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

For the three and nine months ended December 31, 2016

Dated February 24, 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, 2016 and has been prepared with information available as of February 24, 2017. This discussion and analysis should be read in conjunction with our unaudited interim consolidated financial statements and related notes for the nine months ended December 31, 2016 and 2015, and our audited consolidated financial statements and related notes for the years ended March 31, 2016 ("fiscal 2016") and March 31, 2015 ("fiscal 2015"), together with our Management's Discussion & Analysis for fiscal 2016. These documents are available on SEDAR at www.sedar.com and on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

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 34 vessels operating on 24 routes out of 47 terminals spread over 1,000 miles of coastline. We also manage ferry transportation service on other remote routes through contracts with independent operators.

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

We provide a wide range of ferry services for our customers. During the three months ended December 31, 2016 (the third quarter of fiscal 2017), we provided 41,736 sailings (the same level as provided in the three months ended December 31, 2015). During the three months ended December 31, 2016, we carried 1.8 million vehicles and 4.4 million passengers, an increase of 1.5% and 0.8%, respectively, compared to the same quarter in the prior year, despite more days of unfavourable weather. Year-to-date, we carried 6.7 million vehicles and 17.2 million passengers, an increase of 4.1% and 3.0%, respectively, compared to the same period in the prior year and the highest since the same period in fiscal 2008. For a more detailed discussion of our traffic levels, see "Financial and Operational Overview" below.

Significant events during or subsequent to the three months ended December 31, 2016 (the third quarter of fiscal 2017) include the following:

- On November 1, 2016, we announced the launch of an initiative that brings together our existing environmental activities, conservation efforts, community investments and new sustainability endeavours under a single program called SeaForward. (See “Safety and Environment” below for more detail.)

- On November 22, 2016 and November 25, 2016, we drew down $39 million and $6 million, respectively, for a total of $45 million, under the export loan agreement with KfW IPEX-Bank GmbH, to coincide with the contract payment schedule for the purchase of the *Salish Orca*. This amortizing loan will be repaid over a 12-year term and bear an annual interest rate of 2.09%. The net proceeds from the loan were used to partially finance the purchase of the *Salish Orca*. (See “Liquidity and Capital Resources” below for more detail.)

- On December 8, 2016, we executed a letter of agreement with the Province that formalizes its intention to start seasonal direct ferry service between Port Hardy and Bella Coola beginning in the summer of 2018. The letter of agreement sets out the expected level of service to be provided and the respective commitments of BC Ferries and the Province to work towards bringing this new service into operation. (See “Outlook” below for more detail.)

- On January 3, 2017, we submitted an application, under Section 55 of the *Coastal Ferry Act* (the “Act”), to the British Columbia Ferries Commissioner (the “Commissioner”) seeking approval of a major capital expenditure to acquire two new minor class vessels. (See “Outlook – Asset Renewal Program” below for more detail.)

- On January 11, 2017, our new vessel, the *Salish Orca,* arrived in British Columbia after its 50 day, 10,440 nautical mile journey from Gdansk, Poland. On January 18, 2016, we signed the Protocol of Delivery and Acceptance with Remontowa Shipbuilding S.A. and ownership of the vessel transferred to us. The *Salish Orca* will replace the 52-year old *Queen of Burnaby* on the Comox – Powell River route. (See “Outlook – Asset Renewal Program” below for more detail.)

- On February 3, 2017, we conditionally accepted our new vessel, the *Salish Eagle* from Remontowa Shipbuilding S.A. and on February 11, 2017, the vessel departed Gdansk, Poland for its voyage to Canada. The *Salish Eagle* will replace the 53-year old *Queen of Nanaimo* on the Tsawwassen – Southern Gulf Islands route. The Salish class vessels are dual-fuel capable and will run predominantly on liquefied natural gas (“LNG”) which we believe will result in the reduction of carbon dioxide emissions. (See “Outlook – Asset Renewal Program” below for more detail.)

- On February 9, 2017 and on February 17, 2017, we drew down $40 million and $5 million, respectively, for a total of $45 million, under the export loan agreement with KfW IPEX-Bank GmbH, to coincide with the contract payment schedule for the *Salish Eagle*. This amortizing loan will be repaid over a 12-year term and bear an annual interest rate of 2.09%. The net proceeds from the loan were used to partially finance the purchase of the *Salish Eagle*. (See “Liquidity and Capital Resources” below for more detail.)

- On February 10, 2017, our Board announced the appointment of Mark F. Collins as President and CEO effective April 1, 2017. A senior marine executive for the past 20 years, Mr. Collins’ experience includes roles as the President of Rolls Royce Marine Brazil and Italy, and Vice President of Global Technical Services, CSL Group. Mr. Collins is currently Vice President of Strategic Planning & Community Engagement at BC Ferries, and was the Vice President, Engineering between 2004 and 2012. Our current President and CEO, Mike Corrigan, will be stepping down on March 31, 2017.

**Economic Regulatory Environment**

In September 2015, the Commissioner issued Order 15-03 and Order 15-03A. These orders included the following:

- Establishment of the final price cap increase of 1.9% for each of the four years of performance term four ("PT4"), which commenced on April 1, 2016 and ends on March 31, 2020;
- Incorporation of an efficiency target ($27.6 million over the four years of PT4);
- Requirement for a fuel management plan to be submitted prior to the start of PT4 setting out our strategies for fuel procurement, minimizing fuel consumption and the transition to alternate fuels during PT4;
- Authorization to continue to use fuel cost deferral accounts in PT4;
- Establishment of the set price per litre at 91.5 cents for marine diesel (reduced from 99.0 cents per litre in fiscal 2015) in the first year of PT4;
- Establishment of the set price per litre at 46.4 cents for LNG in the first year of PT4; and
- Incorporation of an inflation factor of 2% per year on the price per litre of both marine diesel and LNG for the balance of PT4. (The set price per litre is a required input into the calculation of fuel surcharges or rebates.)

In addition, the Commissioner reset the price caps to an index level of 100 as of April 1, 2016 based on the weighted average tariffs that existed as at March 31, 2016. The price cap compliance calculation for PT4 was adjusted from the compliance calculation for performance term three ("PT3"), which commenced on April 1, 2012 and ended on March 31, 2016, by:

- Combining reservation fee revenue with vehicle revenue at the beginning of PT4. The new advance purchase model outlined in the Fare Flexibility and Digital Experience Initiative approved by Order 15-01 will effectively eliminate separate reservation fees and instead, reservations will be included in variable priced fare products;
- Addressing the impact of the elimination of the funding for BC seniors' discounts in PT4 by recalibrating the seniors' base price level; and
- Setting the opening PT4 Price Compliance Index equal to the price cap underage at the end of PT3.

Effective April 1, 2014, we implemented the Province's decision to amend its program to reduce the passenger fare discount for BC seniors travelling Mondays through Thursdays from 100% to 50% on the Major and regulated Other Routes. The Coastal Ferry Services Contract ("CFSC") was amended to establish the maximum annual amount payable by the Province in respect of senior discounts. The amounts reflected an estimate of what the Province would have paid if there had been no change in the level of senior discounts. To the extent these funds were not required for the reimbursement of discounts provided to BC seniors under the amended policy, the excess was directed to the ferry transportation fees and allocated to the regulated Northern and Other Routes. Effective April 1, 2016, the CFSC was amended to discontinue direct funding of the seniors' discount and direct the maximum annual amount payable by the Province entirely to ferry transportation fees.

It was also established that, for price cap calculations, the consolidated route group effective April 1, 2013 will be in effect until March 31, 2020. In the absence of any further amendments, on April 1, 2020, the route group structure in the CFSC will revert back to the structure that was in place at March 31, 2013. The structure at that time was comprised of three individual route groups, being the Major Routes, Northern Routes and Minor Routes.

Our drop-trailer services have been regulated by Commissioner's Order 11-01 and Memorandum 42, by way of a Minimum Average Allowable Tariff ("MAAT") since April 1, 2011. Under this order, or at the discretion of the Commissioner, when we reached a certain volume of drop-trailer traffic, the MAAT would be reset in light of experience with actual costs and drop-trailer traffic volumes. We reached this volume during fiscal 2016 and the Commissioner undertook a review. In February 2016, the Commissioner issued a notice of procedures regarding drop-trailer regulation under section 45.1 of the Act. The notice set out five questions the Commissioner would consider in making a determination in regard to resetting the MAAT for drop-trailer services.

On September 6, 2016, the Commissioner issued Order 16-01 which supersedes Order 11-01, Confidential Order 11-01A and Memorandum 42. The Commissioner determined that, as we are not pricing our drop-trailer service below costs and do not have any unfair competitive advantages in providing this service, the Commissioner is not authorized by the Act to set a MAAT. The order discontinued the MAAT effective September 6, 2016, and established new reporting requirements intended to enable the Commissioner to confirm that we are not pricing our drop-trailer service below cost in the future.

On January 3, 2017, we submitted an application, under Section 55 of the Act, to the Commissioner seeking approval of a major capital expenditure to acquire two new minor class vessels. In the application, our proposal is to deploy the first new vessel to run from Powell-River to Texada Island and the other new vessel to run from Port McNeill to Alert Bay to Sointula. The Commissioner sought public comments on our proposal with a deadline of January 31, 2017.

**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, in extraordinary situations, 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 transitioned to IFRS effective 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. While these items are treated as assets and liabilities for regulatory purposes, 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 for financial reporting purposes.

Because 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. Reporting for rate-regulated activities provides additional information which we use to assess performance and to make operating decisions.

We continually assess whether our regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes. We believe the regulatory assets at December 31, 2016 will be recovered in the future. These regulatory assets and liabilities are considered supplemental disclosures and are detailed in note 15 to our December 31, 2016 unaudited interim condensed consolidated financial statements.

If IFRS permitted us to report regulatory assets and liabilities in our financial statements, the effect on our net earnings for the three and nine month periods ended December 31, 2016 and 2015 would be as follows:

| ($ millions) | | Three months ended December 31 2016 | Three months ended December 31 2015 | Nine months ended December 31 2016 | Nine months ended December 31 2015 |
|---|---|---|---|---|---|
| **Net (loss) earnings** | | (4.0) | (3.7) | 118.2 | 99.6 |
| **Changes in net earnings:** | | | | | |
| **Regulatory asset or liability** | **Statement line item** | | | | |
| Deferred fuel costs (a) | | | | | |
| Fuel costs under set price | Operations expense | (1.6) | (2.4) | (5.5) | (6.3) |
| Fuel rebates | Fuel rebates | 3.8 | 1.3 | 14.7 | 5.1 |
| Payments from the Province | Ferry service fees | - | (0.3) | - | (0.9) |
| | | 2.2 | (1.4) | 9.2 | (2.1) |
| Tariffs in excess of price cap (b) | | | | | |
| Obligation settled (incurred) during the period | Vehicle and passenger fares | - | - | - | 1.0 |
| Performance term submission costs (c) | | | | | |
| Amortization | Depreciation and amortization expense | - | - | - | (0.1) |
| **Increase (decrease) in total net earnings** | | 2.2 | (1.4) | 9.2 | (1.2) |
| **Adjusted net (loss) earnings** | | (1.8) | (5.1) | 127.4 | 98.4 |

(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.

(b) Tariffs in excess of price cap: The Act contains provisions which ensure that, if the average of tariffs we charge exceeds the established price cap, the excess amounts collected will be returned to customers through future tariffs. Average tariffs charged did not exceed price caps at December 31, 2016.

(c) Performance term submission costs: Costs for incremental contracted services relating to PT3. Our regulator approved recovery of these costs over PT3, which ended on March 31, 2016.

## *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, 2016 and 2015.

| ($millions) | Three months ended December 31 | | | Nine months ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2016** | **2015** | **Variance** | **2016** | **2015** | **Variance** |
| Total revenue | 183.7 | 178.7 | 5.0 | 701.8 | 668.3 | 33.5 |
| Operating expenses | 173.9 | 168.5 | (5.4) | 542.9 | 526.5 | (16.4) |
| Operating profit | 9.8 | 10.2 | (0.4) | 158.9 | 141.8 | 17.1 |
| Net finance and other | 13.8 | 13.9 | 0.1 | 40.7 | 42.2 | 1.5 |
| **Net (loss) earnings** | (4.0) | (3.7) | (0.3) | 118.2 | 99.6 | 18.6 |
| Other comprehensive income (loss) | 6.3 | (11.7) | 18.0 | 15.6 | (11.8) | 27.4 |
| **Total comprehensive income (loss)** | 2.3 | (15.4) | 17.7 | 133.8 | 87.8 | 46.0 |

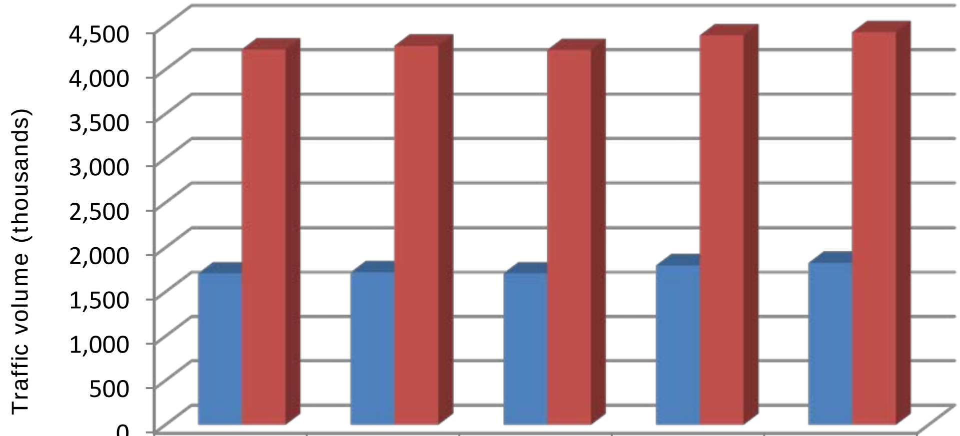
Quarterly results are affected by the seasonality of leisure travel patterns. The second quarter, covering the summer period, experiences the highest traffic levels and the highest net earnings. The third and fourth quarters reflect a seasonal reduction in traffic.

Our net loss in the three months ended December 31, 2016 was $0.3 million greater than in the three months ended December 31, 2015. Year-to-date, net earnings were $118.2 million, representing an increase of $18.6 million compared to the same period in the prior year. The increase in net earnings during the nine months ended December 31, 2016 reflect the effects of higher traffic levels, higher retail sales, higher net ferry transportation and social program fees and lower financing costs, partially offset by operating cost increases mainly due to increases in wages and benefits costs (See "Expenses" below for more detail). In the three months ended December 31, 2016, total comprehensive income was $17.7 million (46.0 million year-to-date) higher than in the three months ended December 31, 2015. The April 1, 2016 tariff increases had a net zero impact to our customers as they were offset by an equal increase in fuel rebates.

Other comprehensive income of $6.3 million for the three months ended December 31, 2016 reflects an increase in the fair value of our fuel swap contracts. Other comprehensive income of $15.6 million for the nine months ended December 31, 2016 reflects a $16.8 million increase in the fair value of our fuel swap contracts, a $0.3 million gain on the actuarial valuation of our workers' compensation benefit plan and a $1.5 million loss on the actuarial valuation of our retirement and death benefit plans. Other comprehensive loss of $11.7 million in the three months ended December 31, 2015 ($11.8 million year-to-date) reflected the decrease in the fair value of our fuel swap contracts.

In the three months ended December 31, 2016, vehicle traffic increased 1.5% (4.1% year-to-date) and passenger traffic increased 0.8% (3.0% year-to-date) compared to the same period in the prior year. We experienced growth in vehicle and passenger traffic system-wide. Overall, commercial traffic, a component of vehicle traffic, increased by 2.2% in the quarter (3.5% year-to-date), while drop-trailer traffic, a component of commercial traffic, increased by 7.4% in the quarter (6.1% year-to-date). The vehicle and passenger traffic levels we experienced in the nine months ended December 31, 2016 are the highest since the same period in fiscal 2008. Our vehicle and passenger traffic levels for the three months ended December 31, 2016, reflect modest growth despite more days of unfavourable weather compared to the same period in the prior year.

The following graph illustrates our vehicle and passenger traffic levels for the third quarter of fiscal 2013 through fiscal 2017:




| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Vehicles | 1,708 | 1,722 | 1,709 | 1,800 | 1,828 |
| Passengers | 4,226 | 4,267 | 4,220 | 4,385 | 4,421 |

**Safety and Environment**

We are dedicated to the safety and well-being of customers and employees at our terminals and on board our vessels, which includes dealing with medical incidents such as passenger illnesses and injuries. We have more than 800 employees who, in addition to their normal duties, are trained as Occupational First Aid Attendants. We also respond to requests from BC Ambulance Service that range from assembling a crew to make unscheduled sailings for medical patients to holding a vessel in dock or turning one around for medical emergencies.

We first received the Certificate of Recognition ("COR") from WorkSafeBC in fiscal 2014. A COR recognizes companies that go beyond the legal requirements of the *Workers' Compensation Act* and the Occupational Health & Safety Regulations by taking a best practices approach to implementing health, safety and return to work programs. A COR requires recertification every three years. In fiscal 2015, the COR audit resulted in a combined score of 94.1%. In fiscal 2016, the COR audit resulted in a 96% score in Health and Safety and 92% score in Injury Management, for a combined score of 95.7%. As a result of the audit, WorkSafeBC provided us with a $566,000 rebate on our 2015 assessed premiums. In fiscal 2014 and 2015, WorkSafeBC provided us with a rebate on each of our 2013 and 2014 assessed premiums of approximately $600,000. During the second quarter of fiscal 2017, we began the process of renewing the COR by engaging an independent external consultant to do a recertification audit. We completed this process during the third quarter and expect to receive recertification in the last quarter of fiscal 2017.

In addition to the COR rebate, effective January 1, 2017, WorkSafeBC reduced our premium rate from $1.96 to $1.16 per $100 of assessable payroll. This represents approximately $2 million in premium savings per year and is a result of our SailSafe program and its focus on safety and reducing time loss injuries. In the third quarter of fiscal 2017, due to our active management of employee injury cases, WorkSafeBC further reduced our premium rate to $1.15 per $100 of assessable payroll.

We are also dedicated to safeguarding the environment. We have training programs in place that include training our staff in environmental awareness and first response to an oil spill and we conduct regularly scheduled oil spill drills on our vessels and at our terminals. We monitor all environment spills and, in the three months ended December 31, 2016, experienced one (eight year-to-date) minor environmental incident, which we immediately addressed. Our aging vessels can experience mechanical issues from time-to-time that may result in small oil leaks. The *Queen of Burnaby* has experienced persistent problems with the seal around the propeller shaft which has resulted in the vessel being removed from service several times in the last two years. The 52-year old *Queen of Burnaby* and the 53-year old *Queen of Nanaimo*, will be replaced in 2017 by the *Salish Orca* and the *Salish Eagle* respectively. The 53-year old *Howe Sound Queen* and the 59-year old *North Island Princess* are in our capital plan to be replaced in 2019.

On November 1, 2016, we announced the launch of an initiative that brings together our existing environmental activities, conservation efforts, community investments and new sustainability endeavours under a single program called SeaForward. Our three key initiatives in the first year of the program include increasing composting and recycling, the tracking of whale sightings in association with the BC Cetacean Sightings Network, and our employees actively participating in the Great Canadian Shoreline Clean-up.

We joined Green Marine in late 2014 and were certified by an independent verifier in May 2015. Green Marine is a globally recognized and voluntary industry sustainability initiative for ship operators, ports, terminals and shipyards. Earlier this year, we were recognized by Green Marine as having achieved significant year-over-year improvement when evaluated against their performance indicators. For 2017, Green Marine has established underwater noise as a key performance indicator. We participate in the Enhancing Cetacean Habitat Observation Program ("ECHO"), established by Port of Vancouver, in collaboration with government agencies, First Nations, marine industry users, non-government organizations and scientific experts, to better understand and manage the potential impacts to cetaceans (whales, porpoises and dolphins) from commercial vessel activities. The long-term goal of ECHO is to develop mitigation measures that will lead to a quantifiable reduction in potential threats to cetaceans which include acoustic disturbance, physical disturbance and environmental contaminants.

With the support of Transport Canada, we partnered with 3GA Marine, Clearlead Consulting and Panevo Services in the development and demonstration of an energy optimization software tool on the *Queen of Oak Bay*. The tool collects electricity data from more than twenty areas on the vessel and provides generator metrics that allow us to manage energy usage. The benefits of this energy initiative are a reduction in fuel consumption, cost and associated carbon emissions, as well as improved asset life and reduced maintenance costs.

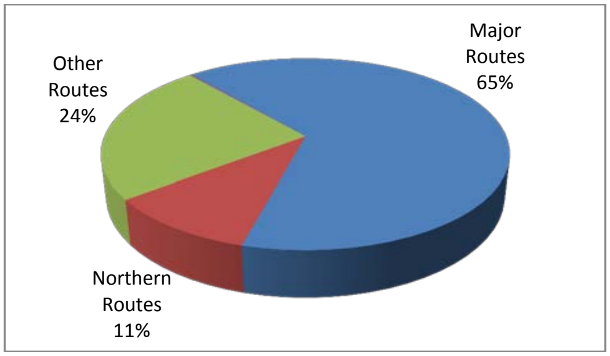
The Maritime Museum of B.C. announced BC Ferries as a recipient of the 2016 SS Beaver Award. The SS Beaver Award is presented in recognition of high operating standards and contributions to the maritime industry in BC. The award was bestowed by the Lieutenant Governor on November 18, 2016.

**Training**

Each year we invest heavily in operational and safety training.

In the third quarter of fiscal 2017, over 5,900 days (21,900 days year-to-date) of operational and Standardized Education and Assessment ("SEA") training were provided to employees. The primary focus of training in the third quarter was on preparing our operations for the future use of liquefied natural gas to fuel our vessels and was mainly directed to employees who will be working on our three new Salish class vessels. We also provided various training programs for new employees.

**Revenue**
The following discussions of revenue are based on IFRS results, with reference to the impacts of rate regulation.




In the nine months ended December 31, 2016, the greatest portion of our revenues (65%) was earned on our Major Routes which provide service between Vancouver Island and the Lower Mainland. Revenue from the Northern Routes contributed 11% and revenue from Other Routes contributed 24%.

Select operational statistics and total revenues for the three and nine months ended December 31, 2016 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** | **2016** | **2015** | **2016** | **2015** |
| Vehicle traffic | 1,827,633 | 1,799,791 | 6,699,416 | 6,434,504 |
| Passenger traffic | 4,420,669 | 4,385,164 | 17,225,433 | 16,718,094 |
| On-time performance | 92.4% | 92.4% | 88.2% | 89.9% |
| Number of round trips | 18,859.5 | 18,842.5 | 59,010.5 | 58,095.5 |
| Capacity provided (AEQs) | 3,586,378 | 3,480,952 | 11,560,186 | 11,259,963 |
| AEQs carried | 2,077,745 | 2,042,236 | 7,597,046 | 7,287,654 |
| Capacity utilization | 57.9% | 58.7% | 65.7% | 64.7% |

In the three months ended December 31, 2016, vehicle traffic increased 1.5% (4.1% year-to-date) and passenger traffic increased 0.8% (3.0% year-to-date) compared to the same quarter in the prior year. Overall, traffic was favourably impacted by an increase in tourism, lower fuel prices and general economic activity in British Columbia and, partially offset by the impact of more days of unfavorable weather in the third quarter of 2016 compared to the same period in the prior year.

On-time performance on the Major and regulated Other Routes is defined as the percentage of our sailings departing within 10 minutes of the scheduled time. On-time performance on the Northern Routes is defined as the percentage of our sailings arriving no later than 10 minutes after the scheduled time. In each case, on-time performance can be impacted by delays due to weather, vessel substitution, terminal dock maintenance or closures and periods of unusually high traffic demand. Meeting customer service expectations in a safe and reliable manner is an important factor in our focus to improve on-time performance. In the three months ended December 31, 2016, on-time performance was comparable to the same period in the prior year. Year-to-date, on-time performance decreased from 89.9% to 88.2% compared to the same period in the prior year. We face particular on-time performance challenges on the routes using the Horseshoe Bay terminal. (See route specific sections below for more detail.) 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.

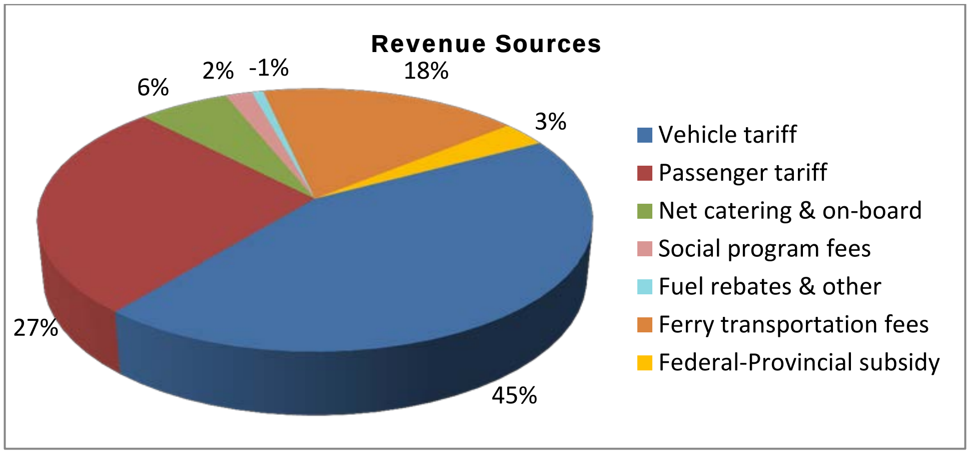
Minimum crewing levels are set by Transport Canada and these levels determine our maximum allowable passenger capacity for each sailing. Passengers are counted as they arrive for a sailing, both as a walk-on and by vehicle, to ensure we do not exceed the maximum allowable passenger capacity.

Vehicle capacity provided, measured in automobile equivalents (“AEQs”), is the available vehicle deck space on a vessel multiplied by the number of round trips. In fiscal 2017, vehicle capacity provided was revised to reflect the change in AEQ as discussed below. Prior periods have also been adjusted for comparative purposes. Round trips normally stay fairly stable as the CFSC stipulates, among other things, the minimum number of round trips to be provided for each regulated ferry service route. 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, or by changes to the number of trips stipulated by the CFSC. In the nine months ended December 31, 2016, we provided 915 additional round trips compared to the same period in the prior year and 13.1% more trips than the minimum required under the CFSC, mainly due to the increase in traffic demand. Overall, this has resulted in a 2.7% increase in capacity provided.

An AEQ is our standard unit of measure for an approximation of one car length. Effective for fiscal 2017, the standard unit of measurement was revised to more accurately reflect actual vehicle sizes. 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.

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 decreased from 58.7% to 57.9% for the three months ended December 31, 2016 compared to the same quarter in the prior year as a result of an increase in capacity provided from additional round trips, partially offset by a higher number of AEQs carried due to higher traffic levels. Capacity utilization increased from 64.7% to 65.7% 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) | **2016** | **2015** | **Increase (Decrease)** | **2016** | **2015** | **Increase (Decrease)** |
| **Direct Route Revenue** | | | | | | |
| Vehicle tariff | 79.8 | 76.0 | 3.8 | 312.0 | 289.6 | 22.4 |
| Passenger tariff | 47.2 | 44.7 | 2.5 | 190.4 | 178.3 | 12.1 |
| Fuel rebates | (3.7) | (1.3) | (2.4) | (14.7) | (5.1) | (9.6) |
| Net retail | 11.6 | 10.8 | 0.8 | 44.1 | 40.9 | 3.2 |
| Social program fees | 4.0 | 6.0 | (2.0) | 13.0 | 19.5 | (6.5) |
| Other revenue | 2.2 | 2.1 | 0.1 | 7.2 | 6.7 | 0.5 |
| **Total Direct Route Revenue** | 141.1 | 138.3 | 2.8 | 552.0 | 529.9 | 22.1 |
| **Indirect Route Revenue** | | | | | | |
| Ferry transportation fees | 34.9 | 33.1 | 1.8 | 125.9 | 115.4 | 10.5 |
| Federal-Provincial subsidy | 7.3 | 7.1 | 0.2 | 21.9 | 21.5 | 0.4 |
| **Total Route Revenue** | 183.3 | 178.5 | 4.8 | 699.8 | 666.8 | 33.0 |
| Other general revenue | 0.4 | 0.2 | 0.2 | 2.0 | 1.5 | 0.5 |
| **Total Revenue** | 183.7 | 178.7 | 5.0 | 701.8 | 668.3 | 33.5 |




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

On April 1, 2016, we implemented tariff increases of 1.9% on average, in accordance with the Commissioner's Order 15-03 dated September 16, 2015. The price cap increase allowed in the Commissioner's order was directly associated with forecast increases in operating and capital expenditures.

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 increase of 1.9% across the system. This completely offset the 1.9% average tariff increase, effectively resulting in no net increase to our customers at the beginning of PT4. Fuel rebates increased from 1.0% to 2.9% on our Major and regulated Other Routes and a fuel rebate of 1.9% was implemented on the Northern Routes. 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 "The Effect of Rate Regulation" for more detail.)

In the three months ended December 31, 2015, social program fees included $2.0 million ($7.1 million year-to-date) in senior discounts. In the three months ended December 31, 2016, social program fees decreased $2.0 million ($6.5 million year-to-date) and ferry transportation fees increased $1.8 million ($10.5 million year-to-date), partially to compensate for the discontinuance of direct funding for seniors' discounts, as discussed above.

From time-to-time, we utilize promotional fares designed to stimulate growth in traffic or to direct traffic towards our less busy sailings and/or to ensure we are in compliance with approved price cap orders. The utilization of promotional fare incentives is one factor that may cause the average vehicle and passenger tariff rate to be under or over the allowed price cap in any one period. Under the Act, we cannot be over price cap for more than four consecutive quarters.

Year-to-year changes in operational statistics and revenue for the three and nine months ended December 31, 2016 and 2015 for the Major, Northern and Other Routes are discussed separately below.

## Major Routes

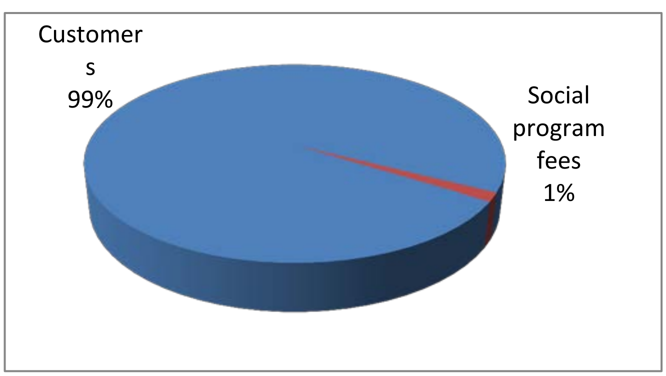
Our Major Routes consist of three regulated routes connecting Metro Vancouver with mid and southern Vancouver Island and our regulated route connecting Horseshoe Bay and Langdale. These are our four busiest routes, carrying approximately 60% of our vehicle traffic and 65% of our passenger traffic during the three and nine month periods ended December 31, 2016 and 2015.

| Operational Statistics | Three months ended December 31 | | Nine months ended December 31 | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Vehicle traffic | 1,085,219 | 1,071,104 | 4,042,633 | 3,891,279 |
| Passenger traffic | 2,855,455 | 2,823,002 | 11,274,354 | 10,936,173 |
| On-time performance | 80.5% | 81.2% | 77.1% | 79.3% |
| Number of round trips | 2,992.0 | 2,944.0 | 10,005.0 | 9,817.0 |
| Capacity provided (AEQs) | 1,886,938 | 1,852,946 | 6,316,128 | 6,187,091 |
| AEQs carried | 1,285,896 | 1,263,698 | 4,758,055 | 4,564,690 |
| Capacity utilization | 68.1% | 68.2% | 75.3% | 73.8% |

In the three months ended December 31, 2016, vehicle traffic increased 1.3% (3.9% year-to-date) and passenger traffic increased 1.1% (3.1% year-to-date) compared to the same period in the prior year. Overall, commercial traffic, a component of vehicle traffic, increased 4.3% in the quarter (6.0% year-to-date), while drop-trailer traffic, a component of total commercial traffic, increased 7.4% in the quarter (6.1% year-to-date). Traffic was favourably impacted by an increase in tourism, lower fuel prices and general economic activity in British Columbia, partially offset by the impact of more days of unfavorable weather in the third quarter of 2016 compared to the same period in the prior year.

In the three months ended December 31, 2016, on-time performance decreased by 0.7% (2.2% year-to-date) compared to the same period in the prior year. The most significant change was on the routes utilizing Horseshoe Bay terminal. The configuration of the terminal limits our operational flexibility particularly during periods of high traffic. 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.

Capacity utilization decreased from 68.2% to 68.1% for the three months ended December 31, 2016 compared to the same quarter in the prior year as a result of a 1.8% increase in capacity provided from additional round trips, mostly offset by a 1.8% higher number of AEQs carried due to higher traffic levels. Capacity utilization for the nine months ended December 31, 2016 compared to the same period in the prior year increased 1.5% 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, 2016, 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** | | |
|---|---|---|---|---|---|---|
| | **2016** | **2015** | **Increase (Decrease)** | **2016** | **2015** | **Increase (Decrease)** |
| **Direct Route Revenue** | | | | | | |
| Vehicle tariff | 68,546 | 64,920 | 3,626 | 263,766 | 244,064 | 19,702 |
| Passenger tariff | 39,222 | 37,146 | 2,076 | 154,136 | 144,525 | 9,611 |
| Fuel rebates | (3,135) | (1,126) | (2,009) | (12,083) | (4,254) | (7,829) |
| Net retail | 10,506 | 9,855 | 651 | 39,054 | 36,367 | 2,687 |
| Social program fees | 2,021 | 3,417 | (1,396) | 6,615 | 11,050 | (4,435) |
| Parking | 1,133 | 1,060 | 73 | 3,934 | 3,744 | 190 |
| Other revenue | 879 | 905 | (26) | 2,870 | 2,547 | 323 |
| **Total Direct Route Revenue** | 119,172 | 116,177 | 2,995 | 458,292 | 438,043 | 20,249 |
| **Indirect Route Revenue** | | | | | | |
| Ferry transportation fees | - | 237 | (237) | - | 709 | (709) |
| **Total Route Revenue** | 119,172 | 116,414 | 2,758 | 458,292 | 438,752 | 19,540 |

| **Average tariff ($)** | **Three months ended December 31** | | | **Nine months ended December 31** | | |
|---|---|---|---|---|---|---|
| | **2016** | **2015** | **Increase** | **2016** | **2015** | **Increase** |
| Vehicle tariff ($000's) | 68,546 | 64,920 | | 263,766 | 244,064 | |
| Vehicle traffic | 1,085,219 | 1,071,104 | | 4,042,633 | 3,891,279 | |
| Average tariff per vehicle | 63.16 | 60.61 | 2.55 | 65.25 | 62.72 | 2.53 |
| Passenger tariff ($000's) | 39,222 | 37,146 | | 154,136 | 144,525 | |
| Passenger traffic | 2,855,455 | 2,823,002 | | 11,274,354 | 10,936,173 | |
| Average tariff per passenger | 13.74 | 13.16 | 0.58 | 13.67 | 13.22 | 0.45 |

In the three months ended December 31, 2016, average tariff revenue per vehicle increased $2.55 or 4.2% ($2.53 or 4.0% year-to-date) and average tariff revenue per passenger increased $0.58 or 4.4% ($0.45 or 3.4% year-to-date) compared to the same period in the prior year. The increase in average tariff revenues reflects the price cap increase authorized by the Commissioner. The average tariff per vehicle also reflects an increase in revenue from reservation fees due to higher traffic and higher usage. The increase in both traffic levels and in average fares during the three and nine months ended December 31, 2016 resulted in a tariff revenue increase of $5.7 million ($29.3 million year-to-date) compared to the same period in the prior year.

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 increase from 1% to 2.9% on our Major Routes. Fuel rebates of 1.0% were in place on our Major Routes in the first three quarters of fiscal 2016. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

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, 2016, net retail sales increased 6.6% (7.4% 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 72% of the total retail revenue. Sales of quality apparel continue to grow and

comprise over 10% of total retail revenue. Cost of goods sold is approximately 40% of total sales.
Social program fees are reimbursements from the Province of discounts provided on fares for BC seniors (prior to April 1, 2016), students travelling to and from school, persons with disabilities and persons travelling under the Ministry of Health Travel Assistance Program ("MTAP"). In the three months ended December 31, 2015, social program fees included $1.4 million ($4.7 million year-to-date) in seniors' discounts. In the three months ended December 31, 2016, social program fees decreased $1.4 million ($4.4 million year-to-date), mainly as a result of the direct funding for seniors' discounts being discontinued (as of April 1, 2016 transportation fees, which are allocated to the Northern and regulated Other Routes, had been increased to compensate for the change), partially offset by an increase in the number of people using the MTAP program.

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

In fiscal 2016, ferry transportation fees on the Major Routes represented funds received from the Province related to the import duty remission on one of our foreign-built vessels. As discussed, effective April 1, 2016, the CFSC was amended and all ferry transportation fees are now allocated to the Northern and regulated Other Routes. (See "Economic Regulatory Environment" above for more detail.)

## Northern Routes

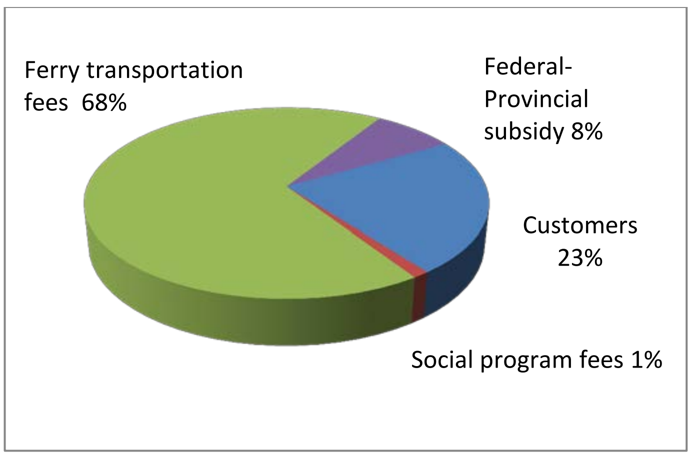
Our Northern Routes consist of two regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island.

| **Operational Statistics** | **Three months ended December 31** | | **Nine months ended December 31** | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Vehicle traffic | 5,219 | 5,105 | 26,805 | 24,930 |
| Passenger traffic | 12,631 | 12,557 | 74,883 | 70,293 |
| On-time performance | 90.4% | 97.1% | 88.3% | 90.9% |
| Number of round trips | 40.5 | 40.0 | 194.0 | 187.0 |
| Capacity provided (AEQs) | 10,330 | 10,112 | 44,408 | 43,438 |
| AEQs carried | 6,517 | 6,305 | 32,539 | 30,217 |
| Capacity utilization | 63.1% | 62.4% | 73.3% | 69.6% |

In the three months ended December 31, 2016, vehicle traffic increased 2.2% (7.5% year-to-date) and passenger traffic increased 0.6% (6.5% year-to-date) compared to the same period in the prior year. Traffic was favourably impacted by an increase in tourism, lower fuel prices and general economic activity in British Columbia, partially offset by the impact of more days of unfavorable weather in the third quarter of 2016 compared to the same period in the prior year.

In the three months ended December 31, 2016, on-time performance decreased by 6.7% (2.6% year-to-date) compared to the same period in the prior year, primarily due to the impact from increased traffic demand and unfavorable weather.

Capacity utilization on these routes during the three and nine months ended December 31, 2016 was higher than the same periods in the prior year as a result of a higher number of AEQs carried, partially offset by increased capacity provided due to an increase in the number of round trips.




In the nine months ended December 31, 2016, revenue from our Northern Routes consisted of 23% from customers and 77% from the Province (1% social program fees, 68% 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 | | |
|---|---|---|---|---|---|---|
| | **2016** | **2015** | **Increase (Decrease)** | **2016** | **2015** | **Increase (Decrease)** |
| **Direct Route Revenue** | | | | | | |
| Vehicle tariff | 1,122 | 1,055 | 67 | 7,596 | 6,966 | 630 |
| Passenger tariff | 682 | 542 | 140 | 6,739 | 6,146 | 593 |
| Fuel rebates | (38) | - | (38) | (299) | - | (299) |
| Net retail | 162 | 127 | 35 | 1,266 | 1,095 | 171 |
| Social program fees | 209 | 199 | 10 | 845 | 945 | (100) |
| Stateroom rental | 298 | 265 | 33 | 1,279 | 1,147 | 132 |
| Hostling & other | 79 | 39 | 40 | 163 | 158 | 5 |
| **Total Direct Route Revenue** | 2,514 | 2,227 | 287 | 17,589 | 16,457 | 1,132 |
| **Indirect Route Revenue** | | | | | | |
| Ferry transportation fees | 10,283 | 9,839 | 444 | 49,846 | 44,912 | 4,934 |
| Federal-Provincial subsidy | 1,870 | 1,843 | 27 | 5,611 | 5,529 | 82 |
| **Total Route Revenue** | 14,667 | 13,909 | 758 | 73,046 | 66,898 | 6,148 |

| **Average tariff ($)** | Three months ended December 31 | | | Nine months ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2016** | **2015** | **Increase** | **2016** | **2015** | **Increase** |
| Vehicle tariff ($000's) | 1,122 | 1,055 | | 7,596 | 6,966 | |
| Vehicle traffic | 5,219 | 5,105 | | 26,805 | 24,930 | |
| Average tariff per vehicle | 214.98 | 206.66 | 8.32 | 283.38 | 279.42 | 3.96 |
| Passenger tariff ($000's) | 682 | 542 | | 6,739 | 6,146 | |
| Passenger traffic | 12,631 | 12,557 | | 74,883 | 70,293 | |
| Average tariff per passenger | 53.99 | 43.16 | 10.83 | 89.99 | 87.43 | 2.56 |

In the three months ended December 31, 2016, average tariff revenue per vehicle increased $8.32 or 4.0% ($3.96 or 1.4% year-to-date) and average tariff revenue per passenger increased $10.83 or 25.1% (increased $2.56 or 2.9% year-to-date) compared to the same period in the prior year. The increase in average tariff revenues reflects a change in the proportion of traffic on routes with higher versus lower tariffs, the price cap increase authorized by the Commissioner and the impact of our passenger fare discounts in the third quarter of fiscal 2016. The increase in traffic levels and in average fares during the three months ended December 31, 2016 resulted in a total tariff revenue increase of $0.2 million ($1.2 million year-to-date) compared to the same period in the prior year.

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 our Northern Routes. There were no fuel surcharges or rebates in place on our Northern Routes in the first three quarters of fiscal 2016.

In the three months ended December 31, 2016, social program fees increased mainly as a result of an increase in the fees received from the MTAP program, partially offset by the decrease in reimbursements from the Province for seniors' discounts. Year-to-date, reimbursements from the Province for social program fees decreased mainly as a result of the direct funding for seniors' discounts being discontinued (as of April 1, 2016, ferry transportation fees had been increased to compensate for the change), partially offset by an increase in the fees received from the MTAP program.

Revenue from net retail services increased 27.6% in the quarter (15.6% year-to-date) compared to the same period in the prior year mainly as a result of higher passenger levels. Stateroom rental revenue increased 12.5% in the quarter (11.5% year-to-date) due to higher passenger levels and increased utilization.

Ferry transportation fees received from the Province increased $0.4 million in the quarter ($4.9 million year-to-date) compared to the same period in the prior year as a result of the following:

- $0.4 million ($5.0 million year-to-date) increase as a result of additional funding from the Province, which includes BC seniors discounts and the differences in the monthly schedule of round trips (fiscal 2017 ferry transportation fees are expected to be $4.6 million higher than the prior fiscal year); and
- $0.1 million decrease year-to-date in fees related to a lower fuel price. For regulatory purposes, the amounts received from or paid to the Province relating to the price of fuel are applied to our deferred fuel cost accounts (see "The Effect of Rate Regulation" above for more detail).

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

## Other Routes

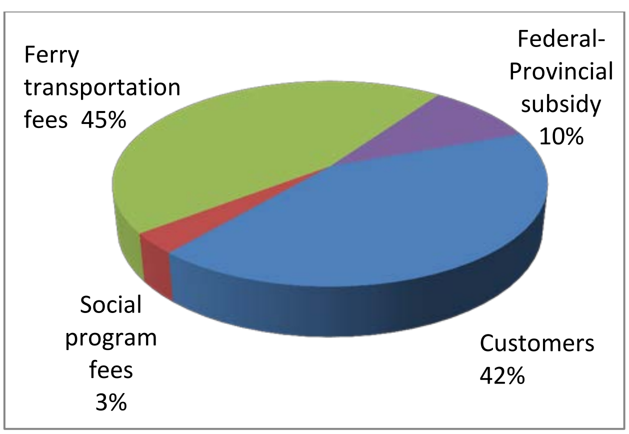
Our Other Routes consist of 18 regulated routes and eight small unregulated routes primarily serving the northern and southern Gulf Islands and the northern Sunshine Coast. One of the regulated routes and all of the unregulated routes are operated under contract by alternative service providers. We receive fees from the Province for the provision of contracted services on these routes, which are included in the ferry transportation fees in the table below. Operational statistics for the unregulated routes are not incorporated in the following analysis.

| | Three months ended December 31 | | Nine months ended December 31 | |
|---|---|---|---|---|
| **Operational Statistics** | **2016** | **2015** | **2016** | **2015** |
| Vehicle traffic | 737,195 | 723,582 | 2,629,978 | 2,518,295 |
| Passenger traffic | 1,552,583 | 1,549,605 | 5,876,196 | 5,711,628 |
| On-time performance | 94.4% | 94.2% | 90.2% | 91.8% |
| Number of round trips | 15,827.0 | 15,858.5 | 48,811.5 | 48,091.5 |
| Capacity provided (AEQs) | 1,689,110 | 1,617,894 | 5,199,650 | 5,029,434 |
| AEQs carried | 785,332 | 772,233 | 2,806,452 | 2,692,747 |
| Capacity utilization | 46.5% | 47.7% | 54.0% | 53.5% |

In the three months ended December 31, 2016, vehicle traffic increased 1.9% (4.4% year-to-date) and passenger traffic increased 0.2% (2.9% year-to-date) compared to the same period in the prior year. Traffic was favourably impacted by an increase in tourism, lower fuel prices and general economic activity in British Columbia, partially offset by the impact of more days of unfavorable weather in the third quarter of 2016 compared to the same period in the prior year.

In the three months ended December 31, 2016, on-time performance increased by 0.2% compared to the same period in the prior year. Year-to-date on-time performance decreased by 1.6% compared to the same period in the prior year, primarily due to the impact from increased traffic demand.

Capacity utilization during the three months ended December 31, 2016 decreased compared to the same period in the prior year as a result of increased capacity provided due to vessel substitutions, partially offset by a higher number of AEQs carried. Capacity utilization during the nine months ended December 31, 2016 increased compared to the same period in the prior year, with a higher number of AEQs carried partially offset by increased capacity provided due to additional round trips and vessel substitutions.




In the nine months ended December 31, 2016, revenue from our Other Routes consisted of 42% from customers and 58% from the Province (3% social program fees, 45% ferry transportation fees, and 10% from payments under the Federal-Provincial subsidy agreement).

## Other Routes cont'd

| **Revenue**<br>($ thousands) | **Three months ended December 31** | | | **Nine months ended December 31** | | |
|---|---|---|---|---|---|---|
| | **2016** | **2015** | **Increase (Decrease)** | **2016** | **2015** | **Increase (Decrease)** |
| **Direct Route Revenue** | | | | | | |
| Vehicle tariff | 10,183 | 10,029 | 154 | 40,664 | 38,607 | 2,057 |
| Passenger tariff | 7,311 | 7,000 | 311 | 29,542 | 27,615 | 1,927 |
| Fuel rebates | (613) | (224) | (389) | (2,381) | (848) | (1,533) |
| Social program fees | 1,773 | 2,359 | (586) | 5,550 | 7,463 | (1,913) |
| Net retail | 622 | 519 | 103 | 2,492 | 2,241 | 251 |
| Parking & other | 115 | 103 | 12 | 259 | 271 | (12) |
| **Total Direct Route Revenue** | 19,391 | 19,786 | (395) | 76,126 | 75,349 | 777 |
| **Indirect Route Revenue** | | | | | | |
| Ferry transportation fees | 24,581 | 23,061 | 1,520 | 76,053 | 69,817 | 6,236 |
| Federal-Provincial subsidy | 5,419 | 5,340 | 79 | 16,257 | 16,019 | 238 |
| **Total Route Revenue** | 49,391 | 48,187 | 1,204 | 168,436 | 161,185 | 7,251 |

| **Average tariff ($)** | **Three months ended December 31** | | | **Nine months ended December 31** | | |
|---|---|---|---|---|---|---|
| | **2016** | **2015** | **Increase (Decrease)** | **2016** | **2015** | **Increase** |
| Vehicle tariff ($000's) | 10,183 | 10,029 | | 40,664 | 38,607 | |
| Vehicle traffic | 737,195 | 723,582 | | 2,629,978 | 2,518,295 | |
| Average tariff per vehicle | 13.81 | 13.86 | (0.05) | 15.46 | 15.33 | 0.13 |
| Passenger tariff ($000's) | 7,311 | 7,000 | | 29,542 | 27,615 | |
| Passenger traffic | 1,552,583 | 1,549,605 | | 5,876,196 | 5,711,628 | |
| Average tariff per passenger | 4.71 | 4.52 | 0.19 | 5.03 | 4.83 | 0.20 |

In the three months ended December 31, 2016, average tariff revenue per vehicle decreased $0.05 or 0.3% compared to the same period in the prior year primarily as a result of changes in the proportion of traffic on routes with lower versus higher tariffs and changes in the mix of vehicle types. Year-to-date, average tariff revenue per vehicle increased $0.13 or 0.8% compared to the same period in the prior year. In the three months ended December 31, 2016, average tariff revenue per passenger increased $0.19 or 4.2% ($0.20 or 4.1% year-to-date) compared to the same period in the prior year. The increase in average tariff revenues reflects the price cap increase authorized by the Commissioner and an increase in the proportion of traffic on routes with higher versus lower tariffs. The increase in both traffic levels and change in average fares during the three months ended December 31, 2016 resulted in a total tariff revenue increase of $0.5 million ($4.0 million year-to-date) compared to the same period in the prior year.

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 increase from 1% to 2.9%. Fuel rebates of 1.0% were in place in the first three quarters of fiscal 2016. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

In the three months ended December 31, 2015, social program fees included $0.6 million ($2.2 million year-to-date) in seniors' discounts. In the three months ended December 31, 2016, social program fees decreased $0.6 million ($1.9 million year-to-date), mainly as a result of funding for seniors' discounts being discontinued (as of April 1, 2016, ferry transportation fees had been increased to compensate for the change), partially offset by an increase in the number of students travelling and in the number of people using the MTAP program.

Revenue from net retail services increased by 19.8% (11.2% 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. Cost of goods sold is approximately 40% of total retail revenues.

Ferry transportation fees received from the Province increased $1.5 million in the quarter ($6.2 million year-to-date) compared to the same period in the prior year, primarily as a result of additional funding in PT4 from the Province (fiscal 2017 ferry transportation fees, which include funding for seniors' discounts and contracted routes, are expected to be $6.9 million higher than the prior fiscal year).

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

**Expenses**
Expenses for the three and nine months ended December 31, 2016 and 2015 are summarized in the table below:

| Operating expenses ($ millions) | Three months ended December 31 2016 | 2015 | Increase (Decrease) | Nine months ended December 31 2016 | 2015 | Increase |
|---|---|---|---|---|---|---|
| Operations | 110.2 | 105.6 | 4.6 | 354.0 | 342.3 | 11.7 |
| Maintenance | 18.0 | 18.5 | (0.5) | 53.2 | 52.7 | 0.5 |
| Administration | 8.6 | 8.5 | 0.1 | 25.4 | 24.7 | 0.7 |
| **Total operations, maintenance & administration** | 136.8 | 132.6 | 4.2 | 432.6 | 419.7 | 12.9 |
| Depreciation and amortization | 37.1 | 35.9 | 1.2 | 110.3 | 106.8 | 3.5 |
| **Total operating expenses** | 173.9 | 168.5 | 5.4 | 542.9 | 526.5 | 16.4 |

We continue to take proactive measures to contain, reduce and optimize expenses while operating a sustainable, safe and reliable service.

Operations expenses increased $4.6 million ($11.7 million year-to-date) compared to the same period in the prior year mainly due to:

- $4.2 million ($11.6 million year-to-date) increase in wages and benefits costs, mainly due to a an increase resulting from additional round trips provided, bargaining unit wage rate increase of 1.5% effective April 1, 2016 in accordance with the Collective Agreement, and an increase in hours spent in training activities; and
- $1.0 million ($3.8 million year-to-date) increase in insurance claims, contracted services, credit card fees and travel expenses;

partially offset by:

- $0.6 million ($3.7 million year-to-date) decrease in fuel expense, reflecting a $1.2 million or 4.8% ($6.0 million or 7.1% year-to-date) decrease in fuel prices, partially offset by a $0.6 million or 2.4% ($2.3 million or 2.8% year-to-date) increase in fuel consumption primarily from additional round trips provided. While we are not permitted to report regulatory assets and liabilities in our financial statements under IFRS, we are in fact rate-regulated. For purposes of rate regulation, $5.6 million over our actual fuel expense in the nine months ended December 31, 2016 is recorded in deferred fuel cost accounts which is expected to be settled through fuel rebates. (See “The Effect of Rate Regulation” above for more detail.)

The $0.5 million decrease ($0.5 million increase year-to-date) in maintenance costs compared to the same period in the prior year was mainly a result of variations in vessel refit scheduling and increased terminal maintenance.

In the three months ended December 31, 2016, administration costs increased $0.1 million ($0.7 million year-to-date) compared to the same period in the prior year mainly due to annual licencing costs incurred in the first half of the year related to new hardware and software that has come into service.

In the three months ended December 31, 2016, depreciation and amortization increased $1.2 million ($3.5 million year-to-date) compared to the same period in the prior year reflecting higher depreciation resulting from the new capital assets that have entered service. (See “Investing in our Capital Assets” below for details of significant capital asset expenditures.)

| **Net finance and other expenses** ($ millions) | **Three months ended December 31** | | | **Nine months ended December 31** | | |
|---|---|---|---|---|---|---|
| | **2016** | **2015** | **Increase (Decrease)** | **2016** | **2015** | **Increase (Decrease)** |
| **Finance expense** | | | | | | |
| Bond interest | 14.6 | 14.6 | - | 43.6 | 43.6 | - |
| KfW bank group (KfW) loans | 1.3 | 1.4 | (0.1) | 3.8 | 4.3 | (0.5) |
| Interest on finance lease | 0.5 | 0.5 | - | 1.4 | 1.5 | (0.1) |
| Short-term debt | - | - | - | 0.2 | 0.2 | - |
| Capitalized interest | (1.3) | (1.4) | 0.1 | (5.0) | (4.0) | (1.0) |
| **Total finance expense** | 15.1 | 15.1 | - | 44.0 | 45.6 | (1.6) |
| Less: finance income | (1.3) | (1.0) | (0.3) | (3.5) | (3.4) | (0.1) |
| **Net finance expense** | 13.8 | 14.1 | (0.3) | 40.5 | 42.2 | (1.7) |
| (Gain) loss on disposal and revaluation of property, plant and equipment, intangible assets and inventory | - | (0.2) | 0.2 | 0.2 | 0.0 | 0.2 |
| **Total net finance and other expenses** | 13.8 | 13.9 | (0.1) | 40.7 | 42.2 | (1.5) |

In the three months ended December 31, 2016, net finance and other expenses decreased $0.1 million compared to the same period in the prior year.

Year-to-date, net finance and other expenses decreased $1.5 million compared to the same period in the prior year mainly due to:

- $1.0 million increase in capitalized interest and
- $0.5 million decrease in interest on KfW loans, reflecting $15.8 million in principal repayments.

**Liquidity and Capital Resources**

We fund our operations and capital acquisitions with cash flow generated from operations, as well as bank financing and issuance of bonds.

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 (May 2004) 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. On November 22, 2016 and November 25, 2016 we drew down $39 million and $6 million, respectively, for a total of $45 million, to coincide with the contract payment schedule for the purchase of the *Salish Orca.* On February 9, 2017 and on February 17, 2017, we drew down $40 million and $5 million, respectively, for a total of $45 million, to coincide with the contract payment schedule for the purchase of the *Salish Eagle*. The net proceeds were used to partially finance the purchase of these vessels. The remaining loan will coincide with the conditional acceptance of the *Salish Raven* from the shipyard and the net proceeds will be used to partially finance the purchase of the vessel.

In the near term, we expect that our cash requirements will be met through operating cash flows, the three new KfW loans, and by accessing our credit facility from time to time. At December 31, 2016, our unrestricted cash and cash equivalents and other short-term investments totalled $236 million.

Our $155 million credit facility was renewed on March 15, 2016 to extend the maturity date of the facility from April 2020 to April 2021. The facility is available to fund capital expenditures and for other general corporate purposes. At December 31, 2016, there were no draws on this credit facility.

We target maintaining a strong investment-grade credit rating to allow capital market access at reasonable interest rates. Our credit ratings at December 31, 2016 were “A” (DBRS) with a stable trend and “AA-” (Standard & Poor’s) with a stable outlook. On January 16, 2017, DBRS confirmed our credit rating at “A” and changed the trend from stable to positive.

Our 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, 2016 we achieved a debt service ratio of 3.34 and a leverage ratio of 73.3%.

**Sources & Uses of Cash**

Our liquidity needs are met through a variety of sources, including cash generated from operations, issuance of bonds, and borrowings under our credit facility. Our primary uses of funds are operational expenses, capital asset acquisitions and upgrades, and payments on our long-term debt.

Sources and uses of cash and cash equivalents for the nine months ended December 31, 2016 and 2015 are summarized in the table below:

| | Nine months ended December 31 | | |
|---|---|---|---|
| ($ millions) | **2016** | **2015** | **Increase (Decrease)** |
| **Cash and cash equivalents, beginning of period** | 79.1 | 65.6 | 13.5 |
| Cash from operating activities: | | | |
| Net earnings | 118.2 | 99.6 | 18.6 |
| Items not affecting cash | 154.7 | 153.4 | 1.3 |
| Changes in non-cash operating working capital | (7.5) | (4.5) | (3.0) |
| Net interest paid | (47.3) | (47.6) | 0.3 |
| Cash generated by operating activities | 218.1 | 200.9 | 17.2 |
| Cash generated by (used in) financing activities | 26.5 | (16.7) | 43.2 |
| Cash used in investing activities | (206.1) | (154.4) | (51.7) |
| **Net increase in cash and cash equivalents** | 38.5 | 29.8 | 8.7 |
| **Cash and cash equivalents, end of period** | 117.6 | 95.4 | 22.2 |

For the nine months ended December 31, 2016, cash generated by operating activities increased by $17.2 million compared to the same period in the prior year, primarily due to an increase in net earnings reflecting the impact of increased traffic levels, higher revenues and lower financing costs, partially offset by higher operating expenses.

Cash generated by financing activities in the nine months ended December 31, 2016 was $26.5 million. This amount consisted of our new $44.9 million loan agreement with KfW IPEX-Bank GmbH, partially offset by: $15.8 million in repayment of other KfW loans; $1.1 million repayment of finance lease obligations; and $1.5 million in deferred financing costs.

Cash used in financing activities in the nine months ended December 31, 2015 was $16.7 million. This amount consisted of $15.8 million in repayment of KfW loans and $0.9 million repayment of finance lease obligations.

Cash used in investing activities in the nine months ended December 31, 2016 increased by $51.7 million compared to the same period in the prior year, mainly due to a $33.2 million increase in cash used for capital expenditures; a $18.0 million increase in cash used for short-term investing; and a $0.5 million change in debt service reserves. (See “Investing in Our Capital Assets” below for detail of significant capital expenditures.)

## *SUMMARY OF QUARTERLY RESULTS*

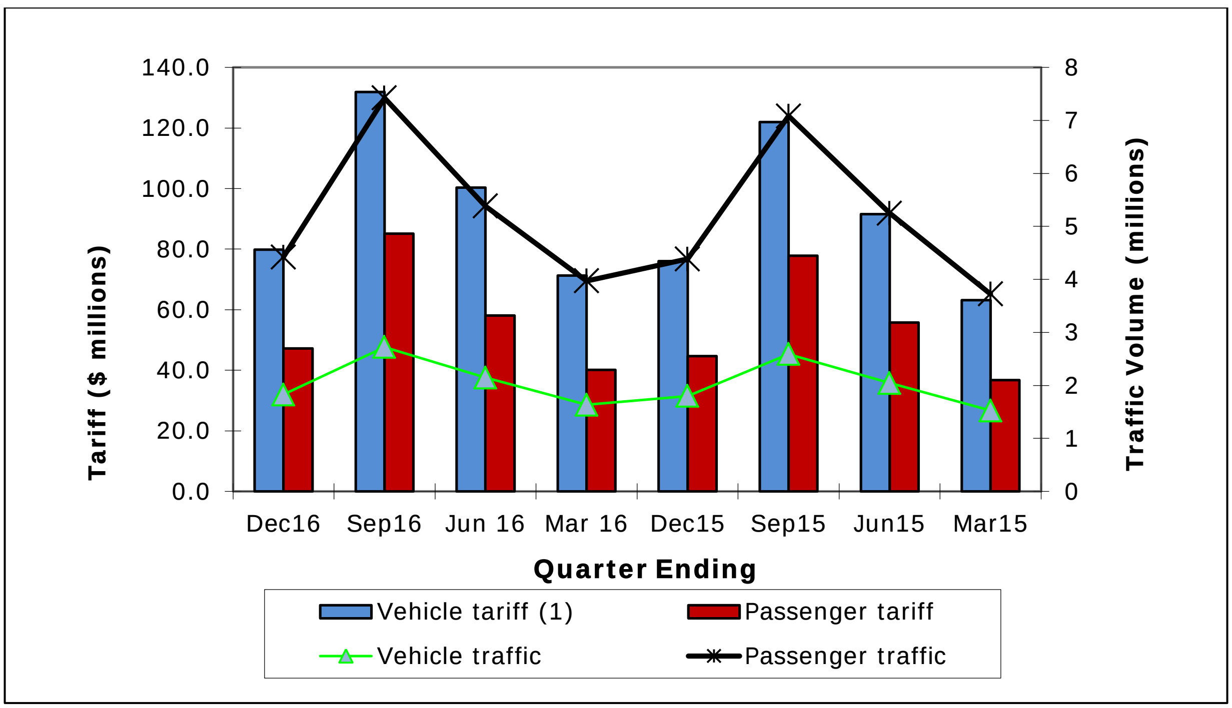
The table below compares earnings and comprehensive income by quarter for the most recent eight quarters:

| ($ millions) | Quarter Ended (unaudited) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Dec 16** | **Sep 16** | **Jun 16** | **Mar 16** | **Dec 15** | **Sep 15** | **Jun 15** | **Mar 15** |
| Total revenue (1) | 183.7 | 298.9 | 219.2 | 166.3 | 178.7 | 280.6 | 209.0 | 55.3 |
| Operating profit (loss) | 9.8 | 108.5 | 40.6 | (16.2) | 10.2 | 98.5 | 33.1 | (11.8) |
| Net (loss) earnings | (4.0) | 95.2 | 27.0 | (30.0) | (3.7) | 84.5 | 18.8 | (35.1) |
| Other comprehensive income (loss) | 6.3 | (1.0) | 10.3 | (12.0) | (11.7) | (3.6) | 3.5 | 2.7 |
| Total comprehensive income (loss) | 2.3 | 94.2 | 37.3 | (42.0) | (15.4) | 80.9 | 22.3 | (32.4) |

(1) Total revenue is net of cost of retail goods sold.

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:




(1) Effective April 1, 2016, vehicle tariff includes reservation fees. For comparative purposes, all quarters reflect this change.

## *INVESTING IN OUR CAPITAL ASSETS*

**Capital Expenditures**
Capital expenditures in the three months ended December 31, 2016 totalled $83.0 million ($153.2 million year-to-date), as set out in the following table:

| ($ millions) | December 31, 2016 | |
|---|---|---|
| | **3 months** | **9 months** |
| Vessel upgrades and modifications | 70.7 | 110.5 |
| Information technology | 6.5 | 24.5 |
| Terminal marine structures | 2.7 | 11.3 |
| Terminal and building upgrades and equipment | 3.1 | 6.9 |
| Total capital expenditures | 83.0 | 153.2 |

**Vessels**
Capital expenditures for new vessels, as well as vessel upgrades and vessel modifications in the three and nine months ended December 31, 2016, included the following:

| ($ millions) | December 31, 2016 | |
|---|---|---|
| | **3 months** | **9 months** |
| New Salish class vessels | 45.8 | 52.8 |
| Major overhauls and inspections | 14.8 | 26.3 |
| Spirit class mid-life upgrades | 1.0 | 15.0 |
| *Queen of Cowichan* betterment | 3.8 | 4.2 |
| Navigational equipment upgrades | 2.4 | 3.3 |
| *Queen of Alberni* betterment | 1.3 | 1.8 |
| *Queen of Surrey* ¾-life upgrade | (0.5) | 1.4 |
| *Queen of Cumberland* mid-life upgrade | 0.1 | 1.5 |
| Other projects | 2.0 | 4.2 |
| | 70.7 | 110.5 |

In July 2014, we entered into contracts with Remontowa Shipbuilding S.A. of Gdansk, Poland to build three new Salish class vessels. The contracts, with a total value of $165 million, form the majority of the total project budget of $206 million. The original project budget of $252 million has been reduced by $46 million, reflecting the elimination of tariffs to import the vessels into Canada. The new vessels will be dual-fuel capable, designed to run primarily on LNG with marine diesel fuel as a backup. On January 11, 2017, the *Salish Orca* arrived in British Columbia after its 50 day, 10,440 nautical mile journey from Gdansk, Poland. On January 18, 2017, we signed the Protocol of Delivery and Acceptance with Remontowa Shipbuilding S.A. and ownership of the vessel transferred to us. On February 3, 2017, we conditionally accepted our new vessel, the *Salish Eagle* from Remontowa Shipbuilding S.A. and on February 11, 2017, the vessel departed Gdansk, Poland for its voyage to Canada. The *Salish Raven* is scheduled for delivery in the first quarter of fiscal 2018. The *Salish Orca* and the *Salish Eagle* will replace the 52-year old *Queen of Burnaby* on the Comox – Powell River route and the 53-year old *Queen of Nanaimo* on the Tsawwassen – Southern Gulf Islands route, respectively. The *Salish Raven* is expected to service the Southern Gulf Islands.

The $26.3 million in major overhauls and inspections of components of hull, propulsion and generators completed in the nine months ended December 31, 2016 or currently underway include:

- $5.2 million for the *Coastal Renaissance*;
- $3.3 million for the *Queen of Alberni*;
- $3.3 million for the *Queen of Cowichan;*
- $2.6 million for the *Bowen Queen*;
- $1.9 million for the *Queen of Surrey*;
- $1.8 million for the *Quinitsa;*
- $1.7 million for the *Northern Expedition*;
- $1.6 million for the *Kahloke*;
- $1.3 million for the *Northern Adventure*;
- $1.1 million for the *Coastal Celebration;* and
- $2.5 million for the *Spirit of Vancouver Island, Spirit of British Columbia, Tachek, Queen of Cumberland* and the *Skeena Queen.*

On March 24, 2016, we announced the award of a contract 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*. In the first quarter of fiscal 2017, expenditures of $13.1 million mainly consisted of the second milestone payment in accordance with the contract payment schedule for the vessels. The mid-life upgrade of the *Spirit of British Columbia* is expected to be completed during the spring of 2018 and the mid-life upgrade of the *Spirit of Vancouver Island* is expected to be completed the following year. We expect the conversion of these vessels to result in substantial savings, as LNG costs considerably less than marine diesel. We also expect the conversion to result in significant environmental benefits, such as reducing carbon dioxide emissions.

A $5 million project upgrade for the *Queen of Cowichan* included upgrades to the mechanical and electrical equipment and standardization of the bridge. The *Queen of Cowichan* returned to service in December 2016.

Fiscal 2017 is the first year of a three-year program to upgrade vessels with new navigational equipment. This year we expect to spend $4 million on upgrading the radar equipment, voyage data recorders and gyro compasses on several vessels to take us towards bridge standardization and further improve navigational safety.

A $4 million project upgrade for the *Queen of Alberni* includes upgrades to the elevator, lighting and the electrical equipment and standardization of the bridge. This project is expected to complete in the fourth quarter of fiscal 2017.

A $6 million project for a three-quarter life upgrade of the *Queen of Surrey* included upgrades to the electrical system, the fire protection system, the elevator and the propulsion, improvements to the pet area and replacement of the emergency generator. The *Queen of Surrey* returned to service in April 2016.

An $18 million major upgrade and refit to the *Queen of Cumberland* included steelwork, upgrades to the propulsion system, passenger accommodation improvements, bridge standardization and safety improvements. The *Queen of Cumberland* returned to service in April 2016.

Other projects include life-saving equipment for the *Northern Adventure* and spare right-angle drive units for the *Queen of Skeena* and the *Island Sky*.

**Information Technology**

Capital expenditures for information technology in the three and nine months ended December 31, 2016 included the following:

| ($ millions) | December 31, 2016 | |
|---|---|---|
| | 3 months | 9 months |
| Customer service program | 1.5 | 10.7 |
| Hardware upgrades | 1.1 | 3.0 |
| Fare flexibility and digital experience initiative | 0.9 | 2.9 |
| Payroll system replacement | 0.4 | 2.8 |
| Operations and security center applications | 0.8 | 1.5 |
| Payment card process enhancement | 0.5 | 1.4 |
| Other projects | 1.3 | 2.2 |
| | 6.5 | 24.5 |

Our customer service program will replace our aged point–of-sale, website, e-commerce platform and reservations systems and allow us to respond in a more timely fashion to changing business needs and to support marketing, travel services and pricing initiatives. The main elements of this multi-year program will be implemented in stages, which began with the installation of the customer relationship management application in 2015. Other elements including software which will allow online bookings, the second phase of the customer relationship management system and the architecture to facilitate integration between the systems were installed by the end of the second quarter of fiscal 2017. We believe this program will significantly improve our transaction processing and enhance our ability to efficiently respond to the changing needs of our customers.

Hardware upgrades include the replacement of aged computers, printers, servers, routers, closed-circuit cameras, antennas, handhelds and digital signage.

Our Fare Flexibility and Digital Experience Initiative will introduce a new system to manage fares and provide customers with a modernized e-commerce platform with greater online functionality and booking options.

Our payroll system replacement is complete. This initiative replaced our legacy payroll and labour distribution systems and provides processing efficiencies and flexibility.

Our operation and security centre application upgrade includes both hardware and software to enhance our ability to response to operational, engineering and security incidents and service interruptions.

Our payment card process enhancement project includes designing and implementing an integrated solution for data processing streams of each application that accepts payments. The first phase was completed in the fall of 2015 and the second phase of our customer payment solution is scheduled to complete in the fall of 2017.

Other projects include upgrading our safety management system and dangerous goods information software.

**Terminal Marine Structures**
Capital expenditures for terminal marine structures in the three and nine months ended December 31, 2016 included the following:

| ($ millions) Terminal | Description | December 31, 2016 3 months | 9 months |
|---|---|---|---|
| Langdale | Replace dolphin and gangways | 2.0 | 4.6 |
| Tsawwassen | Berth rebuild | 0.1 | 4.4 |
| Long Harbour | Life extend trestle and dolphin | - | 0.9 |
| Various | Other projects | 0.6 | 1.4 |
| | | 2.7 | 11.3 |

At Langdale terminal, a $14 million project to replace four dolphins, the baffle wall and catwalk with a floating pontoon is underway. This project is expected to be completed by the end of the first quarter in fiscal 2018.

At Tsawwassen terminal, a $13 million project to replace a tower, abutment, ramp, dolphins, and wingwalls is complete.

At Long Harbour terminal, a $3 million project to life extend the trestle and dolphin, modify the apron (to accommodate a Salish class vessel), upgrade the hydraulics and stabilize the shoreline is underway. This project is expected to be completed by the end of fiscal 2017.

Other projects currently in progress include upgrades at Village Bay, Blubber Bay, Chemainus, Thetis Island, and Prince Rupert terminals.

**Terminal and Building Upgrades and Equipment**
Capital expenditures for terminal and building upgrades and equipment in the three and nine months ended December 31, 2016 included the following:

| ($ millions) | December 31, 2016 | |
|---|---|---|
| | **3 months** | **9 months** |
| Vehicles and other equipment | 0.9 | 2.1 |
| Escalator and elevator upgrades at various terminals | 0.2 | 0.7 |
| Waiting shelter and upgrade water supply at Whaletown terminal | - | 0.5 |
| Richmond maintenance facility | 0.3 | 0.5 |
| Signage standardization | 0.1 | 0.4 |
| Waiting room and upgrade to water treatment at Denman East terminal | 0.3 | 0.3 |
| Other terminal projects | 1.3 | 2.4 |
| | 3.1 | 6.9 |

Vehicles and other equipment include a generator, welding trucks, tow tractors and a forklift at our maintenance facility.

An $8 million project is underway to upgrade escalators and elevators at our Horseshoe Bay, Tsawwassen, Departure Bay and Swartz Bay terminals.

A $1 million project at Whaletown to replace the waiting shelter and to upgrade the water supply was completed in July 2016.

At our Richmond maintenance facility, a major project to seismically upgrade existing buildings, modernize underground infrastructure, and build a centralized shop and life raft servicing centre is in its early stages of design.

Several signage standardization projects are in progress, including way-finding signage at Duke Point, Departure Bay and various minor terminals.

Other projects include a project at our Richmond maintenance facility to build a new parking lot, as well as upgrades at Langdale, Buckley Bay, Hornby, Denman East and Denman West terminals.

## ***OUTLOOK***

There is a fair amount of uncertainty in the market and mixed opinions regarding the impact the new US administration will have on the Canadian economy. We remain confident that as long as the Canadian dollar stays low and oil prices continue at current levels, the fundamentals impacting our traffic will remain favourable, and we should continue to see traffic growth; at least in the near-term. We are continuing our cost containment program, while maintaining safe, reliable service. We will continue to invest in our vessel, marine, terminal and information system infrastructure, as well as our training, safety and maintenance programs.

We continue to explore strategies to create an affordable and sustainable ferry system beyond fiscal 2017 by optimizing our service routes, standardizing our vessels, optimizing our fuel consumption, and reducing our environmental impact. We also continue to look for ways to diversify our revenue sources, increase operational efficiencies, and leverage opportunities for federal infrastructure funding and provincial incentive funding to renew our fleet and terminals.

As a result of the Province's announcement of its intent to start providing direct ferry service between Port Hardy and Bella Coola beginning in the summer of 2018, we commenced the search for a suitable vessel. On December 8, 2016, we executed a letter of agreement with the Province that formalizes its intention to start seasonal direct ferry service between Port Hardy and Bella Coola beginning in the summer of 2018. The letter of agreement sets out the expected level of service to be provided and the respective commitments of BC Ferries and the Province to work towards bringing this new service into operation. This new service will require acquiring a suitable vessel, having it approved by Transport Canada and modifying docks as necessary. An amendment to the CFSC will need to be agreed to in respect of the specific service to be delivered and the corresponding service fees to be paid by the Province.

**Traffic**

Overall, vehicle traffic increased 4.1% and passenger traffic increased 3.0% in the nine months ended December 31, 2016 compared to the same period in the prior year. Traffic levels are discussed above in "Financial and Operational Overview".

With the lower value of the Canadian dollar relative to the US dollar, we believe that passenger and vehicle traffic will remain strong in the near-term, sustaining the improved discretionary traffic levels we have experienced in the current fiscal year.

**Financial Performance**

We expect positive net earnings in fiscal 2017, reflecting continued increases in discretionary traffic due to the low Canadian dollar and cost of fuel, offset somewhat by a slight decrease in traffic primarily due to the timing of Easter and an increase in total expenses.

We expect an increase in total revenue in fiscal 2017, reflecting higher traffic levels, higher net retail revenues and higher ferry transportation fees, partially offset by the net cost of pricing promotions. The April 1, 2016 tariff increases had a net zero impact as they were offset by an equal increase in fuel rebates.

We expect an increase in total expenses in fiscal 2017, reflecting higher wage and benefit costs resulting from the implementation of the new Collective Agreement, the introduction of new assets into service and higher fuel and wage costs resulting from additional round trips provided, partially offset by lower vessel maintenance costs and cost savings from the introduction of our new cable ferry and other operational related efficiencies. We continue to manage our costs prudently without compromising safe operations.

During the last half of the month of March, we will be offering a 50% discount on regular passenger fares, on select sailings across our fleet. Children aged 11 and under will travel free. We believe this promotion will help shift traffic to sailings that typically run with lower capacity utilization. We are considering future pricing promotions.

**Asset Renewal Program**

Our 12-year capital plan, covering fiscal 2015 through 2026, consists of $3 billion to replace 14 aged vessels, execute mid-life upgrades for the Spirit class vessels as well as upgrades and modifications for other vessels, make significant improvements at our terminals, and renew our information technology infrastructure.

Fleet renewal is a top priority of the capital plan. The typical life span of vessels is 40 to 45 years. We are currently operating 34 vessels with an average age of 34 years and, of these, 14 are 45-years old or older. From time to time, our aging fleet can experience mechanical issues that may have environmental and customer service impacts. The 52-year old *Queen of Burnaby*, which has been removed from service several times in the last two years due to a persistent problem with the seal around the propeller shaft, will be replaced with the *Salish Orca*, the first of the new Salish class vessels.

*Salish Class*

In July 2014, we entered into contracts with Remontowa Shipbuilding S.A. in Gdansk, Poland to build three new Salish class vessels. Each vessel will have the capacity to carry approximately 144 vehicles and be designed to operate as dual-fuel capable, so they can run predominantly on LNG with marine diesel fuel as a backup. These vessels will set a new standard of efficiency with standardized bridges, engine rooms and life-saving equipment moving us to a higher safety standard and improving interoperability. The Remontowa contracts, with a total value of $165 million, form the majority of the total project budget of $206 million. The original project budget of $252 million has been reduced by $46 million reflecting the elimination of tariffs to import the vessels into Canada. These contracts are design-build, fixed price contracts that provide us with substantial guarantees related to delivery dates, performance criteria, cost certainty and quality of construction.

On January 11, 2017, the *Salish Orca* arrived in British Columbia after its 50 day, 10,440 nautical mile journey from Gdansk, Poland and on January 18, 2017, we signed the Protocol of Delivery and Acceptance with Remontowa Shipbuilding S.A. and ownership of the vessel transferred to us. On February 3, 2017, we conditionally accepted our new vessel, the *Salish Eagle* from Remontowa Shipbuilding S.A. and on February 11, 2017, the vessel departed Gdansk, Poland for its voyage to Canada. The *Salish Raven* is scheduled for delivery in the first quarter of fiscal 2018. FortisBC Energy Inc. has committed to provide us with $6 million in incentive funding for the new vessels to help offset incremental capital costs associated with the use of LNG. We received the first payment of $1.5 million in fiscal 2015. This funding for the Salish class vessels is to help offset incremental capital costs associated with the use of LNG.

*Spirit Class Mid-life Upgrades*

On March 24, 2016, we announced the award of a contract totalling $140 million to Remontowa Ship Repair Yard S.A. of Gdansk, Poland to conduct the mid-life upgrades, including conversion to dual-fuel, of our two largest vessels, the *Spirit of Vancouver Island* and the *Spirit of British Columbia*. The upgrade of the *Spirit of British Columbia* is expected to be completed during the spring of 2018 and the upgrade of the *Spirit of Vancouver Island* is expected to be completed the following year. The conversion of these vessels is expected 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. 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.

*Minor Vessel Replacements*

On July 29, 2016, we issued a request for proposal for the construction of two, and possibly a third, minor class roll-on/roll-off passenger ferries, each with a capacity of up to 300 passengers and approximately 44 vehicles. We are currently evaluating the responses we received and expect to award a contract in the last quarter of fiscal 2017. 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*, subject to satisfying regulatory requirements. On January 3, 2017, we submitted an application, under Section 55 of the Act, to the Commissioner seeking approval of a major capital expenditure to acquire two new minor class vessels. In the application, the proposal is to deploy the first new vessel to run from Powell-River to Texada Island and the other new vessel to run from Port McNeill to Alert Bay to Sointula.

*Major Customer Service Initiatives*

Our customer service program will replace our aged point of sale, website, e-commerce platform and reservations systems and allow us to respond in a more timely fashion to changing business needs and to support marketing, travel services and flexible pricing initiatives. Our Fare Flexibility and Digital Experience Initiative will introduce a new system to manage fares and provide customers with a modernized e-commerce platform with greater online functionality and booking options.

We believe our information technology systems must be significantly improved to evolve our business model. The rigid technology systems we currently use limit our ability to design attractive and relevant pricing at a sailing level. The Fare Flexibility and Digital Experience Initiative will introduce a new system to manage fares at a sailing level, improve operational efficiency through better capacity management, provide customers with greater online functionality and booking options, and provide better access for mobile, tablet and desktop channels.

Elements including software which will allow online bookings, the second phase of the customer relationship management system and the architecture to facilitate integration between the systems completed in the second quarter of fiscal 2017 with further enhancements expected over the next few years.

## *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 61 through 64 of our fiscal 2016 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the nine months ended December 31, 2016. Our 2016 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

## *BUSINESS RISK MANAGEMENT*

Understanding and managing operational risk is an important part of our business. We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business. A discussion of enterprise wide risk management can be found on pages 65 through 71 of our fiscal 2016 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the nine months ended December 31, 2016. Our 2016 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, 2016 and December 31, 2016 consolidated financial statements. Certain of these policies involve critical accounting estimates because they require us to make particularly subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts could be reported under different conditions or using different assumptions. These judgements, estimates and assumptions are subject to change as new events occur, as more experience is acquired, as additional information is obtained and as the general operating environment changes.

Discussion of the most critical accounting policies and estimates that we have used in the preparation of our consolidated financial statements can be found on pages 72 and 73 of our fiscal 2016 Management's Discussion & Analysis. The following describes the changes to critical accounting policies we have used in the preparation of our consolidated financial statements for the nine months ended December 31, 2016, or expect to use in the future. Our 2016 Management's Discussion & Analysis is available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html.

**Adoption of New Accounting Standards**
The following is a discussion of changes in accounting standards that we adopted effective April 1, 2016:

Amendments to IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*, explicitly state that revenue-based methods of depreciation cannot be used for property, plant and equipment. The application of these amendments did not have any impact on our interim consolidated financial statements.

The IASB has published a *Disclosure Initiative (Amendments to IAS 1)* with narrow-scope amendments clarifying IAS 1 to address perceived impediments to preparers exercising their judgement in preparing their financial reports. The application of this standard did not have any impact on our interim consolidated financial statements. Any immaterial disclosures are expected to be removed from our annual consolidated financial statements.

The IASB published amendments to IAS 7 *Statement of Cash Flows*. These amendments require a disclosure of changes in liabilities arising from financing activities, including changes arising from cash flows and non-cash changes. The mandatory effective date is April 1, 2017. We early adopted, as permitted. The application of these amendments did not have any impact on our interim consolidated financial statements, other than additional disclosure as presented in note 4 to our December 31, 2016 unaudited financial statements.

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

IFRS 15 *Revenue from Contracts with Customers* replaces IAS 18 *Revenue* and IAS 11 *Construction Contracts*, providing guidance on the amount and/or timing of recognition of revenue. IFRS 15 will be effective for us April 1, 2018. Earlier application is permitted. We are in the process of analyzing our revenues and assessing the financial reporting impact of the adoption of this standard. Although we have made progress in our analysis using the IFRS 15 five-step model as the basis to recognition revenue, we have not yet quantified the impact of the new standard on our financial statements.

IFRS 9 *Financial Instruments* (2014) introduces a new expected credit loss model for calculating impairment, and incorporates guidance on the classification and measurement of financial assets and the final general hedge accounting requirements originally published in IFRS 9 (2013). Mandatory adoption of IFRS 9 (2014) for us will be April 1, 2018. We adopted *IFRS 9 Financial Instruments* (2013) in fiscal 2015 and as such will only be impacted by the expected credit loss model when we adopt IFRS 9 (2014). This model applies to our trade receivables and long-term loan receivable. We are in the process of determining the expected credit loss provision needed.

IFRS 16 *Leases* introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all assets with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. This standard will be effective for us April 1, 2019. Early adoption is permitted if IFRS 15 *Revenue from Contracts with Customers* has also been applied. Our audited consolidated financial statements for the year ended March 31, 2016 disclosed our future lease commitments of $3.4 million, representing 15 leases. We are in the process of reviewing our leases and assessing the financial reporting impact of the adoption of this standard.

## *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 US 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, tourism, traffic levels, fuel prices, fiscal 2017 net earnings, recertification of the COR from WorkSafe BC, and the seasonal direct ferry service between Port Hardy and Bella Coola; our short-term and long-range business plans, capital expenditure levels, and asset renewal programs for vessels and terminals; our customer service program, pricing promotions, and Fare Flexibility and Digital Experience Initiative; our Salish Class vessels, the loan agreement with KfW IPEX-Bank GmbH, LNG plans, the agreement with FortisBC Energy Inc. regarding incentive funding, Spirit Class mid-life upgrades, minor vessel replacements, and safety, environmental, and training projects; our expectations regarding food sales, and sales of quality apparel; and total revenue and expense projections, and how our cash requirements will be met in the near term. 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 Nation 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.