

British Columbia Ferry Services Inc. 's C\$200 Million 30-Year Bond Assigned 'A-'

Rationale

On Jan. 11, 2008, Standard & Poor's Ratings Services assigned its 'A-' senior secured debt rating to British Columbia Ferry Services Inc.'s (BCF) C\$200 million Jan. 11, 2038, series 08-1 bond issue. At the same time, Standard & Poor's affirmed its 'A-' issuer credit and senior secured debt ratings on BCF. The outlook is stable. The series 08-1 bonds are issued under the company's master trust indenture dated May 19, 2004. BCF will use the net proceeds from the sale of the bonds to partially fund capital expenditures, to repay amounts outstanding under its operating credit facility, to fund the reserve account in connection with the Series 08-1 bonds, and for general corporate purposes.

The ratings reflect 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; its strong financial profile; and the strength of its service area, which has a long history of generally rising economic growth and income levels and increasing traffic levels. The ratings also reflect the company's long concession period of 60 years, the ongoing payment of an annual service fee by the Province of British Columbia (AAA/Stable/A-1+) to guarantee provision of a minimum level of service on the smaller, less economically viable routes, and the supportive regulatory framework that provides strong provisions to ensure the independence of the regulator from political interference.

These strengths are partially offset by a highly leveraged capital structure that we expect to decline in the medium term. In addition, there are 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.

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Risks inherent with a capital-intensive business and BCF's significant capital spending requirements in the next five years (ending March 31, 2012) also restrain the ratings. 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.

BCF's financial performance 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. BCF's performance remained on track with Standard & Poor's expectations through the second quarter of fiscal 2008. 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.

On Oct. 27, 2007, the first of BCF's three new vessels, the Coastal Renaissance, departed Germany for the trans-Atlantic voyage to British Columbia. The ship arrived in British Columbia in December 2007 for crew training and familiarization. The company expects the Coastal Renaissance to start service on the Departure Bay–Horseshoe Bay route in the spring of 2008.

Regulatory update

On Sept. 18, 2007, the British Columbia Ferries Commissioner released his final performance term two price cap order, and on Nov. 5, 2007, announced that the price caps for the major route group will be changed to correct a commission error in determining BCF's allowable costs for the second performance term. After the change, the price cap increase (starting from a level which includes fuel surcharges in place at March 31, 2008) will be 7.3% on the major routes and 4.0% on all other routes on April 1, 2008. Each subsequent April 1 of the four-year term, the price cap will increase by 2.7% plus 0.49 times the latest reported annual increase in the CPI for British Columbia on the major routes and 5.7% plus 0.73 times the latest reported annual increase in the CPI for British Columbia on all other routes.

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

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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 Assigned	
C\$200 million fixed-rate senior secured bonds	A-
Ratings Affirmed	
Issuer credit rating	A-/Stable/—
Senior secured debt	A-

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