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

For the three and six months and ended September 30, 2019

Dated November 22, 2019

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The following is our discussion and analysis of the financial condition and financial performance of British Columbia Ferry Services Inc. ("BC Ferries" or the "Company") for the three and six months ended September 30, 2019 that has been prepared with information available as of November 22, 2019. This discussion and analysis should be read in conjunction with our unaudited condensed interim consolidated financial statements and related notes for the six months ended September 30, 2019 and 2018, and our audited consolidated financial statements and related notes for the years ended March 31, 2019 ("fiscal 2019") and March 31, 2018 ("fiscal 2018"), together with our Management's Discussion and Analysis for fiscal 2019. These documents are available on our investor webpage at http://www.bcferries.com/investors/financial_reports.html and on SEDAR at www.sedar.com.

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

BUSINESS OVERVIEW

British Columbia Ferry Services Inc. is an independent company, providing passenger and vehicle ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world. We provide frequent year-round transportation service, with 35 vessels operating on 25 routes out of 47 terminals spread over 1,600 kilometres of coastline. We also manage ferry transportation services 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.

Our principal business of ferry transportation requires positive net earnings and ongoing access to capital in order to fund operations, satisfy outstanding long-term debt obligations and fulfill future capital asset obligations.

During the three months ended September 30, 2019 (the second quarter of fiscal 2020), we provided over 48,000 sailings, carrying 7.7 million passengers and 2.9 million vehicles. We experienced a 1.5% decrease in passenger traffic and a 0.1% increase in vehicle traffic compared to the same quarter in the prior year. Year-to-date, we have carried 13.5 million passengers and 5.3 million vehicles, an increase of 0.1% and 1.2%, respectively, compared to the same period in the prior year. For a discussion of our traffic levels, see "Financial and Operational Overview" below.

Our Major Routes, which are our four busiest routes, consist of three regulated routes connecting Metro Vancouver with mid and southern Vancouver Island and one regulated route connecting Horseshoe Bay and Langdale. Our Northern Routes currently consist of three regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island. Our Other Routes consist of 18 regulated routes and 8 unregulated routes primarily serving the northern and southern Gulf Islands and the northern Sunshine Coast.

Significant events during or subsequent to the second quarter of fiscal 2020 include the following:

Vessels

- On October 18, 2019, the British Columbia Ferries Commissioner (the “Commissioner”) issued Order 19-02B, approving a supplementary application to amend the approved major capital expenditure amount for the construction and introduction of one new Salish Class vessel and four new Island Class vessels. The initial Order 19-02 granted on January 7, 2019, and Order 19-02B are available on the Commissioner’s website at www.bcferrycommission.com.

- On October 25, 2019, contracts became effective with Damen Shipyard Group of Netherlands for the construction of four new Island Class vessels expected to enter service during fiscal 2023. These four vessels are in addition to the two Island Class vessels which are expected to enter service in fiscal 2021. The Island Class vessels will be outfitted with hybrid diesel-electric propulsion and will each have a capacity of up to 450 passengers and approximately 47 vehicles. The total project budget for the four additional vessels, including financing and project management costs, is approximately $200 million.

General

- On September 5, 2019, we provided additional information to the Commissioner which outlined our concerns with the preliminary price caps for performance term five (“PT5”), being the four year period commencing on April 1, 2020 and ending on March 31, 2024. This information is in addition to the original PT5 submission which was submitted to the Commissioner on September 28, 2018.

- On September 30, 2019, the Commissioner issued Order 19-04 which established final price cap increases of 2.3% for each of the four years of PT5. Order 19-04 also:
    - maintains the existing fuel deferral accounts;
    - sets an efficiency target equivalent to 1% of annual operating, maintenance and administration costs; and
    - sets the price per litre for the operation of the fuel deferral accounts at $1.03 per litre for marine diesel and 46.9 cents per litre for LNG in the first year of PT5, inflated in each case by 2% per year for the balance of PT5. The set price per litre is a required input into the calculation of fuel surcharges or rebates. (See “Accounting Practices – The Effect of Rate Regulation” for more detail on price caps.)

  Also on September 30, 2019, the Commissioner released a performance review of the efficiency of BC Ferries prepared by PwC. The report concludes that, BC Ferries is exhibiting good cost control, and should continue the current efforts to manage costs and increase efficiencies. These documents are available on the Commissioner’s website at: www.bcferrycommission.ca.

- On October 15, 2019, we completed a private placement of $250 million of 30-year senior secured bonds. These bonds bear interest at a rate of 2.794% per annum, payable semi-annually. The net proceeds of this new issue will be used, together with additional cash on hand, to provide for capital expenditures, general corporate purposes and to fund the series reserve account. These bonds were rated “A (high)” by DBRS and “AA-” by Standard & Poor’s (“S&P”).

FINANCIAL AND OPERATIONAL OVERVIEW

This section provides an overview of our financial and operational performance for the three and six month periods ended September 30, 2019 and 2018.

($ millions)	Three months ended September 30			Six months ended September 30		
	2019	**2018**	**Variance**	**2019**	**2018**	**Variance**
Total revenue	329.3	315.8	13.5	575.7	545.5	30.2
Operating expenses	220.7	211.2	9.5	441.1	421.1	20.0
Operating profit	108.6	104.6	4.0	134.6	124.4	10.2
Net finance and other	13.6	13.7	(0.1)	27.4	27.5	(0.1)
Net earnings	95.0	90.9	4.1	107.2	96.9	10.3
Other comprehensive (loss) income	(4.0)	1.4	(5.4)	(4.0)	9.3	(13.3)
Total comprehensive income	91.0	92.3	(1.3)	103.2	106.2	(3.0)

Our net earnings in the three months ended September 30, 2019 were $4.1 million higher ($10.3 million year-to-date) than the same period in the prior year.

In the three months ended September 30, 2019, revenues increased by $13.5 million or 4.3% ($30.2 million or 5.5% year-to-date) compared to the same period in the prior year, primarily as a result of the expanded service of the Central Coast seasonal route and increases in average vehicle tariff yield, ferry transportation fees, and net retail sales. On April 1, 2019, fares on all routes were held at the fiscal 2019 level.

In addition, a fuel surcharge was implemented June 1, 2019 due to fuel price market conditions.

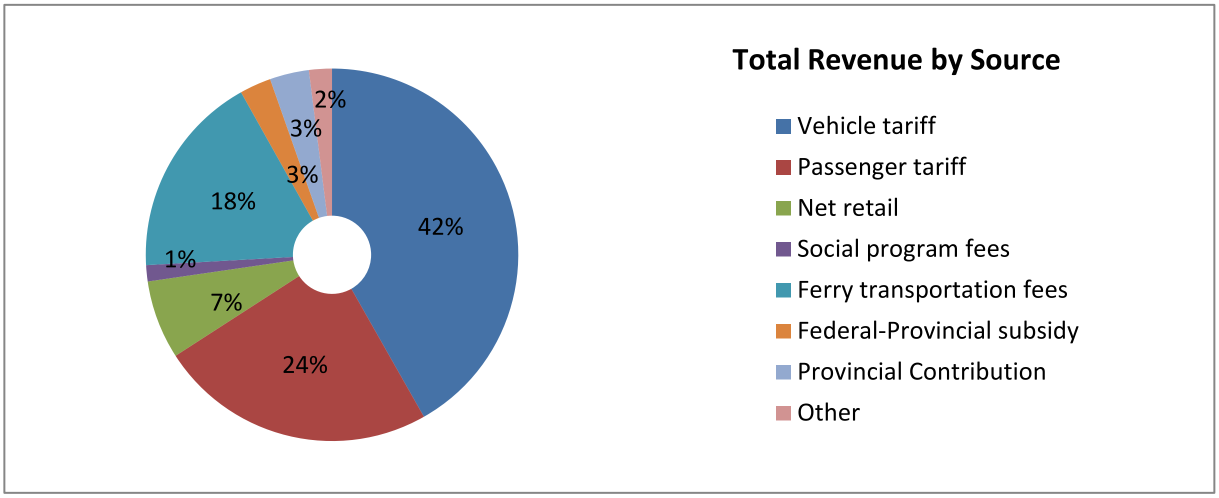
In the three months ended September 30, 2019, operating expenses increased by $9.5 million or 4.5% ($20.0 million or 4.7% year-to-date) compared to the same period of the prior year. We provided 391.5 (1,094 year-to-date) additional round trips compared to the same period in the prior year to satisfy increased service levels agreed to with the Province, accommodate the higher traffic volumes over the Easter holidays, and improve our customer experience. We introduced the *Northern Sea Wolf* and re-introduced the upgraded *Spirit of Vancouver Island* into service. These actions resulted in an increase in labour costs and a decrease in marine diesel fuel consumption. The increase in operating expenses also included the impact of wage rate increases in accordance with the Collective Agreement with the BC Ferry & Marine Workers' Union (the "Union"), higher benefit costs (Employer Health Tax, Workers Compensation and pension), and higher depreciation. (See "Expenses" for more detail.)

During the three months ended September 30, 2019, total comprehensive income decreased $1.3 million ($3.0 million year-to-date) compared to the same period in the prior year, comprised of a decrease in other comprehensive income of $5.4 million ($13.3 million year-to-date) and an increase in net earnings of $4.1 million ($10.3 million year-to-date).

In the three months ended September 30, 2019, the decrease in other comprehensive income of $5.4 million reflects a $5.3 million decrease in the change in fair value of our open fuel swap contracts and $0.1 million loss on the actuarial valuation of our employee benefit plan. Year-to-date, the decrease in other comprehensive income of $13.3 million reflects a $13.2 decrease in the change in fair value of our open fuel swap contracts and $0.1 million loss on the actuarial valuation of our employee benefit plan.

Revenue and Operational Statistics - Overall

The following discussions of revenue are based on IFRS results, with reference to the impacts of rate regulation (See "Accounting Practices - The Effect of Rate Regulation"). Our Major Routes, which are our four busiest routes, consist of three regulated routes connecting Metro Vancouver with mid and southern Vancouver Island and one regulated route connecting Horseshoe Bay and Langdale. Our Northern Routes consist of three regulated routes, including the new route connecting Port Hardy and Bella Coola which commenced in fiscal 2019, operating on the British Columbia coast north of Port Hardy on Vancouver Island. Our Other Routes consist of 18 regulated routes and 8 unregulated routes primarily serving the northern and southern Gulf Islands and the northern Sunshine Coast.



Fuel rebates and surcharges are not included in the above total revenue by source. Rebates and surcharges are recorded in our fuel deferral accounts for rate regulatory purposes as they are implemented as a direct result of rising and declining fuel prices.

Select operational statistics and total revenues for the three and six months ended September 30, 2019 and 2018 are shown in the tables below.

Operational Statistics	Three months ended September 30		Six months ended September 30	
	2019	2018	2019	2018
Vehicle traffic	2,899,775	2,897,321	5,260,051	5,199,018
Passenger traffic	7,718,168	7,834,538	13,547,077	13,539,854
On-time performance	85.2%	83.6%	86.0%	85.1%
Number of round trips	22,066.5	21,675.0	42,656.0	41,562.0
Capacity provided (AEQs)	4,420,082	4,400,431	8,381,007	8,274,277
AEQs carried	3,258,099	3,254,960	5,941,810	5,878,156
Capacity utilization	73.7%	74.0%	70.9%	71.0%

During the three months ended September 30, 2019, vehicle traffic increased 0.1% (1.2% increase year-to-date) and passenger traffic decreased 1.5% (0.1% increase year-to-date) compared to the same quarter in the prior year. We believe passenger and vehicle traffic were negatively impacted by a 15.5% (14.2% year-to-date) decrease in the number of tour buses using our ferry services compared to the same period in the prior year. Year-to-date, we believe this was somewhat offset by holding fares at fiscal 2019 levels and two more days of Easter holidays falling in the first quarter of fiscal 2020.

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 departure 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 arrival time. In each case, on-time performance can be impacted by delays due to weather, vessel substitution, mechanical issues, terminal dock maintenance or closures and periods of high traffic demand.

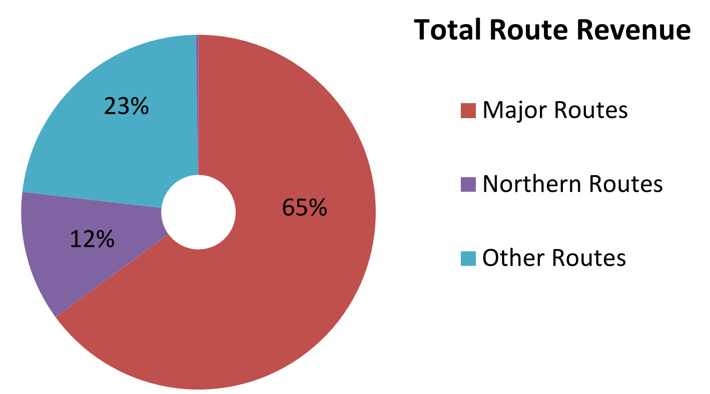
Meeting customer service expectations in a safe and reliable manner is the principal factor guiding our focus on on-time performance. Our initiatives to improve on-time performance include adjusting and/or expanding sailing schedules, adjusting crewing schedules and refining vehicle loading processes during peak periods. In the three months ended September 30, 2019, overall on-time performance improved 1.6% (0.9% year-to-date) compared to the same period in the prior year.

An automobile equivalent ("AEQ") is our standard unit of measure for an approximation of one car length. AEQs are calculated by using a conversion factor for each vehicle type. For example, a passenger vehicle would be one AEQ while a bus would be three AEQs. The change in AEQs from one period to the next may not be proportionate to the change in vehicle traffic, due to variations in the mix of vehicle types (the relative number of buses, commercial vehicles and passenger vehicles) and actual size of vehicles carried.

Vehicle capacity provided, measured in AEQs, is the available vehicle deck space on a vessel multiplied by the number of round trips. The Coastal Ferry Services Contract ("CFSC") stipulates, among other things, the minimum number of round trips to be provided for each regulated ferry service route in exchange for the payment of ferry transportation fees by the Province. The year over year change in the number of round trips provided can be impacted by cancellations and in response to changes in demand or the number of trips stipulated by the CFSC. In the three months ended September 30, 2019, we provided 391.5 (1,094 year-to-date) additional round trips compared to the same period in the prior year, resulting in an increase in capacity provided.

Capacity utilization in a period 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 74.0% to 73.7% for the three months ended September 30, 2019 (from 71.0% year-to-date to 70.9%), compared to the same period 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.

Revenue ($ millions)	Three months ended September 30			Six months ended September 30		
	2019	**2018**	**Increase (Decrease)**	**2019**	**2018**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	135.2	131.0	4.2	240.4	233.3	7.1
Passenger tariff	81.3	82.1	(0.8)	138.6	138.3	0.3
Net retail	23.1	22.4	0.7	39.3	37.4	1.9
Social program fees	3.6	3.5	0.1	8.1	8.0	0.1
Other revenue	3.6	3.3	0.3	6.6	6.1	0.5
Fuel surcharge (rebate)	3.0	(0.1)	3.1	3.8	(4.6)	8.4
Total Direct Route Revenue	249.8	242.2	7.6	436.8	418.5	18.3
Indirect Route Revenue						
Ferry transportation fees	59.5	55.9	3.6	102.2	94.4	7.8
Federal-Provincial subsidy	7.9	7.7	0.2	15.7	15.3	0.4
Provincial contribution: Tariffs	7.9	6.0	1.9	13.6	10.2	3.4
Provincial contribution: Seniors	3.4	3.1	0.3	6.0	5.7	0.3
Total Route Revenue	328.5	314.9	13.6	574.3	544.1	30.2
Other general revenue	0.8	0.9	(0.1)	1.4	1.4	-
Total Revenue	329.3	315.8	13.5	575.7	545.5	30.2



In the three months ended September 30, 2019, the greatest portion of our revenues (65%) was earned on our Major Routes. Revenue from the Northern Routes contributed 12% and revenue from Other Routes contributed 23%.

Vehicle tariffs (which include reservation fee revenue) and passenger tariffs account for the majority of our revenues. Our year-over-year tariff revenues are impacted by factors such as changes in overall traffic levels, traffic types and average tariff yields.

Net retail sales is our second largest source of direct revenue and provides a gross margin of approximately 60%, which contributes favourably to our net earnings and helps to keep fares affordable. Catering, retail and other on-board services are impacted by traffic levels, price, service quality and product offerings.

On April 1, 2019, fares on all routes for fiscal 2020 were held at the fiscal 2019 level. For fiscal 2019, we applied a fare reduction of 15% on the Northern Routes, the regulated Other Routes and on the Major Route connecting Horseshoe Bay and Langdale. Fares were held constant on the three Major Routes connecting Metro Vancouver with mid and southern Vancouver Island. In addition, the BC seniors' passenger discount for fiscal 2019 increased from 50% to 100% for travel Monday to Thursday on the Major and Other Routes. The total value of these initiatives over two years is approximately $98 million, of which BC Ferries will contribute $39 million in foregone revenue. The Province partially funded the fare reductions and the increase to the BC seniors' discount with a contribution of $26.5 million in fiscal 2019 and will contribute $32.5 million in fiscal 2020. In the three months ended September 30, 2019, $11.3 million ($19.6 million year-to-date) of the $32.5 million was recognized as revenue compared to $9.1 million ($15.9 million year-to-date) in the same period in the prior year. In the three months ended September 30, 2019, the number of BC seniors travelling with the discount increased 7.1% (6.7% year-to-date) compared to same period in the prior year.

From time to time, we implement fuel surcharges as a result of rising fuel prices or rebates as a result of falling fuel prices. In fiscal 2019, fuel rebates of 1.9% on the Northern Routes and 2.9% on our Major and regulated Other Routes were in place until they were discontinued, effective June 27, 2018. On June 1, 2019 (fiscal 2020), we implemented a fuel surcharge of 1.5% on average on all routes with the exception of the Northern Routes. For the purpose of rate regulation, surcharges and/or rebates are applied to our deferred fuel cost accounts. (See “Accounting Practices - The Effect of Rate Regulation” for more detail.)

Effective April 1, 2019, we reached an agreement with the Province to amend service levels to include over 2,700 additional trips for which the Province will contribute an incremental aggregate amount not to exceed $5.8 million per year. In fiscal 2020, over 1,700 additional trips will be provided and the Province is expected to pay an additional $3.8 million in ferry transportation fees. In the three months ended September 30, 2019, $1.0 million ($1.6 million year-to-date) was recognized as revenue for 220 (519 year-to-date) additional trips.

Year to year changes in revenue and operational statistics for the three months ended September 30, 2019 and 2018 for the Major, Northern and Other Routes are discussed separately below.

Revenue and Operational Statistics - Major Routes

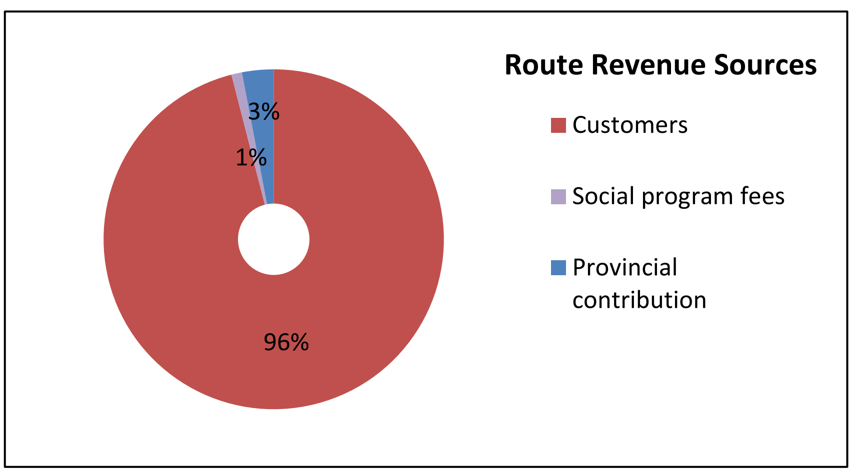
Our Major Routes consist of our four busiest routes, carrying approximately 60% of our total vehicle traffic and 65% of our total passenger traffic, generating approximately 85% of our direct route revenue.

Operational Statistics	Three months ended September 30		Six months ended September 30	
	2019	2018	2019	2018
Vehicle traffic	1,736,523	1,748,243	3,099,543	3,098,991
Passenger traffic	5,026,182	5,139,097	8,696,396	8,781,813
On-time performance	83.7%	76.9%	81.9%	79.9%
Number of round trips	3,985.0	3,972.0	7,430.0	7,373.0
Capacity provided (AEQs)	2,486,288	2,474,224	4,626,310	4,592,308
AEQs carried	2,009,755	2,023,728	3,621,089	3,625,361
Capacity utilization	80.8%	81.8%	78.3%	78.9%

Over the three months ended September 30, 2019, vehicle traffic decreased 0.7% (0.0% year-to-date) compared to the same period in the prior year. Over the three months ended September 30, 2019 passenger traffic decreased 2.2% (1.0% year-to-date) compared to the same period in the prior year. Passenger and vehicle traffic was negatively impacted by a 16.1% (15.0% year-to-date) decrease in the number of tour buses using our ferry services compared to the same period in the prior year. Year-to-date, we believe this was somewhat offset by holding fares at fiscal 2019 levels and two more days of Easter holidays falling in the first quarter of fiscal 2020.

In the three months ended September 30, 2019, overall on-time performance on the Major Routes increased 6.8% (2.0% year-to-date) compared to the same period in the prior year. Our initiatives to improve on-time performance include adjusting and/or expanding sailing schedules, adjusting crewing schedules, changing operational procedures and refining vehicle loading processes during peak periods.

Capacity utilization decreased from 81.8% to 80.8% for the three months ended September 30, 2019 (from 78.9% year-to-date to 78.3%), compared to the same period in the prior year, as a result of an increase in capacity provided and a reduced number of AEQs carried due to a lower traffic level.



In the six months ended September 30, 2019, revenue from our Major Routes consisted of 96% from customers and the remaining 4% from the Province.

Major Routes (continued)

Revenue ($ thousands)	Three months ended September 30			Six months ended September 30		
	2019	2018	Increase (Decrease)	2019	2018	Increase (Decrease)
Direct Route Revenue						
Vehicle tariff	112,968	110,026	2,942	202,306	197,883	4,423
Passenger tariff	65,389	66,879	(1,490)	112,737	113,789	(1,052)
Net retail	19,508	19,190	318	33,912	32,668	1,244
Social program fees	1,917	1,912	5	4,291	4,275	16
Parking	2,185	2,099	86	4,057	3,836	221
Other revenue	1,167	1,065	102	2,175	1,969	206
Fuel surcharge (rebate)	2,554	(2)	2,556	3,273	(3,759)	7,032
Total Direct Route Revenue	205,688	201,169	4,519	362,751	350,661	12,090
Indirect Route Revenue						
Provincial contribution: Tariffs	3,640	2,751	889	6,482	4,873	1,609
Provincial contribution: Seniors	2,565	2,346	219	4,525	4,284	241
Total Route Revenue	211,893	206,266	5,627	373,758	359,818	13,940

In the three months ended September 30, 2019, average tariff revenue per vehicle (tariff revenue divided by traffic volume) increased $2.12 or 3.4% ($1.42 or 2.2% year-to-date) compared to the same period in the prior year, mainly as a result of increased reservations, less traffic on promotional sailings and the mix of traffic. In the three and six months ended September 30, 2019, average tariff revenue per passenger remained at $13.01 ($12.96 year-to-date) compared to the same period in the prior year. The increase in average tariff revenue and the decrease in traffic levels resulted in a total tariff revenue increase of $1.5 million ($3.4 million year-to-date) compared to the same period in the prior year.

All vessels that provide service on our Major Routes have a gift shop and options for food service. In the three months ended September 30, 2019, net retail sales increased 1.7% (3.8% year-to-date) compared to the same period in the prior year as a result of higher average sales per passenger. Food sales remain strong, providing approximately 72% of total retail revenue. Retail sales are presented net of cost of goods sold which is approximately 40% of gross retail sales.

Social program fees are reimbursements from the Province of discounts provided on fares for students travelling to and from school, persons with disabilities and persons travelling under the Ministry of Health Travel Assistance Program (“MTAP”). Social program fees for the three and six months ended September 30, 2019 increased compared to the same period in the prior year, mainly due to an increase in the usage of the MTAP program, slightly offset by a reduction in the number of students travelling under the program.

Revenue from parking increased 4.1% (5.8% year-to-date) in the three months ended September 30, 2019 compared to the same period in the prior year, as a result of higher usage.

Fuel surcharges and rebates are implemented or removed due to changes in fuel market conditions. A fuel rebate of 2.9% on our Major Routes was in place during the first quarter of fiscal 2019 until it was discontinued, effective June 27, 2018. On June 1, 2019, we implemented a fuel surcharge of 1.5% on our Major Routes.

The provincial contribution increased by $1.1 million ($1.8 million year-to-date) compared to the same period in the prior year. The provincial contribution of $6.2 million ($11.0 million year-to-date) in the three months ended September 30, 2019 consisted of $2.6 million (4.5 million year-to-date) towards the increased BC seniors’ discount and $3.6 million ($6.5 million year-to-date) for fare initiatives (a fare reduction of 15% on the Horseshoe Bay – Langdale route and fares held constant on the other three Major Routes).

Revenue and Operational Statistics - Northern Routes

Our Northern Routes currently consist of three regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island. In the fall of 2018, we started service on a new route directly connecting Port Hardy and Bella Coola.

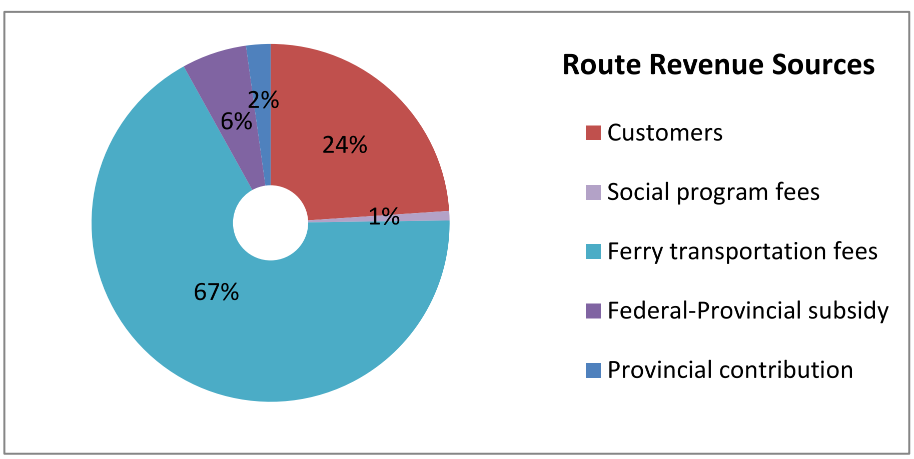
Operational Statistics	Three months ended September 30 2019	Three months ended September 30 2018	Six months ended September 30 2019	Six months ended September 30 2018
Vehicle traffic	18,047	15,392	27,004	23,240
Passenger traffic	51,052	45,516	73,668	65,788
On-time performance	88.6%	86.4%	87.4%	84.6%
Number of round trips	153.0	106.5	240.0	165.5
Capacity provided (AEQs)	24,526	24,374	37,660	36,200
AEQs carried	21,358	18,346	32,458	28,084
Capacity utilization	87.1%	75.3%	86.2%	77.6%

In the three months ended September 30, 2019, vehicle traffic increased 17.2% (16.2% year-to-date) and passenger traffic increased 12.2% (12.0% year-to-date) compared to the same period in the prior year primarily as a result of:

- the impact of the expanded service of the seasonal route connecting Port Hardy and Bella Coola;
- 15% reduction in fares introduced in the prior year; and
- two more days of Easter holidays falling in the first quarter of fiscal 2020.

On-time performance in the three months ended September 30, 2019 increased 2.2% (2.8% year-to-date) compared to the same period in the prior year, primarily due to fewer weather-related delays.

Capacity utilization on these routes during the three months ended September 30, 2019 was 11.8% (8.6% year-to-date) higher than the same period in the prior year, primarily as a result of the increase in the number of AEQs carried, somewhat offset by the increased capacity provided much of it related to the expanded service of the seasonal route.



In the six months ended September 30, 2019, revenue from our Northern Routes consisted of 24% from customers and the remaining 76% from the Province.

Northern Routes (continued)

Revenue ($ thousands)	Three months ended September 30			Six months ended September 30		
	2019	**2018**	**Increase (Decrease)**	**2019**	**2018**	**Increase (Decrease)**
Direct Route Revenue						
Vehicle tariff	4,890	3,922	968	7,169	5,814	1,355
Passenger tariff	4,656	3,895	761	6,293	5,267	1,026
Net retail	1,159	965	194	1,441	1,233	208
Social program fees	320	302	18	584	586	(2)
Stateroom rental	859	710	149	1,368	1,156	212
Hostling & other	78	12	66	139	76	63
Fuel surcharge (rebate)	-	63	(63)	-	-	-
Total Direct Route Revenue	11,962	9,869	2,093	16,994	14,132	2,862
Indirect Route Revenue						
Ferry transportation fees	30,149	26,681	3,468	46,038	39,640	6,398
Federal-Provincial subsidy	2,011	1,956	55	4,021	3,913	108
Provincial contribution: Tariffs	1,099	809	290	1,507	1,107	400
Total Route Revenue	45,221	39,315	5,906	68,560	58,792	9,768

In the three months ended September 30, 2019, average tariff revenue per vehicle (tariff revenue divided by traffic volume) increased $16.15 or 6.4% ($15.31 or 6.1% year-to-date) and average tariff revenue per passenger increased $5.63 or 6.6% ($5.36 or 6.7% year-to-date) compared to the same period in the prior year. Average tariff revenues reflect the impact of the expanded service of the Central Coast seasonal route and a change in the proportion of traffic on routes with higher versus lower tariffs. The changes in traffic levels and changes in average tariff revenue resulted in a total tariff revenue increase of $1.7 million ($2.4 million year-to-date) compared to the same period in the prior year.

Revenue from net retail services increased $0.2 million in the three and six months ended September 30, 2019 compared to the same period in the prior year, as a result of higher average sales per passenger and higher passenger traffic.

Stateroom rental revenue increased due to higher utilization.

No fuel rebate or surcharge was in place during the three and six months ended September 30, 2019 (fiscal 2020). A fuel rebate of 1.9% on the Northern Routes was in place during the first quarter of fiscal 2019 until it was discontinued, effective June 27, 2018 (fiscal 2019), due to the rise in fuel prices.

Ferry transportation fees received from the Province increased $3.5 million ($6.4 million year-to-date) in the quarter compared to the same period in the prior year, mainly as a result of differences in the monthly schedule of round trips and additional funding from the Province for the provision of additional services.

The Federal-Provincial subsidy increased based on the percentage increase in the annual Consumer Price Index ("CPI") (Vancouver).

The provincial contribution increase of $0.3 million ($0.4 million year-to-date) in the three months ended September 30, 2019 was due to a higher contribution towards the fare reduction initiative.

Revenue and Operational Statistics - Other Routes

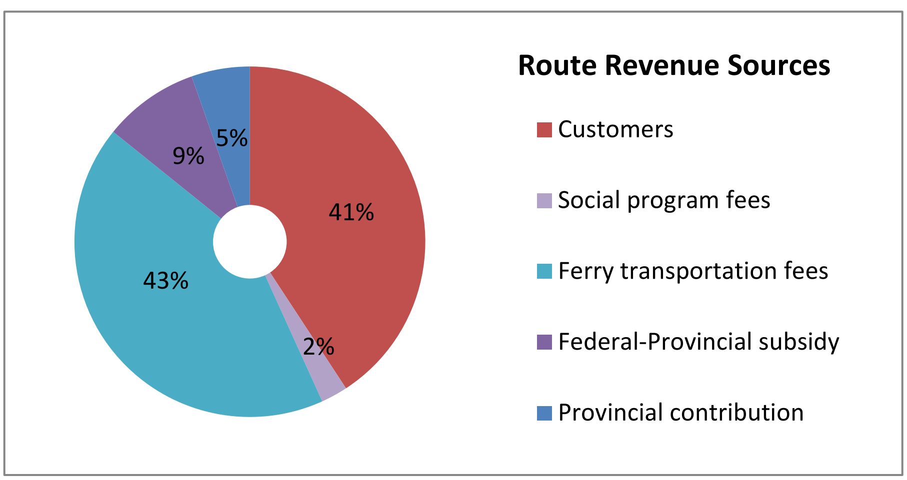
Our Other Routes primarily serve the northern and southern Gulf Islands and the northern Sunshine Coast. One of the 18 regulated routes and all eight of the unregulated routes are operated under contract by alternative service providers. We receive fees from the Province for the provision of contracted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

Operational Statistics	Three months ended September 30 2019	Three months ended September 30 2018	Six months ended September 30 2019	Six months ended September 30 2018
Vehicle traffic	1,145,205	1,133,686	2,133,504	2,076,787
Passenger traffic	2,640,934	2,649,925	4,777,013	4,692,253
On-time performance	85.5%	84.9%	86.8%	86.1%
Number of round trips	17,928.5	17,596.5	34,986.0	34,023.5
Capacity provided (AEQs)	1,909,268	1,901,833	3,717,037	3,645,769
AEQs carried	1,226,983	1,212,886	2,288,260	2,224,711
Capacity utilization	64.3%	63.8%	61.6%	61.0%

During the three months ended September 30, 2019, vehicle traffic increased 1.0% (2.7% year-to-date) and passenger traffic decreased 0.3% (1.8% increase year-to-date) compared to the same period in the prior year. We believe passenger and vehicle traffic were positively impacted by maintaining the 15% reduction in fares introduced in the prior year somewhat offset by a decrease in the number of tour buses using our ferry services. In addition there were fewer sailing disruptions and two more days of Easter holidays falling in the first quarter of fiscal 2020.

On-time performance in the three months ended September 30, 2019 increased 0.6% (0.7% year-to-date) over the same period in the prior year, primarily due to adjustments and/or expansion of sailing schedules.

Capacity utilization on these routes during the three and six months ended September 30, 2019 was slightly higher compared to the same period in the prior year, primarily due to a higher number of AEQs carried, mostly offset by an increase in capacity provided.



In the six months ended September 30, 2019, revenue from our Other Routes consisted of 41% from customers and 59% from the Province.

Other Routes (continued)

Revenue ($ thousands)	Three months ended September 30			Six months ended September 30		
	2019	2018	Increase (Decrease)	2019	2018	Increase (Decrease)
Direct Route Revenue						
Vehicle tariff	17,348	17,102	246	30,895	29,617	1,278
Passenger tariff	11,263	11,363	(100)	19,591	19,244	347
Social program fees	1,433	1,343	90	3,249	3,167	82
Net retail	1,593	1,498	95	2,616	2,325	291
Parking & other	109	98	11	181	198	(17)
Fuel surcharge (rebate)	428	(25)	453	547	(722)	1,269
Total Direct Route Revenue	32,174	31,379	795	57,079	53,829	3,250
Indirect Route Revenue						
Ferry transportation fees	29,430	29,221	209	56,202	54,797	1,405
Federal-Provincial subsidy	5,824	5,670	154	11,649	11,339	310
Provincial contribution: Tariffs	3,194	2,432	762	5,600	4,203	1,397
Provincial contribution: Seniors	831	786	45	1,510	1,449	61
Total Route Revenue	71,453	69,488	1,965	132,040	125,617	6,423

During the three months ended September 30, 2019, average tariff revenue per vehicle (tariff revenue divided by traffic volume) increased $0.06 or 0.4% ($0.22 or 1.5% year-to-date) compared to the same period in the prior year, reflecting an increase in the proportion of traffic on routes with higher versus lower tariffs. During the three months ended September 30, 2019, average tariff revenue per passenger decreased $0.02 or 0.5% and year-to-date remained on par at $4.10 compared to the same period in the prior year. The change in average tariff revenue and the overall increase in traffic levels resulted in a total tariff revenue increase of $0.1 million ($1.6 million year-to-date) compared to the same period in the prior year.

Social program fees for the three months ended September 30, 2019 increased 6.7% (2.6% year-to-date) compared to the same period in the prior year, mainly as a result of an increase in the usage of the MTAP program and a higher number of students travelling under this program.

Net retail services revenue increased in the three and six months ended September 30, 2019 compared to the same period in the prior year mainly due to higher average sales per passenger.

Fuel surcharges and rebates are implemented or removed due to changes in fuel market conditions. A fuel rebate of 2.9% on our Other Routes was in place during the first quarter of fiscal 2019 until it was discontinued, effective June 27, 2018. On June 1, 2019, we implemented a fuel surcharge of 1.5% on our Other Routes.

Ferry transportation fees received from the Province increased by $0.2 million ($1.4 million year-to-date) in the three months ended September 30, 2019 compared to the same period in the prior year, mainly as a result of differences in the monthly schedule of round trips and additional funding from the Province for the provision of additional services.

The Federal-Provincial subsidy increased based on the percentage increase in the annual CPI (Vancouver).

As previously agreed, the provincial contribution towards the fare reduction and increase to the BC seniors' discount increased by $0.8 million ($1.4 million year-to-date) compared to the same period in the prior year. The provincial contribution of $4.0 million ($7.1 million year-to-date) in the three months ended September 30, 2019 consisted of a $0.8 million ($1.5 million year-to-date) contribution towards the increased BC seniors' discount and $3.2 million ($5.6 million year-to-date) contribution towards the fare reduction initiative.

Expenses

Expenses for the three and six months ended September 30, 2019 and 2018 are summarized in the table below:

Operating expenses ($ millions)	**Three months ended September 30**			**Six months ended September 30**		
	2019	**2018**	**Increase (Decrease)**	**2019**	**2018**	**Increase (Decrease)**
Operations	152.2	142.6	9.6	292.9	278.5	14.4
Maintenance	13.4	15.7	(2.3)	39.7	37.9	1.8
Administration	9.3	9.9	(0.6)	18.0	19.7	(1.7)
Total operations, maintenance & administration	174.9	168.2	6.7	350.6	336.1	14.5
Depreciation and amortization	45.8	43.0	2.8	90.5	85.0	5.5
Total operating expenses	220.7	211.2	9.5	441.1	421.1	20.0

We provided 391.5 (1,094 year-to-date) additional round trips compared to the same period in the prior year to satisfy increased service levels agreed to with the Province, accommodate the higher traffic volumes over the Easter holidays, and improve our customer experience. We introduced the *Northern Sea Wolf* and re-introduced the upgraded *Spirit of Vancouver Island* into service. These actions resulted in an increase in labour costs and a decrease in marine diesel fuel consumption. The increase in operating expenses also included the impact of wage rate increases in accordance with the Collective Agreement, higher benefit costs (Employer Health Tax, Workers Compensation and pension), and higher depreciation. We continue to take proactive measures to contain and manage expenses while operating a sustainable, safe and reliable service.

During the three months ended September 30, 2019, operations expense increased $9.6 million compared to the same period in the prior year due to:

- $5.0 million increase in labour costs, mainly due to a wage rate increase of 1.9% effective April 1, 2019 in accordance with the Collective Agreement, benefit costs (Employer Health Tax, Workers Compensation and pension) and staffing level changes for additional round trips provided;
- $2.6 million increase mainly due to incident related repairs to various vessels and terminals;
- $0.8 million increase in fuel expense, mainly due to a higher marine diesel price; and
- $1.2 million increase in miscellaneous other costs.

Expenses (continued)

Year-to-date, operations expense increased $14.4 million compared to the same period in the prior year due to:

- $10.4 million increase in labour costs, mainly due to a wage rate increase of 1.9% effective April 1, 2019 in accordance with the Collective Agreement, benefit costs (Employer Health Tax, Workers Compensation and pension)and staffing level changes for additional round trips provided;
- $3.8 million increase mainly due to incident related repairs to various vessels and terminals;
- $1.4 million increase in contracted services (mostly project related) and miscellaneous other costs; and

partially offset by:

- $1.2 million decrease in fuel expense, mainly due to a reduction in marine diesel consumption and a move to lower-cost LNG.

In the three months ended September 30, 2019, maintenance costs decreased $2.3 million ($1.8 million increase year-to-date) compared to the prior year as a result of the cyclical nature of vessel refit activity.

The $0.6 million ($1.7 million year-to-date) decrease in administration costs compared to the prior year is primarily a result of reduced labour costs, and consulting and contracted services for information technology.

Depreciation and amortization increased $2.8 million ($5.5 million year-to-date), reflecting new capital assets that have entered service. (See "Investing in our Capital Assets" below for details of capital asset expenditures.)

Net finance and other expenses ($ millions)	**Three months ended September 30**			**Six months ended September 30**		
	2019	**2018**	**Increase (Decrease)**	**2019**	**2018**	**Increase (Decrease)**
Finance expense	15.3	15.3	0.0	30.3	30.3	0.0
Less: finance income	(1.5)	(1.6)	0.1	(2.7)	(2.9)	0.2
Net finance expense	13.8	13.7	0.1	27.6	27.4	0.2
(Gain) loss on disposal and revaluation of property, plant and equipment, and intangible assets	(0.2)	0.0	(0.2)	(0.2)	0.1	(0.3)
Total net finance and other expenses	13.6	13.7	(0.1)	27.4	27.5	(0.1)

In the three and six months ended September 30, 2019, net finance and other expenses were on par with the same period in the prior year.

Liquidity and Capital Resources
We fund our operations and capital acquisitions with cash flow generated from operations, as well as bank financing and debt issues. Our financial position could be adversely affected if we fail to arrange sufficient and cost-effective financing to fund, among other things, capital expenditures and the repayment of maturing debt. This is subject to numerous factors, including the results of our operations, our financial position, conditions in the capital and bank credit markets, ratings assigned by rating agencies and general economic conditions.

We expect that our cash requirements will be met through positive operating cash flows, accessing our existing credit facility from time to time, debt issuances and other funding opportunities.

On October 15, 2019, we completed a private placement of $250 million of 30-year senior secured bonds. These bonds bear interest at a rate of 2.794% per annum, payable semi-annually. The net proceeds of this new issue will be used, together with additional cash on hand, to provide for capital expenditures, general corporate purposes and to fund the series' debt service reserve account. These bonds were rated “A (high)” by DBRS and “AA-” by S&P.

At September 30, 2019, our unrestricted cash and cash equivalents and other short-term investments totalled $135 million and $77 million, respectively (at March 31, 2019 - $60 million and $75 million, respectively).

Under our credit agreement with a syndicate of Canadian banks, we have available a revolving facility in the amount of $155 million. Our $155 million credit facility was renewed on March 6, 2019 to extend the maturity date of the facility from April 2023 to April 2024. The facility is available to fund capital expenditures and for other general corporate purposes. At September 30, 2019, there were no draws on this credit facility.

We target maintaining a strong investment-grade credit rating to allow capital market access at reasonable interest rates. At September 30, 2019, our credit rating with S&P's was “AA-” with a positive outlook and with DBRS was “A (high)” with a stable trend.

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 our credit agreement. Under our Master Trust Indenture, securing this facility, we are subject to an additional indebtedness test that prohibits additional borrowing if our leverage ratio exceeds 85%. At September 30, 2019, we achieved a debt service coverage ratio of 3.01 and a leverage ratio of 66.8%.

In fiscal 2017, the Government of Canada approved funding of up to $15.1 million towards a new seasonal direct ferry service between Port Hardy and Bella Coola, $28.3 million towards the purchase of two new Island Class vessels and $17.1 million towards a major upgrade of our Langdale terminal. In total, up to $60.5 million in funding under the New Building Canada Fund has been approved, of which $29.5 million had been received as of September 30, 2019.

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 second quarter of fiscal 2020 and 2019 are summarized in the table below:

	Six months ended September 30		
($ millions)	**2019**	**2018**	**Increase (Decrease)**
Cash and cash equivalents, beginning of period	59.9	69.9	(10.0)
Cash from operating activities:			
Net earnings	107.2	96.9	10.3
Items not affecting cash	119.8	113.9	5.9
Changes in non-cash operating working capital	(30.4)	(6.6)	(23.8)
Net interest paid	(28.9)	(29.7)	0.8
Cash generated by operating activities	167.7	174.5	(6.8)
Cash used in financing activities	(18.7)	(18.7)	0.0
Cash used in investing activities	(74.0)	(137.3)	63.3
Net increase in cash and cash equivalents	75.0	18.5	56.5
Cash and cash equivalents, end of period	134.9	88.4	46.5

For the six months ended September 30, 2019, cash generated by operating activities decreased $6.8 million primarily due to changes in non-cash working capital partially offset by an increase in net earnings.

Cash used in financing activities in the six months ended September 30, 2019 and September 30, 2018 was $18.7 million. This amounts consisted of $17.6 million repayment of loans from KfW IPEX-Bank GmbH and $1.1 million in repayment of lease obligations.

Cash used in investing activities for the six months ended September 30, 2019 decreased by $63.3 million, mainly due to a $66.9 million decrease in year over year capital expenditures partially offset by $3.6 million in cash used for short-term investing. (See “Investing in Our Capital Assets” below for detail of significant capital expenditures.)

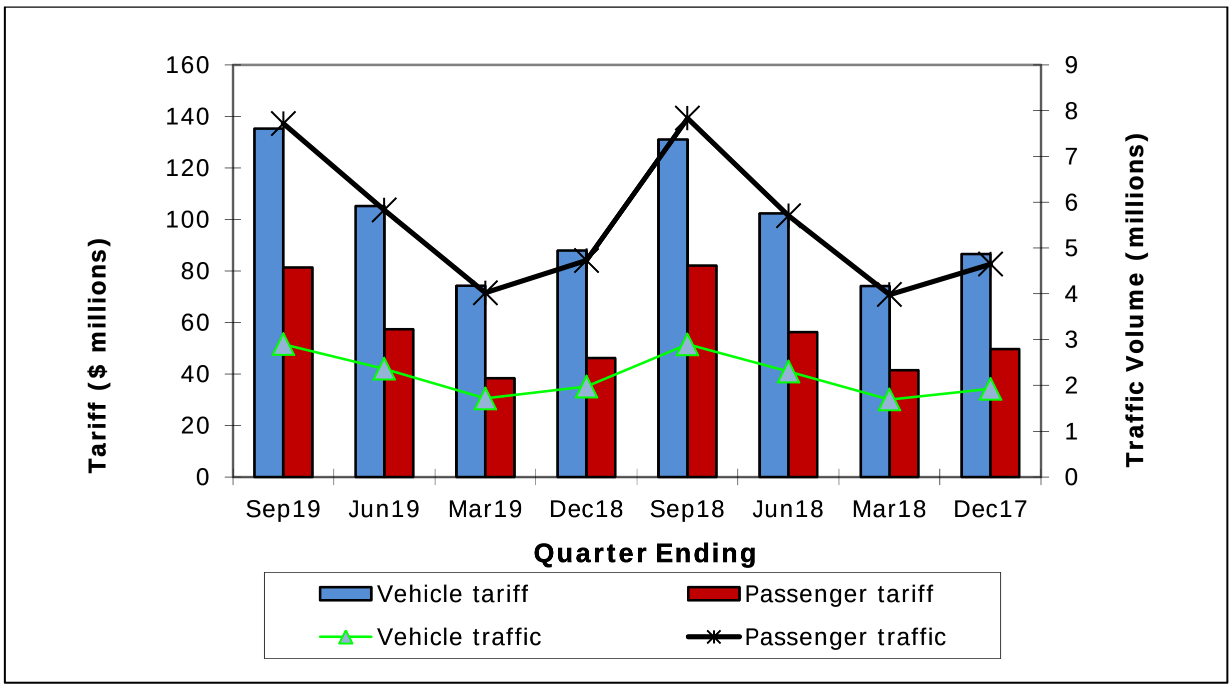
SUMMARY OF QUARTERLY RESULTS

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

	Quarter Ended (unaudited)							
($ millions)	**Sep 19**	**Jun 19**	**Mar 19**	**Dec 18**	**Sep 18**	**Jun 18**	**Mar 18**	**Dec 17**
Total revenue	329.3	246.4	172.5	207.7	315.8	229.7	168.8	195.7
Operating profit (loss)	108.6	26.0	(28.8)	9.4	104.6	19.8	(27.8)	-
Net earnings (loss)	95.0	12.2	(41.0)	(3.7)	90.9	6.0	(41.0)	(14.8)

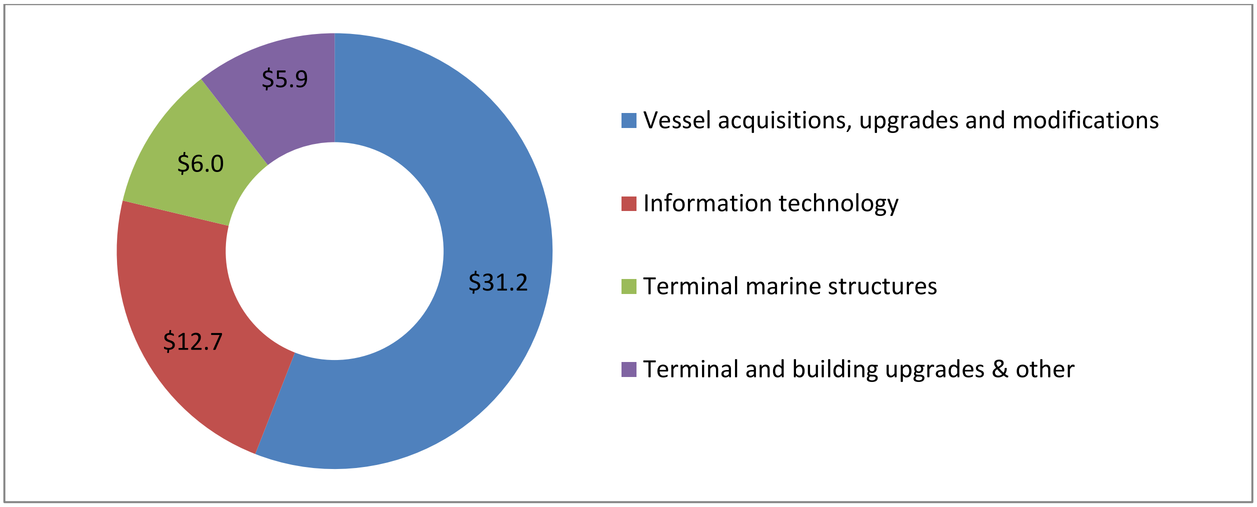
Quarterly results are affected by the seasonality of leisure travel patterns. The second quarter, covering the summer period, experiences the highest traffic levels and the highest net earnings. The third and fourth quarters reflect a seasonal reduction in traffic. We utilize these periods to perform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



Capital Expenditures

Capital expenditures, net of funding from the New Building Canada Fund and FortisBC, in the six months ended September 30, 2019 totalled $55.8 million.



In total, we have been approved for up to $60.5 million in funding under the New Building Canada Fund, consisting of $15.1 million for the *Northern Sea Wolf* project, $28.3 million for the Island Class vessel project and $17.1 million for the Langdale terminal development project. To date we have received a total of $29.5 million comprised of $15.1 million for the *Northern Sea Wolf* project and $14.4 million for the Island Class vessel project.

Capital expenditures, net of funding from the New Building Canada Fund and FortisBC, in the three and six months ended September 30, 2019, included the following:

($ millions)	**3 months ended**	**6 months ended**
	September 30, 2019	
Island Class vessels	10.4	11.6
Spirit Class mid-life upgrades	-	5.7
Customer experience program	3.0	4.9
Hardware upgrades	2.7	4.2
Blubber Bay-Wingwall Replacement	2.4	3.9
Skeena Queen mid-life upgrade	2.5	3.3
Central Coast ferry service	0.1	2.9
Klitsa - three-quarter life upgrade	-	2.1
Langdale upgrades	1.2	2.1
Major overhauls and inspections	0.4	2.1
Time collection & crew scheduling	1.0	1.7
Fleet maintenance facility	0.5	1.0
Various other projects	5.7	10.3
	29.9	55.8

Island Class vessels

On April 13, 2017, we entered into design and build contracts with Damen Shipyard Group of Netherlands for the construction of two Island Class vessels. The Government of Canada has approved funding of up to $28.3 million under the New Building Canada Fund toward these vessels, of which we recorded $2.1 million in the three months ended September 30, 2019 ($2.2 million year-to-date), $11.3 million in fiscal 2019 and $3.1 million in fiscal 2018. These vessels will be outfitted with hybrid diesel-electric propulsion and will each have a capacity of up to 450 passengers and crew and approximately 47 vehicles. These two Island Class vessels are expected to go into service in the first quarter of fiscal 2021. We intend to deploy the first new vessel to provide service between Powell River and Texada Island and the second new vessel to provide service between Port McNeill, Alert Bay and Sointula. The addition of new vessels will allow us to retire the 60-year old *North Island Princess* in fiscal 2021. The 54-year old *Howe Sound Queen* was retired during the first quarter of fiscal 2020.

Spirit Class mid-life upgrades

On June 6, 2018, the *Spirit of British Columbia* and on April 18, 2019, the *Spirit of Vancouver Island* returned to service on our Tsawwassen – Swartz Bay route and this project is now complete. The mid-life upgrades will enable the vessels to be in service for another 25 years. We expect the conversion of these vessels to dual-fuel, to result in substantial savings, as LNG costs are considerably less than marine diesel. We also expect the conversion to result in significant environmental benefits, such as reducing carbon, sulphur and nitrogen dioxide emissions from our vessels. FortisBC has committed to provide us with up to $10 million in incentive funding to help offset incremental capital costs associated with the conversion of the Spirit Class vessels to use LNG. The contribution ($7.0 million has been received as of September 30, 2019) is dependent upon the purchase of at least 10 million gigajoules of LNG over a 10-year period and will be applied to the capital costs as LNG is purchased. In the three months ended September 30, 2019, $0.2 million ($0.4 million year-to-date) was recorded to reduce the capital costs. In fiscal 2019, $0.3 million was recorded to reduce the capital costs.

Customer experience program

Our customer experience program, which includes the Fare Flexibility and Digital Experience Initiative, will replace our aged website, reservation system and e-commerce platform and upgrade our point-of-sale. The main elements will be implemented in stages during 2020. This program will give customers an opportunity to purchase travel in advance at discounted rates on select sailings on reservable routes and will allow us to respond in a more timely fashion to changing business needs and to better support marketing, travel services and pricing initiatives. Our customer experience program will introduce improved transaction processing and online booking with more choices in fares. We have implemented our new internal reservations system as well as enhancements to our customer relationship management system and point of sale system.

Hardware upgrades

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

Blubber Bay terminal

At Blubber Bay terminal, a project to replace wingwalls, increase capacity of a floating lead, upgrade mechanical and electrical systems, and replace the fencing around the terminal, was completed in September 2019.

Skeena Queen mid-life upgrade

The mid-life upgrade of the *Skeena Queen*, including propulsion, electrical, bridge equipment, safety equipment and interior modernization is expected to complete in fiscal 2020.

Central Coast ferry service

On April 7, 2017, we finalized an agreement to acquire a 75-metre used vessel built in 2000, to provide the new seasonal direct ferry service between Port Hardy and Bella Coola. This project included the acquisition and upgrading of the used vessel as well as modifying our terminal marine structures as necessary. On April 5, 2017, the Province contributed an initial $15 million towards the provision of this service for the period up to March 31, 2020. On March 21, 2017, the Government of Canada approved funding towards the capital costs of this vessel of up to $15.1 million from the New Building Canada Fund, of which we recorded $11.8 million in fiscal 2018 and $3.3 million in fiscal 2019. The vessel underwent extensive upgrades necessary to bring it up to the standards of safety and reliability that we and Transport Canada require. On May 18, 2019, the *Northern Sea Wolf* entered service in the Central Coast and on June 3, 2019, started the direct seasonal service between Port Hardy and Bella Coola. The *Northern Sea Wolf* accommodates approximately 35 vehicles and 150 passengers and crew.

Klitsa three-quarter life upgrade

The three-quarter life upgrade of the *Klitsa*, including safety system upgrades, bridge equipment upgrades, interior modernization and replacement of electrical and mechanical components, was completed in May 2019.

Langdale terminal

Our Langdale terminal redevelopment project includes plans for an overhead passenger walkway, a new terminal building, parking lot and pick-up and drop-off area upgrades, as well as a ticketing plaza.

Major overhauls and inspections

In the three months ended September 30, 2019, we had capital expenditures of $0.4 million ($2.1 million year-to-date) in respect of major overhauls and inspections of components of hull, propulsion and generators for three vessels that were completed or underway.

Time collection

A project to replace and enhance our aged time collection and crew scheduling system is underway.

Fleet maintenance facility

In Richmond, a project to redevelop and modernize our ship repair and maintenance facility is in the design stage.

OUTLOOK

We continue to pursue strategies to create an affordable, sustainable and safe ferry system that meets the needs of our customers and the communities we serve for generations to come. We are committed to being a company worthy of the public's trust and valued for the services we provide.

Major Investments

Our 12-year capital plan for fiscal 2019 through fiscal 2030 is $3.9 billion. This plan addresses the need to replace our aged assets and for resiliency. It includes up to 17 new vessels and significant upgrades to our terminals and our fleet maintenance facility. The plan emphasizes system capacity, operational efficiency, resiliency and flexibility to ensure safe, reliable and efficient operations and to deliver an exceptional customer-focused travel experience. All major capital expenditures as defined by the Commissioner require approval.

Our cash forecasts indicate that, due to the significant capital expenditures planned, incremental long-term borrowing will be required. On October 15, 2019, we completed a $250 million private placement of 30-year senior secured bonds.

As we procure new vessels, with emphasis on standardizing our fleet, the following projects are underway:

Salish Class

In November 2018, we issued a Request For Proposal ("RFP") for a fourth Salish Class vessel, which will replace the 54-year old *Mayne Queen*. Our three existing Salish Class vessels, brought into service in fiscal 2018, are dual-fuel capable, running primarily on LNG using marine diesel as backup. The vessel design is part of our standardization strategy which we believe strengthens safety practises and improves interoperability with standardized bridges, engine rooms and life-saving equipment.

Island Class

Construction for two Island Class vessels is complete and the vessels are expected to enter into service in the first quarter of fiscal 2021. The Island Class vessels are outfitted with hybrid diesel-electric propulsion. They are built to be capable of conversion to all-electric propulsion as the technology permits and the necessary infrastructure is available.

On October 25, 2019, contracts became effective with Damen Shipyard Group of Netherlands for the construction of four additional Island Class vessels reinforcing our plan for operational efficiency, resiliency and flexibility. Two of these new vessels will service the route between Campbell River - Quadra Island and the other two will service the route between Nanaimo Harbour - Gabriola Island and are expected to enter service during fiscal 2023.

New Major Vehicles

The next phase of vessel renewal will include replacement of four major vessels that will have an average age of over 50 years when their replacements are anticipated to begin service on our Major Routes. The new vessels will add capacity to the fleet, with vehicle and passenger capacity expected to be similar to the existing Spirit Class vessels. We are also considering the introduction of an additional vessel to accommodate future traffic and build resiliency in the fleet. In August 2019, we issued a RFP for the design, build and delivery of up to five new major vessels.

Fare Flexibility and Digital Experience

Our Fare Flexibility and Digital Experience Initiative is expected to be launched by the end of 2020. It will offer more fare choices and an improved online booking experience. The new website will enable customers to quickly compare fare choices on the dates they are looking to travel. We expect these changes will help shift traffic to sailings that typically run with lower capacity utilization.

Financial

We expect positive net earnings in fiscal 2020. Total revenue is expected to increase resulting from higher vehicle traffic levels, net catering and retail revenues and ferry transportation fees from the Province.

We expect an increase in total expenses in fiscal 2020, reflecting an increase in labour costs, mainly due to a wage rate increase in accordance with the Collective Agreement and increased benefit costs and higher staffing levels for increased service. In addition, costs will increase from the expanded service on a Central Coast route and other service plan changes, higher depreciation, partially offset by savings from operating the Spirit Class vessels and the Salish Class vessels on LNG. We continue to manage our costs prudently without compromising safe operations.

On September 30, 2019, the Commissioner issued Order 19-04, which established final price cap increases of 2.3% for each of the four years of PT5. In the report released assessing our PT5 submission, the Commissioner forecasts declining net earnings, based on this price cap increase, by the end of the performance term. Order 19-04 also:

- maintains the existing fuel deferral accounts;
- sets an efficiency target equivalent to 1% of annual operating, maintenance and administration costs; and
- sets the price per litre for the operation of the fuel deferral accounts at $1.03 per litre for marine diesel and 46.9 cents per litre for LNG in the first year of PT5, inflated in each case by 2% per year for the balance of PT5.

We believe that this price cap decision, being lower than expected, will make it more challenging to achieve our corporate objectives which include replacing our aging fleet, upgrading technology, providing operational resiliency and delivering improved customer service.

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 50 through 51 of our fiscal 2019 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the six months ended September 30, 2019. Our 2019 Management's Discussion & Analysis is available at http://www.bcferries.com/investors/financial_reports.html on our investor webpage.

BUSINESS RISK MANAGEMENT

Understanding and managing operational risk is an important part of our business. We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business. A discussion of enterprise wide risk management can be found on pages 52 through 55 of our fiscal 2019 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the six months ended September 30, 2019. Our 2019 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 level of earnings, 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, sustainable future. We do not believe that material uncertainties exist in regard 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 unaudited condensed interim consolidated financial statements, which have been prepared in accordance with IFRS.

Our significant accounting policies are contained in Note 1 to our March 31, 2019 audited consolidated financial statements and our September 30, 2019 condensed interim consolidated financial statements. Certain of these policies involve critical accounting estimates because they require us to make particularly subjective or complex judgements 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 56 and 57 of our fiscal 2019 Management's Discussion & Analysis. The following describes the changes to critical accounting policies we have used in the preparation of our condensed interim consolidated financial statements for the three and six months ended September 30, 2019, or expect to use in the future.

Adoption of New Accounting Standards
The following is a discussion of changes in accounting standards that we adopted effective April 1, 2019:

On February 7, 2018, the IASB published Amendments to IAS 19 *Employee Benefits* which requires entities to use updated actuarial assumptions to determine current service cost and net interest for the remainder of the period after a plan amendment, curtailment or settlement. It also requires that any reduction in surplus, even amounts not previously recognized due to an asset ceiling limitation, be recognized in profit or loss as part of past service cost of a gain or loss on settlement. We adopted IAS 19 effective April 1, 2019. The application of this standard had no impact on our condensed interim consolidated financial statements.

The Effect of Rate Regulation

We are regulated by the Commissioner to ensure, among other things, that our tariffs are fair and reasonable. Under the terms of the Act, the tariffs we charge our customers over a performance term are subject to price caps set by the Commissioner. A price cap sets the ceiling on the weighted average level of fares that can be charged. The Commissioner may under certain circumstances, allow increases in price caps over the set levels. Certain decisions and orders of the Commissioner may give rise to regulatory assets or liabilities. Regulatory assets generally represent incurred costs that are probable of future recovery in tariffs or fuel surcharges. Regulatory liabilities represent obligations to customers which will be settled through future tariff reductions or fuel rebates.

We 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 IASB issued an interim standard, IFRS 14 *Regulatory Deferral Accounts,* which addresses accounting for rate-regulated activities. However, it does not apply to entities, like ours, that transitioned to IFRS prior to that date. As a result, we are not permitted to recognize in our financial statements the assets and liabilities that result from the regulated price cap setting process, such as our deferred fuel cost accounts. Under IFRS, rather than being charged to regulatory asset or liability accounts on our consolidated statements of financial position, fuel surcharges collected or rebates granted are included in revenue, and increases or decreases in fuel prices from those approved in price caps are included in operating expenses. These items are treated as assets and liabilities for regulatory purposes. Reporting for rate-regulated activities provides additional information which we use to assess performance and to make operating decisions.

Regulatory assets and liabilities do not have standardized meaning within IFRS. Our regulatory assets and liabilities should be considered in addition to, but not as a substitute for, measures of financial performance in accordance with IFRS.

We continually assess whether our regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes. These regulatory assets and liabilities are considered supplemental disclosures and are detailed in Note 16 to our September 30, 2019 unaudited condensed interim consolidated financial statements.

If IFRS permitted us to report regulatory assets and liabilities in our financial statements, the effect on our net earnings for the three and six months ended September 30, 2019 and 2018 would be as follows:

($ millions)		**Three months ended September 30**		**Six months ended September 30**	
		2019	**2018**	**2019**	**2018**
Net earnings		95.0	90.9	107.2	96.9
Changes in net earnings:					
Regulatory asset or liability	**Statement line item**				
Deferred fuel costs					
Fuel costs under set price	Operations expense	(1.3)	(1.6)	(2.2)	(1.1)
Fuel (surcharge) rebates	Fuel surcharge (rebates)	(3.0)	0.1	(3.8)	4.6
Payments from the Province	Ferry service fees	-	-		-
(Decrease) increase in total net earnings		(4.2)	(1.5)	(6.0)	3.5
Adjusted net earnings		90.8	89.4	101.2	100.4

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. In addition, as prescribed by regulatory order, we collect fuel surcharges or provide fuel rebates from time to time, which are applied against deferred fuel cost account balances. We may also receive payments from the Province to be applied against deferred fuel cost account balances.

FORWARD LOOKING STATEMENTS

This Management's Discussion and Analysis contains certain "forward looking statements". These statements relate to future events or future performance and reflect management's expectations regarding our growth, results of operations, performance, business prospects and opportunities and industry performance and trends. They reflect management's current internal projections, expectations or beliefs and are based on information currently available to management. Some of the market conditions and factors that have been considered in formulating the assumptions upon which forward looking statements are based include traffic, the Canadian Dollar relative to the 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, traffic levels, capacity utilization, fares, Performance Term Five, ferry transportation fees from the Province, the effects of rate regulation, and fiscal 2020 net earnings; our short-term and long-range business plans, our 12-year capital plan, capital expenditures, asset renewal and upgrade programs for our vessels, terminals and the fleet maintenance facility, including Spirit Class mid-life upgrades, Skeena Queen mid-life upgrade, Klitsa three-quarter life upgrade, the Langdale terminal redevelopment project, the Blubber Bay terminal upgrades, the new major class vessels, the Island Class vessels, and the Salish Class vessels, and our customer experience program, including our Fare Flexibility and Digital Experience Initiative; FortisBC incentive funding, the New Building Canada Fund, contributions from the Province, LNG costs, benefits and usage, and alternative fuel options; expectations regarding incremental long-term borrowing, 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 Aboriginal rights and title 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.