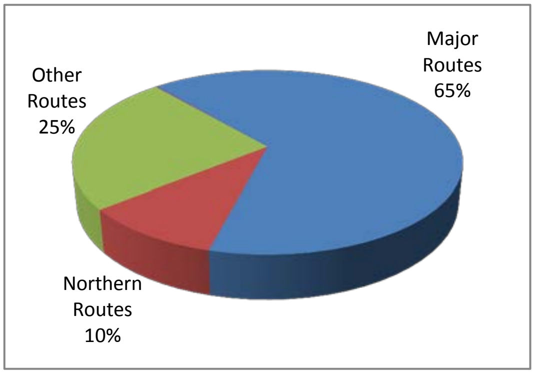
In the three months ended December 31, 2017, vehicle traffic increased 5.2% (5.0% year-to-date) and passenger traffic increased 5.1% (4.8% year-to-date) compared to the same period in the prior year. Passenger and vehicle traffic levels in the third quarter were the highest we have experienced since the third quarter of fiscal 2005. Year-to-date, passenger traffic levels were the highest we have experienced in 20 years and vehicle traffic levels were the highest we have ever experienced. Overall, commercial traffic increased by 5.7% in the quarter (4.0% year-to-date) compared to the same period in the prior year.

In the three months ended December 31, 2017, revenues increased by 6.3% (4.1% year-to-date) compared to the same period in the previous fiscal year, primarily as a result of the increased traffic volumes. The average tariff revenue per passenger (tariff revenue divided by traffic volume) of $11.00 remained unchanged for the quarter and year-to-date compared to the same periods in the previous year. While the average tariff revenue per vehicle increased from $43.69 to $45.04 in the three months ended December 31, 2017, year-to-date it remained unchanged at $46.00 compared to the same periods in the previous year. Average tariff revenue remained unchanged year-to-date as the April 1, 2017 modest increase in vehicle fares on the Major Routes was offset by promotional fares with significant discounts on many sailings.

In the three months ended December 31, 2017, operating expenses increased by 12.3% (8.0% year-to-date) compared to the same period in the previous fiscal year. This reflects our commitment to improve the customer experience. Among other improvements, we enhanced the service plan for routes operating out of Horseshoe Bay terminal to provide more convenient and timely connections. To accommodate the higher traffic volumes and to implement service enhancements, we provided 439.5 additional round trips in the quarter (1,210.5 year-to-date). The additional trips and the introduction of three new vessels in the nine months ended December 31, 2017 resulted in an increase in fuel consumption, labour and training related costs. Maintenance costs were significantly higher, as planned, accounting for 47.7% of the increase in operating expenses for the quarter (21.7% year-to-date). We experienced the highest quarterly maintenance costs in recent years, mainly attributed to the cyclical nature of refit activity. A significant portion of the year-to-date increase occurred in the third quarter and was due to the condensed schedule of refit activity undertaken to ensure vessel coverage while the *Spirit of British Columbia* is undergoing its mid-life upgrade. Our planned maintenance costs for fiscal 2018 and fiscal 2019 are expected to be approximately $12.0 million and $7.0 million higher, respectively, than fiscal 2017.

In the three months ended December 31, 2017, other comprehensive income increased $3.4 million compared to the same period in the prior year reflecting changes in the fair value of our fuel swap contracts. Year-to-date, other comprehensive income decreased $7.0 million compared to the same period in the prior year, comprised of a $6.3 million difference in the changes in the fair value of our fuel swap contracts and $0.7 million greater loss on actuarial valuations of our employee benefit plans.

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 nine months ended December 31, 2017, the greatest portion of our total revenues (65%) was earned on our Major Routes. Revenue from the Northern Routes contributed 10% and revenue from Other Routes contributed 25%.

Select operational statistics and total revenues for the three and nine month periods ended December 31, 2017 compared to the same periods in the prior year are shown in the tables below.

	Three months ended December 31		Nine months ended December 31	
Operational Statistics	**2017**	**2016**	**2017**	**2016**
Vehicle traffic	1,922,846	1,827,633	7,031,452	6,699,416
Passenger traffic	4,646,925	4,420,669	18,045,685	17,225,433
On-time performance	91.1%	92.4%	87.1%	88.2%
Number of round trips	19,299.0	18,859.5	60,221.0	59,010.5
Capacity provided (AEQs)	3,601,146	3,576,454	11,741,951	11,528,908
AEQs carried	2,184,669	2,077,745	7,956,950	7,597,046
Capacity utilization	60.7%	58.1%	67.8%	65.9%

In the three months ended December 31, 2017, vehicle traffic increased 5.2% (5.0% year-to-date) and passenger traffic increased 5.1% (4.8% year-to-date) compared to the same period in the prior year. Overall, we believe traffic continued to be positively impacted by favourable economic activity in British Columbia and the lower Canadian dollar. We believe our vehicle fare pricing promotions 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 high traffic demand.

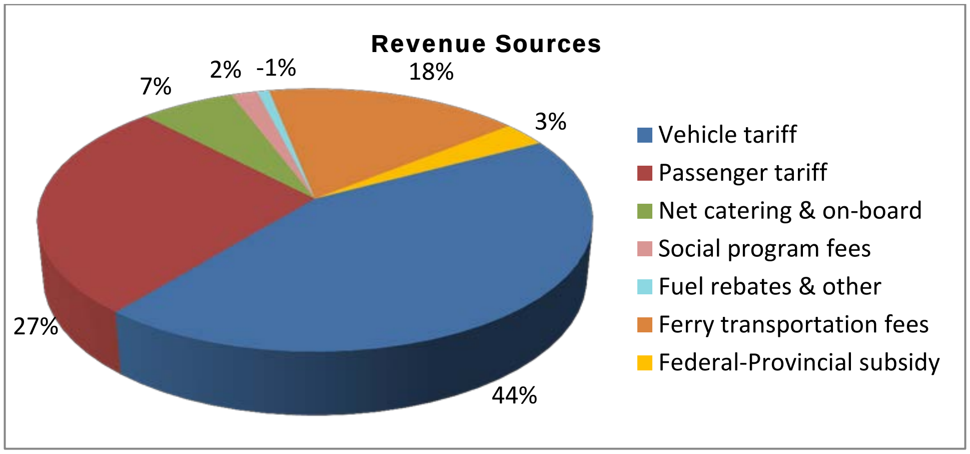
Meeting customer service expectations in a safe and reliable manner is the principal factor guiding our focus on on-time performance. Our initiatives to improve on-time performance include adjusting and/or expanding sailing schedules, adjusting crewing schedules and refining vehicle loading processes during peak periods. In the three months ended December 31, 2017, on-time performance declined by 1.3% (1.1% year-to-date) compared to the same period in the prior year. On-time performance on the Other Routes declined, primarily due to the impact from increased traffic demand and delays due to weather, which offsets the improvement in on-time performance on the Major Routes.

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 the 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 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 December 31, 2017, we provided 439.5 (1,210.5 year-to-date) 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 from 58.1% to 60.7% for the three months ended December 31, 2017 (from 65.9% to 67.8% year-to-date) compared to the same period 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	**Three months ended December 31**			**Nine months ended December 31**		
($ millions)	**2017**	**2016**	**Increase (Decrease)**	**2017**	**2016**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	86.6	79.8	6.8	324.9	312.0	12.9
Passenger tariff	49.6	47.2	2.4	199.7	190.4	9.3
Fuel rebates	(4.2)	(3.7)	(0.5)	(15.8)	(14.7)	(1.1)
Net catering & on-board	12.6	11.6	1.0	48.0	44.1	3.9
Social program fees	4.3	4.0	0.3	13.2	13.0	0.2
Other revenue	2.4	2.2	0.2	7.8	7.2	0.6
Total Direct Route Revenue	151.3	141.1	10.2	577.8	552.0	25.8
Indirect Route Revenue						
Ferry transportation fees	36.1	34.9	1.2	128.7	125.9	2.8
Federal-Provincial subsidy	7.4	7.3	0.1	22.3	21.9	0.4
Total Route Revenue	194.8	183.3	11.5	728.8	699.8	29.0
Other general revenue	0.5	0.4	0.1	1.9	2.0	(0.1)
Total Revenue	195.3	183.7	11.6	730.7	701.8	28.9



Vehicle tariffs (which include reservation fee revenue) and passenger tariffs account for the majority of our revenues. Our year-over-year tariff revenues are impacted by factors such as changes in overall traffic levels, traffic types, and tariff rates. Catering, retail and other on-board services is our second largest 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 price cap increases for the four year performance term ending March 31, 2020 ("PT4") were established. Average fare increases were below those allowed by the Commissioner. Vehicle fares were increased on average by 1.9% on three of the Major Routes: Tsawwassen - Swartz Bay, Tsawwassen - Duke Point and Horseshoe Bay - 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. On April 1, 2017, we also reduced 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 nine months ended December 31, 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 to stimulate growth in traffic or to direct traffic towards less busy sailings or to ensure compliance with approved price cap orders. Under the terms of the *Coastal Ferry Act* (the "Act") we cannot be over the price cap for more than four consecutive quarters. We have been under the approved price cap since the first quarter of fiscal 2016.

Year-to-year changes in operational statistics and revenue for the three and nine months ended December 31, 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 65% of our passenger traffic during the three and nine month periods ended December 31, 2017 and 2016.

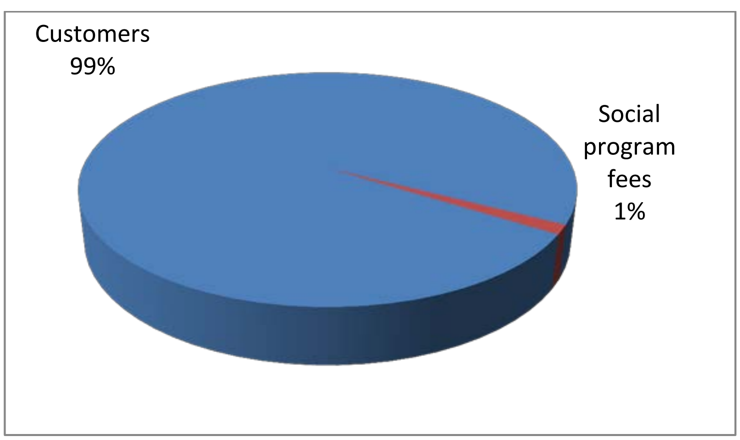
Operational Statistics	Three months ended December 31 2017	Three months ended December 31 2016	Nine months ended December 31 2017	Nine months ended December 31 2016
Vehicle traffic	1,129,240	1,085,219	4,210,589	4,042,633
Passenger traffic	2,992,711	2,855,455	11,773,037	11,274,354
On-time performance	80.3%	80.5%	79.5%	77.1%
Number of round trips	3,062.5	2,992.0	10,321.5	10,005.0
Capacity provided (AEQs)	1,903,553	1,877,014	6,436,949	6,284,850
AEQs carried	1,333,664	1,285,896	4,932,737	4,758,055
Capacity utilization	70.1%	68.5%	76.6%	75.7%

In the three months ended December 31, 2017, vehicle traffic increased 4.1% (4.2% year-to-date) and passenger traffic increased 4.8% (4.4% year-to-date) compared to the same period in the prior year. We believe traffic continued to be positively impacted by favourable economic activity in British Columbia and the lower Canadian dollar. We believe our vehicle pricing promotions also had a positive impact on both passenger and vehicle traffic.

In the three months ended December 31, 2017, on-time performance was essentially on par with the same period in the prior year. Year-to-date, on-time performance on the Major Routes improved 2.4% compared to the same period in the prior year, with all routes showing improvement.

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 at this terminal, have included adjusting and/or expanding sailing schedules, adjusting crewing schedules, changing operational procedures and refining vehicle loading processes during peak periods. These initiatives have helped improve the on-time performance on the route connecting Horseshoe Bay and Langdale by 5.3% (from 65.2% to 70.5%) compared to the same quarter of the prior year.

Capacity utilization on these routes during the three months ended December 31, 2017 improved 1.6% (0.9% year-to-date) compared to the same period in the prior year, mainly 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.



In the nine months ended December 31, 2017, revenue from our Major Routes consisted of 99% from customers and 1% from the Province.

Major Routes cont'd

Revenue ($ thousands)	Three months ended December 31			Nine months ended December 31		
	2017	**2016**	**Increase (Decrease)**	**2017**	**2016**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	73,439	68,546	4,893	271,894	263,766	8,128
Passenger tariff	41,084	39,222	1,862	161,076	154,136	6,940
Fuel rebates	(3,404)	(3,135)	(269)	(12,756)	(12,083)	(673)
Net catering & on-board	11,501	10,506	995	42,452	39,054	3,398
Social program fees	2,137	2,021	116	6,679	6,615	64
Parking	1,273	1,133	140	4,144	3,934	210
Other revenue	914	879	35	3,163	2,870	293
Total Direct Route Revenue	126,944	119,172	7,772	476,652	458,292	18,360
Indirect Route Revenue	-	-	-	-	-	-
Total Route Revenue	126,944	119,172	7,772	476,652	458,292	18,360

On April 1, 2017 we implemented a modest increase in vehicle fares, no increase in passenger fares, and a reduction in reservation fees. During the nine months ended December 31, 2017, we offered promotional fares with significant discounts on more than 2,800 sailings.

In the three months ended December 31, 2017, average tariff revenue (tariff revenue divided by traffic volume) per vehicle increased $1.87 or 3.0% to $65.03 compared to the same period in the prior year. Year-to-date, average tariff revenue per vehicle decreased $0.67 or 1.0% to $64.57 compared to the same period in the prior year. The changes in the average tariff revenue are mainly as a result of the many promotional discounts offered during the period. No increase in passenger fares was implemented on April 1, 2017, which resulted in the average tariff revenue per passenger in the three and nine month periods ended December 31, 2017 remaining at $13.73 (year-to-date $13.68), unchanged from the same periods in the prior year.

The tariff revenue increase of $6.8 million ($15.1 million year-to-date) during the three months ended December 31, 2017, compared to the same period in the prior year, was mainly due to higher traffic levels.

As discussed above, a fuel rebate of 2.9% was in place on our Major Routes during the nine month periods ended December 31, 2017 and December 31, 2016.

All vessels that provide service on our Major Routes have a gift shop and options for food service. In the three months ended December 31, 2017, net catering and on-board sales increased 9.5% (8.7% year-to-date) 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 73% of the total retail revenue. Sales of quality apparel comprise over 11% of the total retail revenue.

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 quarter and year-to-date increased slightly compared to the same period in the prior year, mainly as a result of an increase in the usage of the MTAP program.

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

Northern Routes

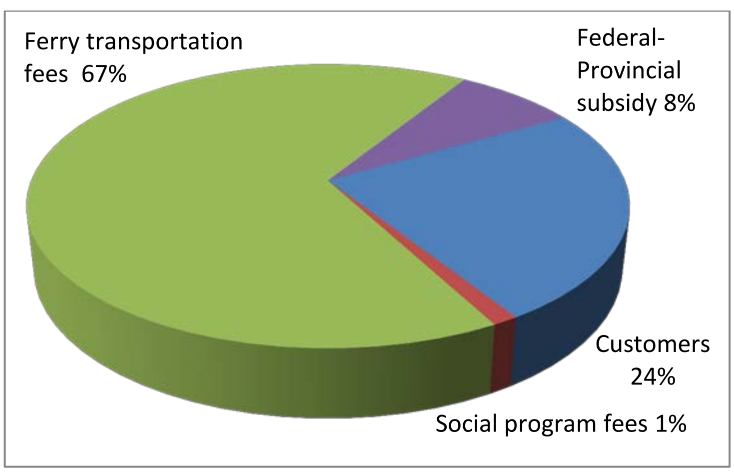
Our Northern Routes consist of two regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island.

Operational Statistics	Three months ended December 31 2017	Three months ended December 31 2016	Nine months ended December 31 2017	Nine months ended December 31 2016
Vehicle traffic	5,178	5,219	27,788	26,805
Passenger traffic	12,094	12,631	78,320	74,883
On-time performance	87.0%	90.4%	88.7%	88.3%
Number of round trips	48.5	40.5	208.0	194.0
Capacity provided (AEQs)	12,079	10,330	47,408	44,408
AEQs carried	6,543	6,517	33,951	32,539
Capacity utilization	54.2%	63.1%	71.6%	73.3%

In the three months ended December 31, 2017, vehicle traffic decreased 0.8% and passenger traffic decreased 4.3% compared to the same period in the prior year. The prior year was positively impacted by vehicle promotional discounts. Year-to-date, vehicle traffic increased 3.7% and passenger traffic increased 4.6% compared to the same period in the prior year.

On-time performance in the three months ended December 31, 2017 declined from 90.4% to 87.0% over the same period in the prior year, primarily due to the impact from unfavourable weather. Year-to-date, on-time performance is essentially on par with the same period in the prior year.

Capacity utilization on these routes during the three months ended December 31, 2017 was 8.9% (1.7% year-to-date) lower than the same period in the prior year, primarily as a result of increased capacity provided due to an increase in the number of round trips partially offset by a higher number of AEQs carried.



In the nine months ended December 31, 2017, revenue from our Northern Routes consisted of 24% from customers and 76% from the Province (1% social program fees, 67% ferry transportation fees, and 8% from payments under the Federal-Provincial subsidy agreement).

Northern Routes cont'd

Revenue ($ thousands)	Three months ended December 31			Nine months ended December 31		
	2017	**2016**	**Increase (Decrease)**	**2017**	**2016**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	1,259	1,122	137	8,124	7,596	528
Passenger tariff	670	682	(12)	7,161	6,739	422
Fuel rebates	(44)	(38)	(6)	(334)	(299)	(35)
Net catering & on-board	141	162	(21)	1,373	1,266	107
Social program fees	225	209	16	877	845	32
Stateroom rental	309	298	11	1,406	1,279	127
Hostling & other	54	79	(25)	195	163	32
Total Direct Route Revenue	2,614	2,514	100	18,802	17,589	1,213
Indirect Route Revenue						
Ferry transportation fees	10,735	10,283	452	49,174	49,846	(672)
Federal-Provincial subsidy	1,910	1,870	40	5,731	5,611	120
Total Route Revenue	15,259	14,667	592	73,707	73,046	661

No fare increases were implemented on these routes on April 1, 2017. In the three months ended December 31, 2017, average tariff revenue (tariff revenue divided by traffic volume) per vehicle increased $28.16 or 13.1% to $242.95 ($8.98 or 3.2% to $292.36 year-to-date) compared to the same period in the prior year. This increase is mainly as a result of the vehicle promotional discounts offered during the same period in the prior year. Average tariff revenue per passenger during the same period increased $1.41 or 2.6% to $55.40 ($1.44 or 1.6% to $91.43 year-to-date) compared to the same period in the prior year. The increase in average tariff revenues also reflects a shift in the mix of traffic types with higher versus lower tariffs. The increase in traffic levels and the shift in traffic during the three months ended December 31, 2017 resulted in a total tariff revenue increase of $0.1 million ($0.9 million year-to-date) 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 nine month periods ended December 31, 2017 and December 31, 2016.

Reimbursements from the Province for social program fees increased in the quarter and year-to-date compared to the same periods in the prior year, mainly as a result of an increase in the usage of the MTAP program.

Net revenue from catering and on-board services decreased in the three months ended December 31, 2017, mainly as a result of reduced passenger levels. Year-to-date, net revenue from catering and on-board increased compared to the same period in the prior year, mainly as a result of higher passenger levels.

Stateroom rental revenue increased mainly due to increased utilization and higher passenger levels year-to-date.

Ferry transportation fees received from the Province increased $0.5 million in the quarter and decreased $0.7 million year-to-date compared to the same periods 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

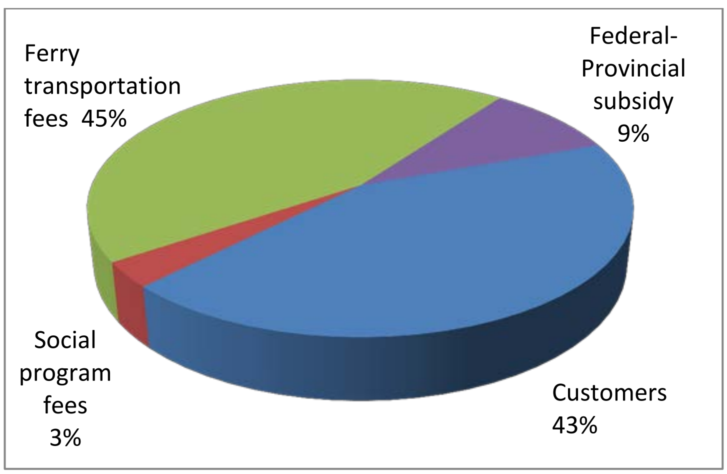
Our Other Routes primarily serve the northern and southern Gulf Islands and the northern Sunshine Coast. One of the 18 regulated routes and all eight of the unregulated routes are operated under contract by alternative service providers. We receive fees from the Province for the provision of contracted 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 December 31		Nine months ended December 31	
	2017	2016	2017	2016
Vehicle traffic	788,428	737,195	2,793,075	2,629,978
Passenger traffic	1,642,120	1,552,583	6,194,328	5,876,196
On-time performance	92.9%	94.4%	88.5%	90.2%
Number of round trips	16,188.0	15,827.0	49,691.5	48,811.5
Capacity provided (AEQs)	1,685,514	1,689,110	5,257,594	5,199,650
AEQs carried	844,462	785,332	2,990,262	2,806,452
Capacity utilization	50.1%	46.5%	56.9%	54.0%

In the three months ended December 31, 2017, vehicle traffic increased 6.9% (6.2% year-to-date) and passenger traffic increased 5.8% (5.4% year-to-date) compared to the same period in the prior year.

On-time performance in the three months ended December 31, 2017 decreased from 94.4% to 92.9% (from 90.2% to 88.5% year-to-date) 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 December 31, 2017 was 3.6% higher compared to the same period in the prior year due to a higher number of AEQs carried and a decrease in capacity provided, mainly as a result of vessel substitutions. Year-to-date, capacity utilization on these routes was 2.9% higher compared to the same period in the prior year, primarily due to a higher number of AEQs carried partially offset by an increase in capacity provided, mainly due to an increase in the number of round trips.



In the nine months ended December 31, 2017, revenue from our Other Routes consisted of 43% from customers and 57% from the Province (3% social program fees, 45% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

Other Routes cont'd

Revenue ($ thousands)	Three months ended December 31			Nine months ended December 31		
	2017	2016	Increase (Decrease)	2017	2016	Increase (Decrease)
Direct Route Revenue						
Vehicle tariff	11,899	10,183	1,716	44,921	40,664	4,257
Passenger tariff	7,850	7,311	539	31,451	29,542	1,909
Fuel rebates	(720)	(613)	(107)	(2,692)	(2,381)	(311)
Social program fees	1,909	1,773	136	5,653	5,550	103
Net catering & on-board	669	622	47	2,776	2,492	284
Parking & other	73	115	(42)	262	259	3
Total Direct Route Revenue	21,680	19,391	2,289	82,371	76,126	6,245
Indirect Route Revenue						
Ferry transportation fees	25,374	24,581	793	79,491	76,053	3,438
Federal-Provincial subsidy	5,536	5,419	117	16,606	16,257	349
Total Route Revenue	52,590	49,391	3,199	178,468	168,436	10,032

No fare increases were implemented on the regulated Other Routes on April 1, 2017. In the three months ended December 31, 2017, average tariff revenue per vehicle (tariff revenue divided by traffic volume) increased $1.28 or 9.3% to $15.09 ($0.62 or 4.0% to $16.08 or year-to-date) reflecting an increase in the proportion of traffic on routes with higher versus lower tariffs, an increase in the proportion of higher tariff vehicle types, and the pricing promotions in the prior year. In the three months ended December 31, 2017, average tariff revenue per passenger remained at a similar level of $4.78 ($5.08 year-to-date) compared to the same period in the prior year. The total tariff revenue increase of $2.3 million ($6.2 million year-to-date) 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 nine months ended December 31, 2017 and December 31, 2016.

Reimbursements from the Province for social program fees increased in the quarter and year-to-date compared to the same periods in the prior year, mainly as a result of an increase in the number of students travelling and the increased usage of the MTAP program.

Revenue from net catering and on-board services increased in the quarter and year-to-date compared to the same periods in the prior year, mainly as a result of higher passenger traffic.

Ferry transportation fees received from the Province increased $0.8 million in the quarter ($3.4 million year-to-date) 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 and nine month periods ended December 31, 2017 and 2016 are summarized in the table below:

Operating expenses ($ millions)	**Three months ended December 31**			**Nine months ended December 31**		
	2017	**2016**	**Increase (Decrease)**	**2017**	**2016**	**Increase (Decrease)**
Operations	117.6	110.2	7.4	376.5	354.0	22.5
Maintenance	28.2	18.0	10.2	62.7	53.2	9.5
Administration	9.1	8.6	0.5	28.3	25.4	2.9
Total operations, maintenance & administration	154.9	136.8	18.1	467.5	432.6	34.9
Depreciation and amortization	40.4	37.1	3.3	119.1	110.3	8.8
Total operating expenses	195.3	173.9	21.4	586.6	542.9	43.7

To improve our customer experience and to accommodate the higher traffic volumes, we provided 439.5 (1,210.5 year-to-date) additional round trips and introduced three new vessels. These initiatives 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 December 31, 2017, operations expenses increased $7.4 million compared to the same period in the prior year mainly due to:

- $3.6 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 on training activities where temporary replacements were required;
- $1.9 million increase in materials, supplies and contracted services, mainly resulting from increased traffic volumes;
- $0.7 million increase in fuel expense in the quarter, reflecting a 3.1% increase in fuel prices. For purposes of rate regulation, in the three months ended December 31, 2017, $1.2 million would be recorded in deferred fuel cost accounts. (See "Accounting Practices - The Effect of Rate Regulation" below for more detail.); and
- $1.2 million year-to-date increase in training related expenses, computer licences, and credit card fees.

Year-to-date, operations expenses increased $22.5 million compared to the same period in the prior year mainly due to:

- $13.7 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, an increase in overtime and an increase in hours spent in training activities where temporary replacements were required;
- $3.2 million increase in materials, supplies and contracted services, mainly resulting from increased traffic volumes;
- $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;
- $1.1 million increase in fuel expense, reflecting a $1.7 million or 2.2% increase in fuel consumption primarily from additional round trips partially offset by a decrease in fuel prices of $0.6 million or 0.8%; and
- $2.8 million year-to-date increase in training related expenses, utilities, computer licences, credit card fees and promotional costs.

Maintenance costs were $10.2 million higher in the three months ended December 31, 2017 ($9.5 million year-to-date) compared to the same period in the prior year as a result of planned variations in vessel refit scheduling, unplanned vessel maintenance and timing of repairs to our terminals. We experienced the highest quarterly maintenance costs in recent years mainly attributed to the cyclical nature of refit activity. A significant portion of the year-to-date increase occurred in the third quarter and was due to the condensed schedule of refit activity undertaken to ensure vessel coverage while the *Spirit of British Columbia* is undergoing its mid-life upgrade. Our planned maintenance costs for fiscal 2018 and fiscal 2019 are expected to be approximately $12.0 million and $7.0 million higher, respectively, than fiscal 2017.

Administration costs were $0.5 million higher in the three months ended December 31, 2017 ($2.9 million year-to-date) compared to the same period in the prior year, mainly due to higher wages and benefits and consulting costs.

Depreciation and amortization increased $3.3 million in the three months ended December 31, 2017 ($8.8 million year-to-date) compared to the same period in the prior year reflecting 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 December 31**			**Nine months ended December 31**		
	2017	**2016**	**Increase (Decrease)**	**2017**	**2016**	**Increase (Decrease)**
Finance expense						
Bond interest	14.8	14.6	0.2	44.2	43.6	0.6
KfW bank group (KfW) loans	1.6	1.3	0.3	4.8	3.8	1.0
Interest on finance lease	0.5	0.5	-	1.4	1.4	-
Short-term debt	-	-	-	0.3	0.2	0.1
Capitalized interest	(1.6)	(1.3)	(0.3)	(4.8)	(5.0)	0.2
Total finance expense	15.3	15.1	0.2	45.9	44.0	1.9
Less: finance income	(1.5)	(1.3)	(0.2)	(3.9)	(3.5)	(0.4)
Net finance expense	13.8	13.8	-	42.0	40.5	1.5
Loss on disposal and revaluation of property, plant and equipment, intangible assets and inventory	1.0	-	1.0	1.2	0.2	1.0
Total net finance and other expenses	14.8	13.8	1.0	43.2	40.7	2.5

In the three months ended December 31, 2017, net finance and other expenses increased $1.0 million ($2.5 million year-to-date) compared to the same period in the prior year mainly due to:

- $1.0 million ($1.0 million year-to-date) increase in loss on asset disposals;
- $0.3 million ($1.0 million year-to-date) increase in interest on KfW loans, reflecting interest on the additional KfW loans for the Salish Class vessels; and
- $0.2 million ($0.6 million year-to-date) increase in amortization of debt issue costs.

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.

In addition to the $15.1 million, in fiscal 2017, the Government of Canada also approved funding of up to $45 million under the New Building Canada Fund towards the purchase of two new minor class vessels and major upgrade of our Langdale terminal. In total, up to $60.5 million in funding under the New Building Canada Fund has been approved.

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 December 31, 2017, our unrestricted cash and cash equivalents and other short-term investments totalled $105 million and $143 million, respectively.

Our $155 million credit facility, with a syndicate of Canadian banks, 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 December 31, 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. At December 31, 2017, our credit rating with Standard & Poor's was "AA-" with a stable outlook. On January 16, 2018, DBRS upgraded our Issuer Rating and Senior Secured Bonds Rating from "A" with a positive trend to "A (high)" with a stable trend. DBRS states that the upgrades "acknowledge the proven operating resilience and reliable management demonstrated by the Company, having weathered challenging macroeconomic conditions while maintaining satisfactory financial metrics and successfully returning to growth."

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 December 31, 2017, we achieved a leverage ratio (total borrowings as a percentage of total borrowings plus shareholders equity) of 71.0% and a debt service ratio of 2.83.

Sources & Uses of Cash

Sources and uses of cash and cash equivalents for the nine month periods ended December 31, 2017 and 2016 are summarized in the table below:

($ millions)	2017	2016	Increase (Decrease)
	Nine months ended December 31		
Cash and cash equivalents, beginning of period	72.0	79.1	(7.1)
Cash from operating activities:			
Net earnings	100.9	118.2	(17.3)
Items not affecting cash	166.5	154.7	11.8
Changes in non-cash operating working capital	7.8	(7.5)	15.3
Net interest paid	(47.8)	(47.3)	(0.5)
Cash generated by operating activities	227.4	218.1	9.3
Cash generated by financing activities	18.4	26.5	(8.1)
Cash used in investing activities	(212.6)	(206.1)	(6.5)
Net increase in cash and cash equivalents	33.2	38.5	(5.3)
Cash and cash equivalents, end of period	105.2	117.6	(12.4)

For the nine months ended December 31, 2017, cash generated by operating activities increased by $9.3 million compared to the same period in the prior year, primarily due to changes in non-cash working capital (payables, receivables and deferred revenue) and items not affecting cash (depreciation) partially offset by a decrease in net earnings. The decrease in net earnings reflects higher revenues offset by higher operating expenses relating to increased traffic levels, additional round trips, and costs to bring three new vessels into service, as well as higher maintenance expenses.

Cash generated by financing activities in the nine months ended December 31, 2017 was $18.4 million. This amount consisted of our new $45.3 million loan from KfW IPEX-Bank GmbH partially offset by $25.5 million in repayment of KfW loans and finance lease obligations and $1.4 million in deferred financing costs.

Cash used in financing activities in the nine months ended December 31, 2016 was $26.5 million. This amount consisted of our new $44.9 million loan from KfW IPEX-Bank GmbH partially offset by $16.9 million in repayment of KfW loans and finance lease obligations and $1.5 million in deferred financing costs.

Cash used in investing activities in the nine months ended December 31, 2017 increased by $6.5 million compared to the same period in the prior year, due to a $35.4 million increase in cash used for capital expenditures, a $0.1 million decrease in debt service reserves and a $28.8 million decrease in the amount provided by short-term investments. (See “Investing in Our Capital Assets” below for detail of significant capital expenditures.)

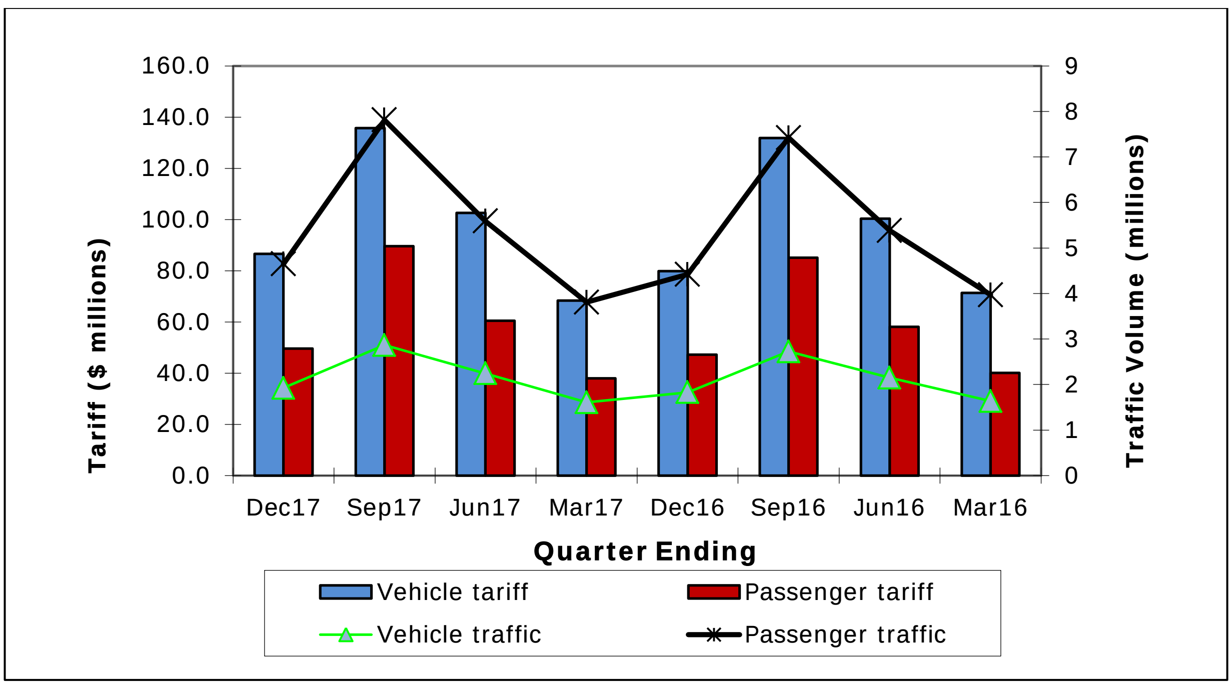
SUMMARY OF QUARTERLY RESULTS

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

($ millions)	Quarter Ended (unaudited)							
	Dec 17	**Sep 17**	**Jun 17**	**Mar 17**	**Dec 16**	**Sep 16**	**Jun 16**	**Mar 16**
Total revenue	195.3	309.5	225.9	157.5	183.7	298.9	219.2	166.3
Operating (loss) profit	-	112.6	31.5	(25.8)	9.8	108.5	40.6	(16.2)
Net (loss) earnings	(14.8)	98.4	17.3	(40.8)	(4.0)	95.2	27.0	(30.0)
Other comprehensive income (loss)	9.7	4.6	(5.7)	(1.0)	6.3	(1.0)	10.3	(12.0)
Total comprehensive (loss) income	(5.1)	103.0	11.6	(41.8)	2.3	94.2	37.3	(42.0)

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.

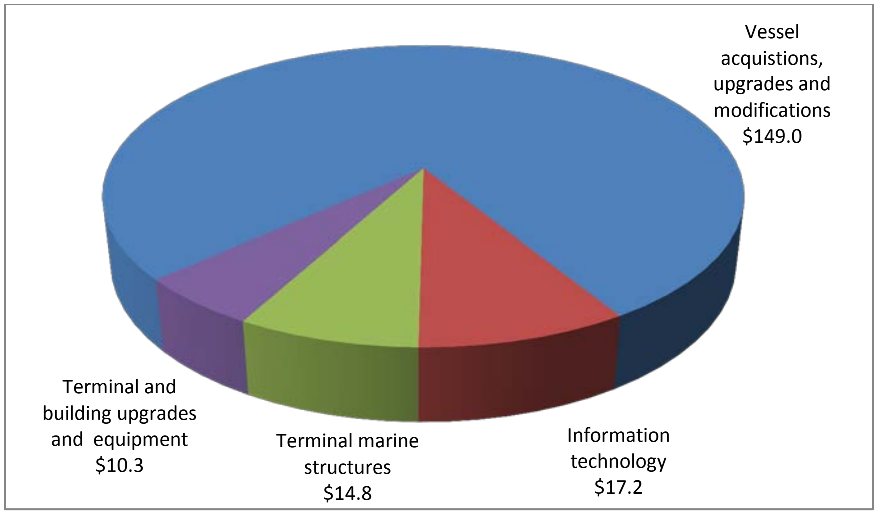
The following graph demonstrates the seasonality of our revenue and shows the relationship of traffic volume and tariff revenue over the most recent eight quarters:



INVESTING IN OUR CAPITAL ASSETS

Capital Expenditures

Capital expenditures in the nine months ended December 31, 2017 totalled $191.3 million.



In fiscal 2017, the Government of Canada approved funding of up to $60.5 million 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 provide mid-coast service, including a new seasonal direct ferry service between Port Hardy and Bella Coola. In the three months ended December 31, 2017, we recorded $7.6 million in funding, $3.1 million to the New Minor Class vessel project and $4.5 million to the Northern Sea Wolf project.

Capital expenditures in the three and nine month periods ended December 31, 2017, comprised the following:

($ millions)	**December 31, 2017**	
	3 months	**9 months**
New Salish Class vessels	0.1	54.5
Spirit Class mid-life upgrades	22.5	49.1
Major overhauls and inspections	12.1	23.2
Northern Sea Wolf and terminal modifications	2.3	15.0
Trestle and Dolphin upgrades at Prince Rupert terminal	2.4	9.0
Customer service program	2.6	8.9
New Minor Class vessels	(2.8)	7.0
Hardware upgrades	1.3	5.3
Various other projects	7.3	19.3
	47.8	191.3

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, formed the majority of the total project budget of $206 million. The new vessels are dual-fuel capable, designed to run primarily on liquefied natural gas ("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 August 3, 2017, the *Salish Eagle* and the *Salish Raven,* respectively, commenced regularly-scheduled service in the Southern Gulf Islands. Introduction of these vessels enabled 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. In fiscal 2017, we received $5.3 million in funding from FortisBC.

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*. On October 21, 2017, the *Spirit of British Columbia* arrived at Remontowa Ship Repair Yard S.A., in Gdansk, Poland, for its mid-life upgrade. In the three months ended December 31, 2017, $22.5 million ($49.1 million year-to-date) in capital expenditures primarily consisted of installment payments made based on the contract. The *Spirit of British Columbia* is expected to return to service by the summer of 2018 and the mid-life upgrade of the *Spirit of Vancouver Island* is expected to be completed the following year. The mid-life upgrades will enable the vessels to be in service for another 25 years. 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. In the nine months ended December 31, 2017, we received $1.8 million in funding from FortisBC.

Major overhauls and inspections

In the three months ended December 31, 2017, we had capital expenditures of $12.1 million ($23.2 million year-to-date) in respect of major overhauls and inspections of components of hull, propulsion and generators for eight vessels that were completed or underway.

Northern Sea Wolf

On April 7, 2017, we finalized an agreement to acquire a 75-metre used vessel to provide a new seasonal direct ferry service between Port Hardy and Bella Coola. Ownership transferred on August 30, 2017. On December 15, 2017, the *Northern Sea Wolf* arrived in British Columbia after a 10,097 nautical mile journey from Athens, Greece. The 75-metre used vessel is undergoing extensive upgrades at Esquimalt Drydock Company, a local shipyard, in preparation for regular service commencing in the summer of 2018. 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 from the New Building Canada Fund of up to $15.1 million. In the three months ended December 31, 2017, $2.3 million ($15.0 million year-to-date) in capital expenditures, net of $4.5 million in funding from the New Building Canada Fund, consisted primarily of payments to acquire the vessel, to begin vessel upgrades and start modifications to our terminal marine structures.

Prince Rupert Terminal

In the three months ended December 31, 2017, we incurred capital expenditures of $2.4 million ($9.0 million year-to-date) to replace the existing marine structures with a new trestle and three new dolphins. These are expected to be in service in the last quarter of fiscal 2018.

Customer service program

In the three months ended December 31, 2017, we spent $2.6 million ($8.9 million year-to-date) on our customer service program. The 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.

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 December 31, 2017, the $2.8 million negative amount reflects $3.1 million of funding from the New Building Canada Fund and expenditures of $0.3 million. Year-to-date, $7.0 million reflects expenditures of $10.1 million primarily consisting of installment payments made based on the contract, less $3.1 million in funding. These vessels will each have a capacity of up to 300 passengers and approximately 47 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 between Powell River and Texada Island and the second new vessel to provide service between Port McNeill, Alert Bay and Sointula.

Hardware Upgrades

Hardware upgrades include the replacement of aged computers, servers, printers, routers, closed-circuit cameras, antennas, digital signage and handheld units for inventory management.

OUTLOOK

Financial

We expect positive net earnings in fiscal 2018, reflecting higher traffic levels that generate higher tariff revenue and higher net catering and on-board revenue. Increases in discretionary traffic are primarily due to favourable economic conditions, strong tourism, favourable weather and the timing of Easter.

Fare increases on April 1, 2017 were limited to vehicle fares on three of our Major Routes and were mainly offset by a reduction in reservation fees. We continue to review the level of fuel rebates in light of the volatility of fuel costs.

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.

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

On February 23, 2018, we reconfirmed our commitment to fare affordability with our contribution to the Province's fare initiatives which include freezing fares on the major routes, reducing fares by 15% on the minor and northern routes and reinstating the full seniors' passenger discount Monday through Thursday starting April 1, 2018. We are working with the Province to amend the CFSC to reflect these initiatives.

Major Investments

Our capital plan includes replacement of aged vessels, mid-life upgrades for the Spirit Class vessels as well as upgrades and modifications for other vessels. It also includes significant upgrades at our terminals and at our vessel maintenance facility, and renewal of our information technology infrastructure. In fiscal 2018, our capital spending is projected to be $297 million excluding external funding 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 the *Northern Sea Wolf* and modifications to minor terminals for the new seasonal direct ferry service between Port Hardy and Bella Coola beginning in the summer of 2018.

Summary

We continue to pursue strategies to provide a customer focused, affordable and sustainable ferry system by optimizing our service on routes, standardizing our vessels and terminals, 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 BC economy, weather, the value of the Canadian dollar, 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 US administration will have on the Canadian economy. We remain confident that as long as the BC economy continues to grow and 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 nine months ended December 31, 2017. Our 2017 Management's Discussion & Analysis is available at http://www.bcferries.com/investors/financial_reports.html on our investor webpage.

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 nine months ended December 31, 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.

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 December 31, 2017 condensed interim 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 judgments, 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 condensed interim financial statements for the three and nine months ended December 31, 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. We are planning to apply IFRS 15 using the modified retrospective approach and recognize the cumulative impact of the application in retained earnings at April 1, 2018. We are currently assessing the effects of applying the new standard and do not expect the application to have a significant impact on our consolidated financial statements, other than additional disclosure.

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 leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. This standard will be effective for us April 1, 2019. We are planning to early adopt IFRS 16 for the annual reporting period beginning on April 1, 2018 using the modified retrospective approach with no restatement of prior periods. We are reviewing the effects of applying the new standard and do not expect the application of IFRS 16 to have a significant impact on our consolidated financial statements, other than additional disclosure.

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. These regulatory assets are considered supplemental disclosures and are detailed in note 16 to our December 31, 2017 unaudited condensed interim 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 and nine month periods ended December 31, 2017 and 2016 would be as follows:

($ millions)		**Three months ended December 31**		**Nine months ended December 31**	
		2017	**2016**	**2017**	**2016**
Net earnings		(14.8)	(4.0)	100.9	118.2
Changes in net earnings:					
Regulatory asset or liability	**Statement line item**				
Deferred fuel costs (a)					
Fuel costs under set price	Operations expense	(1.2)	(1.6)	(7.5)	(5.6)
Fuel rebates	Fuel rebates	4.1	3.8	15.7	14.7
Payments from the Province	Ferry service fees	-	-	0.3	0.1
Increase in total net earnings		2.9	2.2	8.5	9.2
Adjusted net earnings		(11.9)	(1.8)	109.4	127.4

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

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, the new Provincial government initiatives, 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 *Northern Sea Wolf* and the seasonal direct ferry service between Port Hardy and Bella Coola, the minor class vessel replacements, the loan agreement with KFW IPEX-Bank GmbH, the agreements with FortisBC Energy Inc. regarding incentive funding, the New Building Canada Fund, and Spirit Class mid-life upgrades; total 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.