

British Columbia Ferry Services Inc. 'A-' Ratings Affirmed On Continued Strength

Rationale

On Nov. 6, 2007, Standard & Poor's Ratings Services affirmed its 'A-' long-term issuer credit and senior secured debt ratings on British Columbia Ferry Services Inc. (BCF). The outlook is stable.

The ratings on BCF reflect the following positive factors:

- The company's near-monopoly position as a provider of an essential transportation service that provides 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 2007 (year ended March 31, 2007) despite a modest decline in EBITDA performance during the 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 2007, higher fuel prices, and the impact on traffic and revenues from the loss of the Queen of the North in March 2006. The EBITDA performance contributed to a modest increase in BCF's debt service coverage ratio (DSCR) to 4.65x in fiscal 2007 from 4.55x in the previous year. Standard & Poor's expects average annual DSCRs to fall somewhat in the near term alongside the expected acceleration in BCF's capital spending in the next five years (year ending March 31, 2012). Nevertheless, we do not expect DSCRs to drop below 2x. In the medium term, the company's DSCRs should return back above 3x. BCF's strong financial profile is partially offset by a somewhat weaker business risk profile compared with that of similarly rated peers. The difference is due to BCF's status as a regulated commercial entity.
- A strong service area that 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 serve to boost tourism to British Columbia's Lower Mainland. The main risk to this outlook is that

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the strength in the Canadian dollar could continue to dampen tourism in the medium term.

- The ongoing contractual payment of an annual service fee by the Province of British Columbia (AAA/Stable/A-1+) 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.
- A regulatory regime that has worked as Standard & Poor's expected through the first performance term, ending March 31, 2008. Moreover, the BC Ferries Commissioner's recent decision with respect to price cap increases and the fuel deferral accounts for the second performance term also appear to be supportive for BCF's credit quality.

These strengths are partially offset by:

- A highly leveraged capital structure that we expect to decline in the medium term.
- Presence of passenger traffic growth risks associated with volume-dependent assets. Passenger traffic volumes in the long run depend on the region's population and economic growth, real disposable incomes, sensitivity to price increases, and tourism.
- 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 C\$1.2 billion to upgrade and replace aging assets, to be financed using internal cash flow and debt. This risk is mitigated somewhat by provisions that allow for major capital costs to be taken into consideration in 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 capital-intensive nature of the business makes competition less likely to emerge.
- The lack of unfettered rate-setting autonomy and risks associated with BCF's regulatory regime, with the potential for unfavorable decisions to hurt BCF's financial performance.

Outlook

The stable outlook reflects BCF's strong financial risk profile and near-monopoly position as a provider of an essential service. The outlook also reflects the expectations 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, which would help ensure the maintenance of healthy debt service coverage levels. With the bulk of the company's capital program and its debt likely to peak in the next two fiscal years, Standard & Poor's expects that a continuation of BCF's recent strong performances could lead us to revise the outlook to positive or raise the credit rating in the medium term. Conversely, a substantial and sustained deterioration in the company's financial performance could lead to downward pressure on BCF's credit quality.

Ratings List

British Columbia Ferry Services Inc

Ratings Affirmed

Issuer credit rating A-/Stable/—

Senior secured

Local currency A-

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