

Condensed Interim Consolidated Financial Statements

BRITISH COLUMBIA FERRY SERVICES INC.

Three and nine months ended December 31, 2020 and 2019
(Unaudited)

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Financial Position (unaudited)

(Expressed in thousands of Canadian dollars)

	Note	As at	
		December 31, 2020	March 31, 2020
Assets			
Current assets			
Cash and cash equivalents		323,329	169,141
Restricted short-term investments	7(b)	33,198	33,393
Other short-term investments		144,529	91,588
Trade and other receivables		23,176	19,488
Prepaid expenses		10,615	11,057
Inventories		36,806	31,897
Derivative assets	11	-	28
		571,653	356,592
Non-current assets			
Loan receivable		24,515	24,515
Property, plant and equipment	3	1,837,311	1,879,517
Intangible assets	4	96,692	99,893
		1,958,518	2,003,925
Total assets		2,530,171	2,360,517
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	5	98,637	132,296
Provisions		2,297	1,794
Current portion of lease liabilities	6	2,772	2,536
Contract liabilities	14	136,088	21,702
Current portion of long-term debt	6,7	15,317	21,644
Interest payable on long-term debt	6	17,490	21,512
Current portion of accrued employee future benefits		2,500	3,000
Derivative liabilities	11	8,539	15,507
		283,640	219,991
Non-current liabilities			
Lease liabilities	6	36,557	38,675
Contract liabilities	14	36,941	-
Long-term debt	6,7	1,419,558	1,427,426
Accrued employee future benefits		20,608	20,151
Other liabilities	9	10,039	10,962
Derivative liabilities	11	9,707	17,212
		1,533,410	1,514,426
Total liabilities		1,817,050	1,734,417
Equity			
Share capital		75,478	75,478
Contributed surplus		25,000	25,000
Retained earnings		622,012	547,745
Total equity before reserves		722,490	648,223
Reserves	12(a)	(9,369)	(22,123)
Total equity including reserves		713,121	626,100
Total liabilities and equity		2,530,171	2,360,517

Commitments (note 3)

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Profit or Loss and Other Comprehensive Income (Loss) (unaudited)

(Expressed in thousands of Canadian dollars)

	Note	Three months ended		Nine months ended	
		December 31		December 31	
		2020	2019	2020	2019
Revenue					
Vehicle and passenger fares		94,691	134,699	343,441	513,691
Net retail	13	4,811	14,583	13,975	55,249
Fuel (rebates) surcharges	18	(1,525)	1,620	(5,432)	5,440
Other income		1,937	2,754	5,546	9,323
Revenue from customers		99,914	153,656	357,530	583,703
Safe restart funding	14,19	154,802	-	154,802	-
Ferry service fees		49,118	49,457	160,535	179,445
Federal-Provincial Subsidy Agreement		8,007	7,835	24,021	23,505
Total revenue		311,841	210,948	696,888	786,653
Expenses					
Operations	15	120,616	128,339	352,740	421,258
Maintenance		24,290	22,166	62,533	61,918
Administration		8,514	9,312	28,594	27,279
Depreciation and amortization		45,613	45,913	134,159	136,375
Total operating expenses		199,033	205,730	578,026	646,830
Operating profit		112,808	5,218	118,862	139,823
Net finance and other expenses					
Finance expenses	16	15,445	16,056	45,988	46,377
Finance income		(1,077)	(2,520)	(3,361)	(5,201)
Net finance expense		14,368	13,536	42,627	41,176
Loss (gain) on disposal and revaluation of property, plant and equipment and intangible assets		4	(8)	1,968	(214)
Net finance and other expenses		14,372	13,528	44,595	40,962
NET EARNINGS (LOSS)		98,436	(8,310)	74,267	98,861
Other comprehensive income (loss)					
Items that are or may be reclassified subsequently to net earnings (loss)	12(b)	7,585	4,645	2,042	755
Items not to be reclassified to net earnings (loss)		-	-	(1,933)	(126)
Total other comprehensive income		7,585	4,645	109	629
Total comprehensive income (loss)		106,021	(3,665)	74,376	99,490

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Cash Flows (unaudited)

(Expressed in thousands of Canadian dollars)

	Nine months ended December 31	
	2020	2019
Operating activities		
Net earnings	74,267	98,861
Items not affecting cash:		
Net finance expense	42,627	41,176
Depreciation and amortization	134,159	136,375
Loss (gain) on disposal and revaluation of property, plant and equipment and intangible assets	1,968	(214)
Other non-cash changes to property, plant and equipment	(294)	(686)
Changes in:		
Accrued employee future benefits	(1,976)	204
Derivative assets and liabilities recognized in net loss	55	2
Provisions	503	4,859
Accrued financing costs	(270)	89
Total non-cash items	176,772	181,805
Movements in operating working capital:		
Trade and other receivables	(3,688)	(2,497)
Prepaid expenses	442	(4,381)
Inventories	(4,909)	(896)
Accounts payable and accrued liabilities	(33,659)	(42,768)
Contract liabilities	151,327	(7,348)
Change in non-cash working capital	109,513	(57,890)
Change in non-cash working capital attributable to investing activities	25,673	32,324
Change in non-cash operating working capital	135,186	(25,566)
Cash generated from operating activities before interest	386,225	255,100
Interest received	3,628	5,272
Interest paid	(55,769)	(50,468)
Cash generated from operating activities	334,084	209,904

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed Interim Consolidated Statements of Cash Flows (unaudited)

(Expressed in thousands of Canadian dollars)

	<u>Nine months ended December 31</u>	
	<u>2020</u>	<u>2019</u>
Financing activities		
Repayment of long-term debt	(14,837)	(69,212)
Repayment of lease liabilities	(1,886)	(1,650)
Proceeds from the issue of bonds	-	250,000
Transaction costs related to bonds	-	(1,587)
Cash (used in) from financing activities	(16,723)	177,551
Investing activities		
Proceeds from disposal of property, plant and equipment	93	309
Purchase of property, plant and equipment and intangible assets	(110,520)	(172,322)
Changes in restricted short-term investments	195	(1,937)
Net purchase of other short-term investments	(52,941)	(45,984)
Cash used in investing activities	(163,173)	(219,934)
Net increase in cash and cash equivalents	154,188	167,521
Cash and cash equivalents, beginning of period	169,141	59,888
Cash and cash equivalents, end of period	323,329	227,409

BRITISH COLUMBIA FERRY SERVICES INC.

Condensed 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 12(a))	Total equity including reserves
Balance as at April 1, 2019	75,478	25,000	525,006	625,484	12,834	638,318
Net earnings	-	-	98,861	98,861	-	98,861
Other comprehensive income	-	-	-	-	629	629
Realized hedge gains recognized in fuel swaps	-	-	-	-	(5,575)	(5,575)
Hedge losses on interest rate forward contract reclassified to net earnings	-	-	-	-	186	186
Balance as at December 31, 2019	75,478	25,000	623,867	724,345	8,074	732,419
Balance as at April 1, 2020	75,478	25,000	547,745	648,223	(22,123)	626,100
Net earnings	-	-	74,267	74,267	-	74,267
Other comprehensive income	-	-	-	-	109	109
Realized hedge losses recognized in fuel swaps	-	-	-	-	12,459	12,459
Hedge losses on interest rate forward contract reclassified to net earnings	-	-	-	-	186	186
Balance as at December 31, 2020	75,478	25,000	622,012	722,490	(9,369)	713,121

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Three and nine months ended December 31, 2020 and 2019

(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 originally 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.

On March 11, 2020, the World Health Organization declared the outbreak of novel coronavirus (“COVID-19”) as a pandemic. The preventative measures and imposed travel restrictions significantly impacted the Company’s earnings and cash from operations during the nine months ended December 31, 2020.

Historically, 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 at terminals. However, given the impact of the COVID-19 pandemic, the normal seasonal pattern is not occurring in fiscal 2021; certain revenues, expenses, and balance sheet items tied directly to sales and operating activities are and will continue to be significantly impacted by the drop in vehicle and passenger traffic. Refer to Note 14 for information on a one-time contribution of \$308.0 million received from the Province of British Columbia (“the Province”), following the Contribution Agreement signed with the Province in November 2020 (“Safe Restart Funding Agreement”). The funding will provide relief from the operating fiscal impacts of COVID-19, and help ensure that the Company continues to deliver essential ferry services to coastal communities through pandemic recovery while avoiding service reductions and minimizing fare increases.

The Company is actively monitoring the situation to ensure the transportation of essential goods and services, adjusting service levels by following the directives and guidance provided by the Province and Transport Canada, adhering to provincial and federal guidelines and putting preventative measures in place to protect passengers and employees aboard the vessels, terminals and in all workplaces, while managing to preserve cash and protect the financial well-being of the Company.

1. Accounting policies:

(a) Reporting entity:

British Columbia Ferry Services Inc. is a company domiciled in Canada. The address of the Company’s registered office is Suite 500, 1321 Blanshard Street, Victoria, BC Canada, V8W 0B7. These condensed interim consolidated financial statements, as at and for the nine months ended December 31, 2020 and 2019, comprise the Company and its subsidiaries (together referred to as the “Group”).

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)
Three and nine months ended December 31, 2020 and 2019
(Tabular amounts expressed in thousands of Canadian dollars)

1. Accounting policies:

(b) Basis of preparation:

These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and its interpretations and comply with International Accounting Standard ("IAS") 34, *Interim Financial Reporting*. These condensed interim consolidated financial statements do not include all disclosures normally provided in annual financial statements and should be read in conjunction with the Company's last annual consolidated financial statements as at and for the year ended March 31, 2020, as they follow the same accounting policies.

These condensed interim consolidated financial statements have been prepared using the historical cost method, except for items that IFRS permits to be measured at fair value - owned land, head office land under lease and certain financial assets and liabilities including derivatives.

These condensed interim consolidated financial statements are presented in Canadian dollars ("CAD") which is the Group's functional currency. All tabular financial data is presented in Canadian dollars and rounded to the nearest thousand, unless otherwise stated.

These condensed interim consolidated financial statements were approved by the Board of Directors on February 18, 2021.

(c) Amended Revenues accounting policy effective December 1, 2020:

Revenue from vehicle fares, including reservation fees, passenger fares and fuel surcharges (rebates), is recognized when transportation is provided. Revenue from fares represents a single performance obligation to which the entire transaction price is allocated. Payments for fares sold in advance of providing transportation are included in the statement of financial position as contract liabilities.

Net retail revenue consists primarily of food services and gift shop sales less the cost of goods sold and is recognized when the customer receives the goods.

Safe Restart Funding revenue is recognized based on the estimated loss of earnings for the following three components, for each of the fiscal years 2021 to 2024, in accordance with the Safe Restart Funding Agreement:

- Base Operating Relief – derived from the estimated operational fiscal impact or loss of earnings in fiscal years 2021 and 2022 due to COVID-19;
- Fare Increase Relief – derived from the estimated revenue losses during the Term from limiting fare increases to an average of 2.3% in each of fiscal years 2022, 2023 and 2024; and
- Discretionary Sailing Relief – derived from the estimated costs of discretionary sailings in fiscal years 2022, 2023 and 2024.

Ferry service fees and federal-provincial subsidies are recognized as revenue as services specified in the related agreements with the Province are provided.

2. Adoption of new and amended standards:

Changes in accounting policies:

The Group did not adopt any new or amended standards during the nine months ended December 31, 2020.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Three and nine months ended December 31, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

3. Property, plant and equipment:

	Vessels	Berths, buildings and equipment	Right-of-use assets – Berths, buildings and equipment	Right-of-use assets - Land	Land	Construction in progress	Total
Cost:							
Balance as at March 31, 2020	1,769,775	679,386	174,721	42,538	29,665	200,013	2,896,098
Additions	(923) ¹	-	7	-	-	80,912	79,996
Disposals	(14,872)	(1,095)	(30)	(5)	-	(1,973)	(17,975)
Transfers from construction in progress	67,614	10,188	-	-	-	(77,802)	-
Balance as at December 31, 2020	1,821,594	688,479	174,698	42,533	29,665	201,150	2,958,119
Accumulated depreciation:							
Balance as at March 31, 2020	705,645	235,590	74,051	1,295	-	-	1,016,581
Depreciation	88,873	25,832	5,081	421	-	-	120,207
Disposals	(14,873)	(1,077)	(30)	-	-	-	(15,980)
Balance as at December 31, 2020	779,645	260,345	79,102	1,716	-	-	1,120,808
Net carrying value:							
As at March 31, 2020	1,064,130	443,796	100,670	41,243	29,665	200,013	1,879,517
As at December 31, 2020	1,041,949	428,134	95,596	40,817	29,665	201,150	1,837,311

¹ Reclassifications from Other liabilities (note 9)

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

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3. Property, plant and equipment (continued):

During the nine months ended December 31, 2020, financing costs capitalized during construction amounted to \$5.9 million (December 31, 2019: \$3.2 million) with an average capitalization rate of 4.57% (December 31, 2019: 4.99%).

Contractual commitments as at December 31, 2020, for assets to be constructed totalled \$73.5 million (March 31, 2020: \$121.5 million). The majority of these contractual commitments relate to the construction of four Island class vessels and one Salish class vessel.

During the nine months ended December 31, 2020, the Group recognized property, plant and equipment impairments of \$2.0 million (March 31, 2020: \$nil). The impairment loss is reported under "Loss (gain) on disposal and revaluation of property, plant and equipment and intangible assets" in the consolidated statement of profit or loss for the nine months ended December 31, 2020.

The Government of Canada, through the New Building Canada Fund, agreed to provide funding of up to \$43.4 million to help offset the costs of the newly established route connecting Port Hardy and Bella Coola and the replacement of two minor vessels. During the nine months ended December 31, 2020, the Group recognized \$0.3 million (March 31, 2020: \$9.7 million) as a reduction of the cost of property, plant and equipment. Funding of \$39.3 million was recorded as a cumulative reduction of the cost of the property, plant and equipment in fiscal years 2020, 2019 and 2018.

FortisBC Energy Inc. has committed to provide the Group with funding as part of the Natural Gas for Transportation ("NGT") incentive funding. The contributions are dependent upon the purchase of liquefied natural gas ("LNG"). During the nine months ended December 31, 2020, the Group recognized \$0.9 million (March 31, 2020: \$1.2 million) as a reduction of the cost of property, plant and equipment.

During the nine months ended December 31, 2020, the Group received \$0.3 million (December 31, 2019: \$0.8 million) of rental income earned from buildings held for leasing purposes. These buildings have a cost and accumulated depreciation of \$11.9 million and \$4.3 million, respectively, as at December 31, 2020.

During the nine months ended December 31, 2020, the *North Island Princess* and the *Nimpkish* were decommissioned and sold. The *Queen of Burnaby* (decommissioned during the year ended March 31, 2018) is classified as held for sale and has no carrying value.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

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(Tabular amounts expressed in thousands of Canadian dollars)

4. Intangible assets:

	Acquired software, licenses and rights	Internally developed software and website	Assets under development	Total
Cost:				
Balance as at March 31, 2020	137,877	19,898	29,469	187,244
Additions	-	-	10,751	10,751
Transfers from assets under development	2,233	23,452	(25,685)	-
Balance as at December 31, 2020	140,110	43,350	14,535	197,995
Accumulated amortization:				
Balance as at March 31, 2020	74,425	12,926	-	87,351
Amortization	11,645	2,307	-	13,952
Balance as at December 31, 2020	86,070	15,233	-	101,303
Net carrying value:				
As at March 31, 2020	63,452	6,972	29,469	99,893
As at December 31, 2020	54,040	28,117	14,535	96,692

Capitalized financing costs during construction for intangible assets with an average capitalization rate of 4.57% (December 31, 2019: 4.99%) for the nine months ended December 31, 2020 totalled \$0.7 million (December 31, 2019: \$0.8 million).

During the nine months ended December 31, 2020, intangible assets totalling \$7.6 million (December 31, 2019: \$7.5 million) were acquired and \$3.2 million (December 31, 2019: \$5.1 million) were internally developed.

BRITISH COLUMBIA FERRY SERVICES INC.

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(Tabular amounts expressed in thousands of Canadian dollars)

5. Accounts payable and accrued liabilities:

Wages payable consists of contractual liabilities to employees for deferred or accrued compensation. Liabilities for deferred compensation amounts are generally settled through either payment or provision of paid time off.

	As at	
	December 31, 2020	March 31, 2020
Trade payable and accrued liabilities	27,805	62,551
Wages payable	70,832	69,745
Accounts payable and accrued liabilities	98,637	132,296

6. Liabilities arising from financing activities:

Continuity of liabilities arising from financing activities:

	Long-term debt	Lease liabilities ¹	Interest payable on long-term debt
Balance as at March 31, 2020	1,449,070	41,211	21,512
Additions	-	4	50,117
Payments	(14,837)	(1,886)	(54,139)
Amortization of debt issue costs	642	-	-
Balance as at December 31, 2020	1,434,875	39,329	17,490
Current	15,317	2,772	17,490
Non-current	1,419,558	36,557	-
Balance as at December 31, 2020	1,434,875	39,329	17,490

¹ Interest expense related to lease liabilities is presented in net finance expense (note 16).

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

Three and nine months ended December 31, 2020 and 2019

(Tabular amounts expressed in thousands of Canadian dollars)

7. Long-term debt:

	As at	
	December 31, 2020	March 31, 2020
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
2.79% Senior Secured Bonds, Series 19-1, due October 2049 (effective interest rate of 2.83%)	250,000	250,000
12 Year Loan, maturing June 2020 Tranche A (effective interest rate of 5.18%)	-	1,875
2.95% Loan, maturing January 2021 (effective interest rate of 3.08%)	4,500	9,000
2.09% Loan, maturing October 2028 (effective interest rate of 2.70%)	29,895	32,699
2.09% Loan, maturing January 2029 (effective interest rate of 2.68%)	31,109	33,938
2.09% Loan, maturing January 2029 (effective interest rate of 2.70%)	31,109	33,938
	1,446,613	1,461,450
Less: Unamortized deferred financing costs and bond discounts	(11,738)	(12,380)
Total	1,434,875	1,449,070
Current	15,317	21,644
Non-current	1,419,558	1,427,426
Total	1,434,875	1,449,070

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Condensed Interim Consolidated Financial Statements (unaudited)

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(Tabular amounts expressed in thousands of Canadian dollars)

7. Long-term debt (continued):

The Group has six outstanding series of obligation bonds and a credit facility agreement secured by pledged bonds. In addition, the Group has a 2.95% loan agreement and three 2.09% loans outstanding with KfW IPEX-Bank GmbH ("KfW"), a German export credit bank.

(a) Credit facility:

The Group has a credit facility with a syndicate of Canadian banks, secured by pledged bonds. This revolving facility, in the amount of \$155.0 million, was renewed on April 7, 2020 to extend the maturity date to April 20, 2025. There were no draws on this credit facility as at December 31, 2020 or March 31, 2020. There was no interest expensed during the nine months ended December 31, 2020 and December 31, 2019. Letters of credit outstanding against this facility as at December 31, 2020 totalled \$0.6 million (March 31, 2020: \$0.6 million).

(b) Debt service reserves:

Long-term debt agreements require the Group to maintain debt service reserves equal to a minimum of six months of interest payments. In the event that the debt service coverage ratio is less than 1.50, the Group is required to increase the amount in the debt service reserves to an amount equal to 12 months of interest payments no later than 12 months after the occurrence of such event.

As at December 31, 2020, the debt service coverage ratio was 2.62, a change from the debt service coverage ratio of 1.46 as at September 30, 2020. This change reduced the debt service reserves requirement from an amount equal to 12 months of interest payments to an amount equal to 6 months of interest payments.

As at December 31, 2020, debt service reserves of \$33.2 million (March 31, 2020: \$33.4 million) were held in short-term investments and have been classified as restricted short-term investments on the statement of financial position.

(c) Debt service coverage:

Debt service coverage (earnings before interest, taxes, depreciation, amortization and rent) is required to be at least 1.25 times the debt service cost under the credit facility agreement and KfW loans.

On May 15, 2020, the Group's banking syndicate approved an Amendment to the Credit Facility Agreement whereby the debt service coverage of the impacted quarters in fiscal 2021 (first, second and third) is replaced by an average of the debt service coverage from the respective quarters in fiscal years 2018, 2019 and 2020. As at December 31, 2020, the debt service coverage ratio calculated under this method was 2.77.

On June 19, 2020, KfW waived the debt service coverage covenant until and including March 2021.

As a condition for both the credit facility agreement and the KfW loans, for the duration of the relief period, the Group is required to maintain \$50.0 million in unrestricted cash, which can be comprised of cash, short-term investments, and undrawn credit facility.

In addition, there are other covenants contained in the Master Trust Indenture (May 2004) available at www.SEDAR.com. The Group was in compliance with all of its covenants at December 31, 2020 and at March 31, 2020.

BRITISH COLUMBIA FERRY SERVICES INC.

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8. Accrued employee future benefits:

During the nine months ended December 31, 2020, the Group recognized total defined benefit costs of \$1.8 million (December 31, 2019: \$1.6 million) within operating expenses.

During the nine months ended December 31, 2020, the Group recognized a loss of \$1.9 million in other comprehensive income, in the not to be reclassified to net earnings (loss) category, reflecting the actuarial valuation for the retirement and death defined benefit plans as at March 31, 2020.

During the nine months ended December 31, 2019, the Group recognized a loss of \$0.1 million in other comprehensive income, in the not to be reclassified to net earnings (loss) category, reflecting an actuarial valuation for the residual liability for Worker's Compensation Claims arising from the Worker's Compensation Board deposit coverage system as at March 31, 2019.

9. Other liabilities:

FortisBC Energy Inc. has committed to provide the Group with funding of \$6.0 million for the Salish Class vessels and up to \$10.0 million for the two Spirit Class vessels to be applied towards their mid-life upgrade and conversion to LNG. The funding is part of the NGT incentive funding and is dependent upon the purchase of LNG and the incremental costs of building/converting vessels to be capable of using LNG for propulsion.

As of March 31, 2020, the Group had received \$7.0 million of the total eligible contributions related to the Spirit class vessels, and all of the eligible contributions related to the Salish Class vessels.

During the nine months ended December 31, 2020, the Group recognized \$0.9 million (March 31, 2020: \$1.2 million) as an offset to the capital costs of the vessels.

	Note	Salish Class	Spirit Class	Total
Balance as at March 31, 2020		4,975	5,987	10,962
Reclassifications to property, plant and equipment	3	(273)	(650)	(923)
Balance as at December 31, 2020		4,702	5,337	10,039

10. Financial instruments:

The carrying values of the Group's financial instruments approximate fair value as at December 31, 2020 and March 31, 2020 for all financial instruments except for long-term debt.

	As at December 31, 2020		As at March 31, 2020	
	Carrying Value	Approx Fair Vaue	Carrying Value	Approx Fair Vaue
Long-term debt, including current portion ¹	1,434,875	1,896,994	1,449,070	1,758,082

¹ 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 Condensed Interim Consolidated Financial Statements (unaudited)

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(Tabular amounts expressed in thousands of Canadian dollars)

10. Financial instruments:

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

The following items shown in the consolidated statements of financial position as at December 31, 2020 and March 31, 2020 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, 2020, or at March 31, 2020, valued using Level 3 inputs.

	As at December 31, 2020		As at March 31, 2020	
	Level 1	Level 2	Level 1	Level 2
Asset (liability):				
Cash ^{1,2}	282,655	-	140,703	-
Cash equivalents ²	138	-	138	-
Derivative assets ³	-	-	-	28
Derivative liabilities ³	-	(18,246)	-	(32,719)
	282,793	(18,246)	140,841	(32,691)

¹ Excluding Cash and cash equivalents of \$40.5 million (March 31, 2020: \$28.3 million) held at amortized cost.

² Classified in Level 1 as the measurement inputs are derived from observable, unadjusted quoted prices in active markets for identical assets.

³ 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, 2020.

During the nine months ended December 31, 2020, gains or losses related to Level 2 derivatives have been recorded in other comprehensive income ("OCI").

There were no Level 3 instruments outstanding during the period.

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.

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11. Financial risk management:

(a) Credit risk:

The Group is using the lifetime expected credit loss (“ECL”) simplified approach as the method to determine the provision for impairment. The Group reviews for changes in circumstances at each reporting date.

Based on the historical default experience, the Group has established a lifetime ECL allowance of 1% of the trade receivables. Amounts due from the Government of Canada and the Province are considered low credit risk and are excluded. As at December 31, 2020, the provision for impairment was \$0.1 million.

Based on historical default experience, financial position of the counterparties and estimating the probability of default, the lifetime ECL equals zero for the Group’s restricted and other short-term investments.

The Group has a loan receivable with a term of 15 years, secured by a second mortgage. The collateral is expected to exceed the amount of the loan and be available while the loan is outstanding.

(b) Fuel price risk:

The Group is exposed to risks associated with changes in the market price of marine diesel fuel and LNG 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. The Group’s Financial Risk Management Policy limits hedging, to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period; 90% of anticipated monthly fuel consumption for the 12 month period thereafter; 85% of anticipated monthly fuel consumption for the period thereafter to the end of 36 month period; and to 70% of anticipated monthly fuel consumption for the period between 36 months and the end of the fifth performance term. Performance term five (“the Term”) commenced April 1, 2020 and will end on March 31, 2024.

The Group is also allowed by regulatory order to use deferred fuel cost accounts to mitigate the impact of changes in fuel price on its regulatory (non-IFRS) earnings (note 18).

The Group hedges using CAD denominated ultra-low sulfur diesel (“ULSD”) fuel swaps to reduce its exposure to changes in ULSD and foreign exchange risk components associated with forecast diesel fuel purchases. No ULSD fuel swap contracts were entered into during the nine months ended December 31, 2020. The notional value of all fuel swap contracts outstanding as at December 31, 2020 was \$98.1 million (March 31, 2020: \$132.2 million). Hedge accounting was applied to these contracts. No LNG swap contracts were entered into during the nine months ended December 31, 2020 and no LNG swap contracts were outstanding as at December 31, 2020.

An economic relationship exists between the hedged item and the hedging instrument as the value of the hedging instrument and the value of the hedged item move in the opposite direction as a result of the change in the hedged risk. A change in the credit risk of the hedging instrument or the hedged item does not dominate the value changes that result from the economic relationship.

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11. Financial risk management (continued):

(b) Fuel price risk (continued):

During the nine months ended December 31, 2020, open fuel swap contracts had unrealized hedging gains of \$2.0 million recognized in OCI (December 31, 2019: unrealized hedging gains of \$0.8 million). In addition, for closed fuel swap contracts net realized hedging losses of \$12.5 million were reclassified from reserves and included in the Group's fuel expense during the nine months ended December 31, 2020 (December 31, 2019: net realized hedging gains of \$5.6 million).

Due to the drastic reduction in fuel consumption as a result of COVID-19, the Group determined that the hedged amounts related to one of the Group's contracts for the three months ended June 30, 2020 were no longer considered highly probable to occur and the Group discontinued hedge accounting for this contract effective March 31, 2020. The hedging loss related to this contract was included within the \$12.5 million of fuel swap contract losses recognized in the consolidated statement of profit or loss for the nine months ended December 31, 2020.

Cash flow hedges:

	Fiscal 2021	Fiscal 2022	Fiscals 2023-2024	Total
Fuel contracts (litres in thousands)	14,400	63,490	78,175	156,065
Contract price range (\$/litre)	\$0.6016-\$0.6470	\$0.6270-\$0.6499	\$0.6090-\$0.6336	

The impact of hedging instruments designated in hedging relationships as of December 31, 2020 on the statements of financial position was as follows:

	Notional amount	Carrying amount	Line item in the statement of financial position	Change in fair value used for measuring ineffectiveness for the period
Fuel swap contracts	41,192	(8,512)	Current derivative liabilities	(8,512)
Fuel swap contracts	56,893	(9,707)	Non-current derivative liabilities	(9,707)
Foreign exchange forward contracts	428	(27)	Current derivative liabilities	(27)

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11. Financial risk management (continued):

(b) Fuel price risk (continued):

Cash flow hedges (continued):

The impact of hedged items designated in hedging relationships as of December 31, 2020 on the statements of financial position was as follows:

	Change in value used for measuring ineffectiveness	Cash flow hedge reserve
Fuel swap contracts	18,262	18,219

Cash flow hedge reserve (note 12(a)):

	Three months ended December 31		Nine months ended December 31	
	2020	2019	2020	2019
Hedging gains recognized in cash flow hedge reserve:				
Fuel swap contracts	7,585	4,645	2,042	755
Hedging losses (gains) reclassified from cash flow hedge reserve:				
Interest rate forward contracts – Amortization of hedge loss	62	62	186	186
Fuel swap contracts – Losses (gains) recognized in net earnings	3,078	(1,240)	12,459	(5,575)
Net change in cash flow hedge reserve	10,725	3,467	14,687	(4,634)

12. Other comprehensive loss:

(a) Continuity of reserves:

	Note	Land revaluation reserves	Employee future benefit revaluation reserves	Fuel swap reserves	Interest rate forward contract reserves	Total
Balance as at March 31, 2020		22,658	(6,095)	(32,720)	(5,966)	(22,123)
Actuarial losses on post-employment benefit obligations:	8	-	(1,933)	-	-	(1,933)
Derivatives designated as cash flow hedges:	11					
Net change in fair value		-	-	2,042	-	2,042
Realized losses		-	-	12,459	-	12,459
Amortization of losses		-	-	-	186	186
Balance as at December 31, 2020		22,658	(8,028)	(18,219)	(5,780)	(9,369)

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12. Other comprehensive income (continued):

(b) Other comprehensive income:

	Note	Three months ended December 31		Nine months ended December 31	
		2020	2019	2020	2019
Items that are or may be reclassified subsequently to net earnings:					
Hedge gains on fuel swaps	11	7,585	4,645	2,042	755
Items that will not be reclassified to net earnings:					
Actuarial losses on post-employment benefit obligations	8	-	-	(1,933)	(126)
Total other comprehensive income		7,585	4,645	109	629

13. Net retail:

	Three months ended December 31		Nine months ended December 31	
	2020	2019	2020	2019
Retail revenue	8,321	23,868	23,068	88,491
Cost of goods sold	(3,510)	(9,285)	(9,093)	(33,242)
Net retail	4,811	14,583	13,975	55,249

14. Safe restart funding:

In December 2020, the Group received a contribution of \$308.0 million from the Province under the Safe Restart Funding Agreement.

The contribution consists of the following three components:

- Base Operating Relief - \$280.0 million in respect of the estimated operational fiscal impact or loss of earnings in fiscal years 2021 and 2022 due to COVID-19;
- Fare Increase Relief - \$24.0 million in respect of the estimated revenue losses during the Term from limiting fare increases to an average of 2.3% in each of fiscal years 2022, 2023 and 2024; and
- Discretionary Sailing Relief - \$4.0 million in respect of the estimated costs of discretionary sailings in fiscal years 2022, 2023 and 2024.

The revenue recognition of the contribution is consistent with the Group's submission to the Province from August 2020 which was based on the estimated loss of earnings in relation to the above three components for fiscal years 2021 to 2024, and reflects the normal seasonal pattern of earnings.

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14. Safe restart funding (continued):

The Group recognized \$154.8 million of the contribution under “Safe restart funding” in the consolidated statement of profit or loss for the three and nine months ended December 31, 2020. The remaining balance of \$153.2 million was included in contract liabilities in the consolidated statement of financial position.

For more details on the Group’s obligations under the Safe Restart Funding Agreement, see the agreement online at: on SEDAR at <http://www.sedar.com>.

15. Operating expenses:

	Three months ended		Nine months ended	
	December 31		December 31	
	2020	2019	2020	2019
Salaries, wages & benefits	95,996	97,549	282,251	311,849
Fuel	22,760	26,034	67,267	85,815
Materials, supplies and contracted services	21,127	20,109	57,500	65,103
Other operating expenses	13,537	16,125	36,849	47,688
Depreciation and amortization	45,613	45,913	134,159	136,375
Total operating expenses	199,033	205,730	578,026	646,830

16. Net finance expense:

	Three months ended		Nine months ended	
	December 31		December 31	
	2020	2019	2020	2019
Finance expenses:				
Long-term debt	16,760	16,889	50,155	47,872
Short-term debt	66	49	232	159
Lease liabilities	447	475	1,363	1,459
Amortization of deferred financing costs and bond discounts	210	289	829	863
Interest capitalized in the cost of qualifying assets	(2,038)	(1,646)	(6,591)	(3,976)
Total finance expenses	15,445	16,056	45,988	46,377
Finance income	(1,077)	(2,520)	(3,361)	(5,201)
Net finance expense	14,368	13,536	42,627	41,176

17. 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, 2020, the Group paid \$113,673 (December 31, 2019: \$176,384) of such expenses.

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

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18. Economic effect of rate regulation:

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

In January 2014, the IASB issued IFRS 14, *Regulatory Deferral Accounts*. IFRS 14 is an interim standard, pending the outcome of IASB's more comprehensive rate regulated activities project.

The Standard 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, such as the Group, that had already transitioned to IFRS. The Group transitioned to IFRS effective April 1, 2011, prior to the issuance of IFRS 14, and therefore does not recognize regulatory assets or liabilities.

As a result, the Group is not permitted to recognize its regulatory assets and regulatory liabilities in its consolidated statements of financial position.

Regulatory assets generally represent incurred costs that have been deferred for purposes of rate regulation because they are probable of future recovery in tariffs or fuel surcharges. Regulatory liabilities represent obligations to customers which will be settled through future tariff reductions or fuel rebates. Management continually assesses whether the Group's regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes. Management believes that the obligations represented by the regulatory liabilities at December 31, 2020, will be settled through future tariff reductions or fuel rebates.

The Act contains provisions which ensure that if tariffs charged by the Group exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. At December 31, 2020 and March 31, 2020, tariffs charged to customers were below established price caps.

If the Group was permitted under IFRS to recognize the effects of rate regulation, the regulatory liabilities at December 31, 2020 would have been \$1.5 million (March 31, 2020: \$2.1 million).

If the Group was permitted under IFRS to recognize the effects of rate regulation and to record regulatory assets and regulatory liabilities, net earnings for the three months ended December 31, 2020 would have been \$0.6 million lower (December 31, 2019: \$1.0 million lower), and during the nine months ended December 31, 2020 would have been \$0.6 million higher (December 31, 2019: \$7.0 million lower) as detailed below:

Effect of rate regulation on net earnings	Three months ended		Nine months ended	
	December 31		December 31	
	2020	2019	2020	2019
Regulatory accounts:				
Deferred fuel costs:				
Fuel costs (under) over set price	(2,089)	634	(4,881)	(1,564)
Rebates (surcharges)	1,525	(1,620)	5,432	(5,440)
Total (decrease) increase in net earnings	(564)	(986)	551	(7,004)

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19. Economic effect of Safe restart funding:

The Group received a one-time contribution of \$308.0 million from the Province, following the Safe Restart Funding Agreement signed with the Province in November 2020. The funding will provide relief from the operating fiscal impacts of COVID-19, and help ensure that the Company continues to deliver essential ferry services to coastal communities through pandemic recovery while avoiding service reductions and minimizing fare increases.

If the Group did not receive and recognize \$154.8 million of the Safe restart funding, the net loss for the nine months ended December 31, 2020 would have been \$80.5 million, \$179.4 million lower than the prior year period as detailed below:

Effect of Safe restart funding on net earnings	Three months ended December 31			Nine months ended December 31		
	2020	2019	Increase (Decrease)	2020	2019	Increase (Decrease)
Net earnings (loss)	98,436	(8,310)	106,746	74,267	98,861	(24,594)
Safe restart funding	(154,802)	-	(154,802)	(154,802)	-	(154,802)
Net (loss) earnings excluding Safe restart funding	(56,366)	(8,310)	(48,056)	(80,535)	98,861	(179,396)

If the Group did not receive Safe restart funding of \$308.0 million, the net decrease in cash and cash equivalents for the nine months ended December 31, 2020 would have been \$153.8 million, \$321.3 million lower than the prior year period as detailed below:

Effect of Safe restart funding on Net increase in cash and cash equivalents	Nine months ended December 31		
	2020	2019	Decrease
Net increase in cash and cash equivalents	154,188	167,521	(13,333)
Safe restart funding	(308,000)	-	(308,000)
Net (decrease) increase in cash and cash equivalents excluding Safe restart funding	(153,812)	167,521	(321,333)