

November 10, 2008

Research Update:

**British Columbia Ferry Services Inc.
Outlook To Positive On Strong
Financial Risk Profile**

Primary Credit Analyst:

Mario Angastiniotis, Toronto (1) 416-507-2520; mario_angastiniotis@standardandpoors.com

Secondary Credit Analyst:

Bhavini Patel, CFA, Toronto (1) 416-507-2558; bhavini_patel@standardandpoors.com

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Rationale

On Nov. 10, 2008, Standard & Poor's Ratings Services revised its outlook on British Columbia Ferry Services Inc. (BCF) to positive from stable. At the same time, Standard & Poor's affirmed its 'A-' long-term issuer credit and senior secured debt ratings on BCF.

The ratings on BCF reflect the following positive factors:

- The company's near-monopoly position as a provider of an essential transportation service providing ferry services between British Columbia's Lower Mainland, Vancouver Island, and the province's many coastal communities;
- BCF's financial risk profile, which remained strong in fiscal 2008 (year ended March 31, 2008). EBITDA growth rebounded by 11.7% in fiscal 2008 following a 3.7% decline in the previous fiscal year. BCF's robust performance remained in place despite a number of operating challenges stemming from a further slide in tourism to the province in 2008, higher fuel prices, and their impact on passenger and vehicle traffic. BCF's debt service coverage ratio (DSCR; Standard & Poor's-adjusted) declined to 3.20x in fiscal 2008 from 3.96x in the previous year, reflecting the increase in cash interest paid. Standard & Poor's expects average annual DSCRs to decline somewhat in the near term, reflecting the acceleration in BCF's capital spending in the next four years (to March 31, 2012). Nevertheless, we expect DSCRs to remain above 2.3x. In the medium term, the company's DSCRs should remain at or above that level, in our opinion. We believe BCF's weaker business risk profile compared with that of similarly rated peers partially offsets its strong financial risk profile. In our opinion, the difference is due to BCF's status as a regulated commercial entity;
- BCF's strong service area, which is a major tourist attraction and has a long history of generally rising economic growth, income levels, and increasing traffic levels. The 2010 Winter Olympics will only add to the overall attraction of the region and boost tourism to British Columbia. In the near term, however, the main risk to this outlook is that a U.S. recession, strong fuel prices, and a strong Canadian dollar could continue to dampen tourism;
- The continuing and extraordinary credit support received from the Province of British Columbia (AAA/Stable/A-1+) and the ongoing contractual payment of an annual service fee from the province to guarantee a minimum level of service on the smaller, less economically viable routes;
- A long concession period, giving the company the exclusive right to use the terminals for a period of 60 years with an option, subject to mutual agreement, to renew for another 60 years; and

- A regulatory regime that has worked as Standard & Poor's expected through the first performance term (ended March 31, 2008). Moreover, the BC Ferries Commissioner's decision in the fall of 2007 with respect to price cap increases and the fuel deferral accounts for the second performance term, also lend support to BCF's credit quality.

Credit concerns include:

- A highly leveraged capital structure currently that we expect will decline in the medium term;
- Traffic growth risks associated with volume-dependent assets. Traffic volumes in the long run depend on the region's population and changing demographics, its economic growth, real disposable incomes, sensitivity to price increases, tourism, and changes in the Canadian dollar;
- Risks inherent with a capital-intensive business and BCF's significant capital spending requirements in the next five years. In this period, the company plans to spend about C\$1 billion to upgrade and replace aging assets, to be financed using internal cash flow and debt. Somewhat mitigating this risk are provisions that allow for major capital costs to be recovered through the rate-setting process;
- The potential for competition to emerge on BCF's largest and most profitable routes. Competition to date has been limited and the business' capital-intensive nature makes competition less likely; and
- The lack of unfettered rate-setting autonomy and risks associated with BCF's regulatory regime, with the potential for unfavorable decisions to hurt its financial performance.

Outlook

The positive outlook reflects BCF's strong financial risk profile and near-monopoly position as an essential service provider as well as the credit supportive nature of the regulatory regime, in our view. The outlook also reflects Standard & Poor's expectation of steady traffic and revenue growth in the medium term and the government's continued commitment to provide service fees as per its contractual obligations. We believe the latter would help ensure the maintenance of healthy debt service coverage levels. With the bulk of the company's capital program and its debt forecast to peak in the next fiscal year, Standard & Poor's expects BCF's debt burden to stabilize and begin to decline on a forecast basis. BCF needs the latter for us to raise the rating within the next two years. Conversely, a substantial and sustained deterioration in the company's financial performance could lead us to revise the outlook back to stable.

Ratings List

British Columbia Ferry Services Inc.

Outlook Revised To Positive

	To	From
Issuer credit rating	A-/Positive/--	A-/Stable/--

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Rating Affirmed

Senior secured debt (4 issues) A-

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