

**Management's Discussion & Analysis
of
Financial Condition
and
Results of Operations**

**For the fiscal year ended March 31, 2010
Dated May 19, 2010**



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**Management's Discussion & Analysis
of Financial Condition and Results of Operations
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The following is our discussion and analysis of the financial condition and results of operations for British Columbia Ferry Services Inc. as of May 19, 2010. This should be read in conjunction with our audited consolidated financial statements and related notes for the years ended March 31, 2010 (fiscal 2010) and March 31, 2009 (fiscal 2009). These documents are available on SEDAR at www.sedar.com and on our Investor webpage at <http://www.bcferries.com/about/investors/index.html>.

Except where indicated, all financial information herein is expressed in Canadian dollars and determined on the basis of Canadian generally accepted accounting principles.

BUSINESS OVERVIEW

British Columbia Ferry Services Inc. is an independent company providing ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world, providing frequent year-round transportation service on 25 routes, supported by 36 vessels and 47 terminals. 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 and varied range of ferry services for our customers. In fiscal 2010, we provided more than 186,000 sailings, carrying 21.0 million passengers and 8.3 million vehicles.

In fiscal 2010, we experienced a 1.5% increase in both vehicle and passenger traffic levels, as economic conditions began to improve and vehicle fuel prices declined compared to the prior year.

Fiscal 2010 marked the first full year of our drop-trailer service launched in March, 2009. With this service, commercial customers on two of our Major Routes can drop their trailers off at one terminal and pick them up at another. This drop-trailer service has been well received in the commercial market and improves our overall productivity by utilizing otherwise unused capacity.

During fiscal 2010, we assessed the feasibility of enhancing our northern service to Prince Rupert by commencing periodic service from our Tsawwassen terminal on the Lower Mainland to our Port Hardy terminal on Vancouver Island, with the objective of increasing tourism and providing a new service to our existing customers. We were not able to receive unanimous support for this initiative from the various northern communities; therefore we suspended our efforts to launch this enhanced service. We remain committed to creating new and innovative travel options for our customers.

In December 2009, the Province and First Nations signed the Coastal Reconciliation Protocol. This agreement includes \$25 million in funding from the federal and provincial governments which will be used by the Province to build a new, larger ferry terminal at Klemtu, an isolated community 200 kilometres north of Vancouver Island. This new terminal will be able to accommodate the *Northern Expedition*, one of the vessels providing service on our Northern Routes, which cannot utilize the current facility at Klemtu. The new terminal is expected to be completed by March 31, 2011.

Significant events during or subsequent to fiscal 2010:

- On April 3, 2009, the 45-year-old *Queen of New Westminster*, which formerly operated on our Duke Point–Tsawwassen route, returned to service on our Tsawwassen–Swartz Bay route following an extensive \$52 million upgrade to prepare it for another 13 years of service.
- On April 15, 2009, the 47-year-old *Queen of Vancouver* was decommissioned and on April 20, 2009, the 43-year-old *Queen of Prince Rupert* was decommissioned. The *Queen of Vancouver* and the previously decommissioned *Queen of Saanich* have been sold, while the *Queen of Prince Rupert* remains available for sale. Losses on disposal and impairment of \$2.9 million relating to these three vessels have been reflected in our fiscal 2010 financial results.
- On May 18, 2009, the new *Northern Expedition* made its inaugural voyage on our northern route through the Inside Passage from Port Hardy to Prince Rupert. This 150-metre vessel, which replaced the 43-year-old *Queen of Prince Rupert*, has 55 staterooms and accommodates up to 130 vehicles and 600 passengers. The total project budget for this vessel was \$200 million. The project was completed on schedule and on budget.
- On May 21, 2009, our new operations and security centre (OSC) officially began operations. The OSC is a central location for monitoring day-to-day operations and providing incident management support. The primary purpose of the OSC is to collect information from throughout the company, provide enhanced situational awareness and assessments, increased security monitoring and a coordinated response during any incidents.
- From June 2 to September 10, 2009, we offered our “CoastSaver” program. This promotional fare incentive program provided mid-week price discounts of 33% on passenger and passenger vehicle fares on our Major Routes. This program will be offered again from May 25 through July 29, 2010.
- On July 15, 2009, fares were reduced as average fuel rebates were increased from 5% to 8% on many of our routes. On September 1, 2009, the fuel rebates were further increased to 10% on these routes and then subsequently reduced to 5% on January 25, 2010, due to higher fuel prices. On April 1, 2010, a fuel rebate of 2% was implemented on our Major Routes. Fuel rebates are not currently in place on our Northern Routes.
- On July 23, 2009, the Province announced its intention to harmonize its existing 7% provincial sales tax with the 5% federal goods and services tax into a single harmonized sales tax (HST) of 12%, effective July 1, 2010. We expect this tax to add approximately \$5 to \$6 million annually to the cost of our operations. It will also increase the price to our customers for our food and certain retail offerings. .
- On September 24, 2009, the provincial government announced that, as part of the federal government’s Infrastructure Stimulus Fund program, BC Ferries will qualify for partial reimbursements of eligible costs of eight sewage pump-ashore and waste water treatment projects, as well as other terminal projects. The net funding expected to be received is \$7.5 million. (See “Investing in our Capital Assets” below for more project detail)
- On December 1, 2009, we opened new self-ticketing kiosks at two of our major terminals. The self-ticketing system is designed to simplify and speed up the foot passenger ticketing process. Customers now have the option of using a self-ticketing machine or purchasing a ticket from a ticket agent.

- On December 14, 2009, we were advised by the credit rating agency DBRS that they have upgraded our long-term rating from A (low) to A. DBRS acknowledged our tight management of service offerings and expenses as an important factor contributing to this upgrade. On February 24, 2010, Standard & Poor's also upgraded our long-term rating from A- to A+.
- On April 29, 2010, the Province introduced legislation, *Bill 20 - Miscellaneous Statutes Amendment Act (No.3), 2010* (Bill 20), to amend several statutes, including the *Coastal Ferry Act*. The amendments respond to the Comptroller General's Report on Review of Transportation Governance Models released November 6, 2009, and include changes to the governance and regulatory framework within which we operate. (See "Corporate Structure" below for more detail).
- On March 18, 2010, we reached an agreement with British Columbia Institute of Technology Marine Campus (BMC) to participate, along with other industry partners, in BMC's simulator renewal initiative which will provide our employees with access to the most modern marine simulation centre in the world.
- On May 11, 2010, our new vacations centre in downtown Vancouver officially opened to the public. With the aid of a 37-foot long interactive media wall display, customers are able to view route maps, vessel schematics, and destination images to help them choose from a variety of travel package options.
- Results of our Customer Satisfaction Tracking surveys in 2009 indicated that 91% of customers surveyed report being satisfied with their overall trip experience, up from 86% in the prior year.

CORPORATE STRUCTURE

Coastal Ferry Services Contract

We operate ferry services under a regulatory regime as defined by the *Coastal Ferry Act*, and under the terms set out in the Coastal Ferry Services Contract. This 60-year services contract with the Province, which commenced April 1, 2003, stipulates, among other things, the number of round trips that must be provided for each regulated ferry service route in exchange for specified fees (ferry transportation fees). The contract was amended to, among other things, establish the ferry service levels and ferry transportation fees for the second performance term commencing April 1, 2008. The Coastal Ferry Services Contract also includes fees for the provision of specific social program services delivered on behalf of the Province.

Under the terms of the Coastal Ferry Services Contract, we also receive an annual amount from the Province based on its agreement with the Government of Canada to fulfill the obligation of providing ferry services to coastal British Columbia. The amount of this payment is adjusted annually based on the Consumer Price Index (Vancouver).

Economic Regulatory Environment

The office of the British Columbia Ferries Commissioner (the Commissioner) was created under the *Coastal Ferry Act*, enacted by the Province on April 1, 2003. The Commissioner establishes price caps for designated ferry route groups for the purpose of regulating our tariffs. The Commissioner is also responsible for regulating the reduction of service, discontinuance of routes and certain other matters. The *Coastal Ferry Act* requires the Commissioner to undertake regulation in accordance with several principles, including placing priority on the financial sustainability of ferry operators, encouraging ferry operators to adopt a commercial approach to ferry service delivery and moving over time to a greater reliance on a user pay system.

Our first performance term ended March 31, 2008, and our second performance term will end March 31, 2012. The price cap increase authorized by the Commissioner for the second performance term was 7.3% on the Major Routes and 4.0% on all other routes effective April 1, 2008, starting from a level which included fuel surcharges in place at March 31, 2008. On each April 1 for the subsequent three years, the price cap increases by 2.7% plus 0.49 times the latest reported annual change in the Consumer Price Index (British Columbia) on the Major Routes and 5.7% plus 0.73 times the change in the Consumer Price Index (British Columbia) on all other routes. On April 1, 2010, the price cap increased by 2.68% (3.74% on April 1, 2009) on the Major Routes and 5.68% (7.25% on April 1, 2009) on all other routes. These price cap increases reflect changes in the Consumer Price Index (British Columbia) of -0.03% applied April 1, 2010 and 2.13% applied April 1, 2009.

Amendments to the *Coastal Ferry Act*

On April 29, 2010, the Province introduced legislation, Bill 20, to amend several statutes, including the *Coastal Ferry Act*. The amendments respond to the Comptroller General's Report on Review of Transportation Governance Models released November 6, 2009, and include changes to the governance and regulatory framework within which we operate.

The proposed governance changes include: broadening the mandate of the B.C. Ferry Authority (Authority) to include responsibility for the compensation plans of our directors and certain executive officers, such compensation plans to be comparable to those of public sector organizations; a requirement that effective September 30, 2010, a director of the Authority cannot also be a director of British Columbia Ferry Services Inc. (BC Ferries); and, the subsection of the records of the Authority and BC Ferries to the *Freedom of Information and Protection of Privacy Act*.

The proposed amendments included in Bill 20 also expand the regulatory responsibilities of the Commissioner to include: consideration of the interests of ferry users; regulation of our reservation fees; approval and public disclosure of our process for handling customer complaints; and review and public disclosure of our ten year capital plan, our plan for improving efficiency in the next performance term, and our methodology for allocating costs among the regulated routes. These amendments also broaden the Commissioner's role in regulating ferry transportation services where the Commissioner determines that we have an unfair competitive advantage. Bill 20 further includes amendments modifying the process by which the Commissioner regulates our activities in seeking additional or alternative service providers on our regulated routes; and requires the Commissioner to issue an opinion on the performance of the Authority in carrying out its legislated responsibilities.

We are currently assessing the cost of these regulatory and administrative changes, which could be in the range of \$2 million to \$3 million per annum.

FINANCIAL AND OPERATIONAL OVERVIEW

This section provides an overview of our financial and operational performance over the past three fiscal years.

(\$ millions)	Year ended March 31		
	2010	2009	2008
Total revenue	732.3	681.8	640.7
% Growth	7.4%	6.4%	7.4%
Operating expenses	660.0	624.2	569.6
Earnings from operations	72.3	57.6	71.1
Interest and other	68.9	48.6	34.0
Net earnings and comprehensive income	3.4	9.0	37.1
	As at March 31		
	2010	2009	2008
Total assets	1,807.0	1,842.2	1,550.5
Total long-term financial liabilities	1,363.9	1,369.0	1,059.5
Dividends on preferred shares	6.0	6.0	6.0

Our earnings from operations in fiscal 2010 were \$14.7 million higher and net earnings were \$5.6 million lower than in fiscal 2009. As expected, the reduction in net earnings reflects increased amortization and financing costs as a result of new capital assets that have entered service with the completion of our fleet and asset renewal program for our Major and Northern Routes. Earnings from operations and net earnings in fiscal 2009 were \$13.5 million and \$28.1 million lower, respectively, than in the previous year, also reflecting the added costs of the new capital assets.

We have now completed the first phase of our SailSafe program, which is a partnership initiative with the BC Ferry & Marine Workers' Union to achieve world class safety performance. We implemented more than 90% of the 48 action items identified to be completed in the first phase, with the balance deliberately carried forward into subsequent phases. We have seen significant improvements in overall safety performance. During fiscal 2010, the number of lost time injuries was down 20% and work days lost to injury were down 26%, compared to the prior year. The next phase, encompassing 41 action plan items, will focus on continuously improving and sustaining our safety performance.

Transport Canada regulates the safety of our vessels by authority of the *Canada Shipping Act 2001*, which came into effect on July 1, 2007. Certain revised regulations resulted in a requirement for vessel upgrades which principally included improvements to lifesaving appliances for a number of vessels and the installation of marine evacuation systems. On January 1, 2009, a new Transport Canada requirement took effect whereby each domestic ferry must have a minimum safe manning document. This document dictates the minimum crew complement and crew certification required to operate the vessel at various passenger levels. In order to comply with these changes for vessels providing service on certain of our Other Routes, either the number of crew would need to increase or the allowable number of passengers carried would need to be lowered. We completed a comprehensive analysis of our capacity requirements on these routes and have either increased crew levels, reduced allowable passenger levels while still maintaining the passenger capacity required by the Coastal Ferry Services Contract or introduced multiple license levels. Multiple license levels permit the ability to manage crew levels higher or lower to match short term passenger demand. These actions have resulted in reducing the potential impact that the regulatory changes would have otherwise had on future fares. As always, the safety of our customers and employees remains our highest priority.

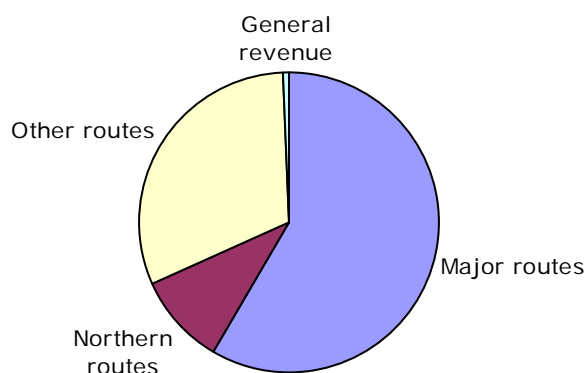
In 2001, the federal government enacted the *Marine Transportation Security Act*. Initially the legislation and the associated regulations were limited to international ports and vessels. Effective January 15, 2010, new regulations came into effect and domestic ferries and facilities are now included within the *Marine Transportation Security Act* framework. We are now required to satisfy a specific level of security on our vessels and at our terminals servicing our Major and certain Other Routes. Following our corporate security strategy, location-specific enhancements have been completed and we have received a security certificate of compliance from Transport Canada. Enhancements included perimeter fencing and gates, closed circuit TV, better access controls, canine screening and patrols.

We have now switched all of our vessels to biodiesel where the product is available. This fuel blend is 5% canola-based biodiesel with 95% low sulphur petroleum diesel. Biodiesel is cleaner with significantly less unburned hydrocarbons, carbon monoxide and particulate matter in emissions.

Revenue

Our total revenues have increased steadily over the past three fiscal years as shown in the table below.

In fiscal 2010, the greatest portion of our revenues, 58%, was earned on our three Major Routes connecting Vancouver Island to Vancouver and the Lower Mainland. The revenue from the Northern Routes contributed 10% and Other Routes contributed 31%.



Revenue (\$ millions)	Year ended March 31		
	2010	2009	2008
Direct Route Revenue			
Vehicle traffic (volume)	8,255,409	8,130,356	8,578,703
Vehicle tariff	281.2	269.1	240.6
Passenger traffic (volume)	21,035,644	20,727,493	21,788,461
Passenger tariff	169.3	160.0	141.6
Social program fees	22.1	19.3	17.3
Catering & on-board	79.1	76.4	77.4
Other revenue	22.2	20.7	24.0
Total Direct Route Revenue	573.9	545.5	500.9
Indirect Route Revenue			
Ferry transportation fees	127.4	105.2	105.5
Federal-Provincial subsidy	26.9	26.3	25.8
Total Route Revenue	728.2	677.0	632.2
Other general revenue	4.1	4.8	8.5
Total Revenue	732.3	681.8	640.7

Our largest revenue source is vehicle and passenger tariffs. The price cap increase authorized by the Commissioner, effective April 1, 2008, was 7.3% on the Major Routes and 4.0% on all other routes, starting from a level which included fuel surcharges in place at March 31, 2008. Effective April 1, 2009, the Commissioner authorized further price cap increases of 3.74% on the Major Routes and 7.25% on all other routes. In response to these price cap increases, we implemented tariff increases. On each remaining April 1 of the four-year performance term, ending March 31, 2012, the price cap increases by 2.7% plus 0.49 times the latest reported annual change in the Consumer Price Index (British Columbia) on the Major Routes and 5.7% plus 0.73 times the change in the Consumer Price Index (British Columbia) on all other routes. On April 1, 2010, the price caps increased by 2.68% on the Major Routes and 5.68% on all other routes. These price cap increases reflect a change in the Consumer Price Index (British Columbia) of -0.03%.

From time to time, we utilize promotional fares designed to stimulate growth in traffic or direct traffic towards our less busy sailings. In calculating the price cap, vehicle and passenger tariffs are combined. The utilization of promotional fare incentives and the effects of being over or under the price cap may cause the average vehicle and passenger tariff rate to be under or over the allowed increase in any one period.

Our traffic levels have historically been relatively stable. However, during fiscal 2009, vehicle and passenger traffic were lower than the prior year by 5.2% and 4.9%, respectively. Dramatically higher vehicle fuel prices during the first part of fiscal 2009, lower levels of tourism, and the general economic decline all contributed to this reduction. In fiscal 2010, we experienced a 1.5% increase in both vehicle and passenger traffic levels, as economic conditions began to improve and vehicle fuel prices declined compared to the prior year.

In fiscal 2009, a fare reduction agreement was made with the Province to provide \$19.6 million in funding to allow a 33% reduction on fares for all routes during the months of December 2008 and January 2009 and for our Prince Rupert-Skidegate route during February 2009. Fares were reduced and this \$19.6 million was recorded in tariff revenue. Although this fare reduction was expected to stimulate traffic, our service areas experienced three weeks of severe weather conditions which resulted in a 10% decrease in traffic in the month of December 2008.

Year to year changes for the past two fiscal years for the Major, Northern and Other Routes are discussed separately below.

Year to Year Comparison of Revenues 2010 – 2009

Major Routes

Direct Route Revenue (\$ thousands)	Fiscal year ended March 31			
	2010	2009	Increase (Decrease)	
Vehicle traffic (volume)	3,739,735	3,696,322	43,413	1.2%
Vehicle tariff	209,530	203,192	6,338	3.1%
Passenger traffic (volume)	10,804,836	10,664,158	140,678	1.3%
Passenger tariff	122,697	117,617	5,080	4.3%
Social program fees	10,774	9,907	867	8.8%
Catering & on-board	64,226	62,302	1,924	3.1%
Reservation fees	12,245	12,038	207	1.7%
Parking	3,474	3,229	245	7.6%
Assured loading	2,365	2,040	325	15.9%
Other revenue	2,035	1,538	497	32.3%
Total Direct Route Revenue	427,346	411,863	15,483	3.8%
Indirect Revenue				
Ferry transportation fees	0	0	0	0.0%
Federal-Provincial subsidy	0	0	0	0.0%
Total Route Revenue	427,346	411,863	15,483	3.8%

Both vehicle traffic and passenger traffic increased in fiscal 2010 from the prior year. The increase in average tariff revenue per vehicle was \$1.06 or 1.9% while the increase in average tariff revenue per passenger was \$0.33 or 3.0%. The higher average fares and increase in traffic resulted in a total increase of \$11.4 million in tariff revenue.

Social program fees are reimbursements from the Province of discounts provided on fares for BC seniors, students travelling to and from school, persons with disabilities and persons travelling under the Ministry of Health Travel Assistance Program. Social program fees increased as a result of higher program usage, higher fares and a \$0.4 million billing correction in fiscal 2009. Neither ferry transportation fees nor federal/provincial subsidies are received in support of services provided on our Major Routes.

All vessels that provide service on our Major Routes have a gift shop and options for food service. Both food and gift shop sales increased as a result of higher traffic and higher average spending per passenger. In our gift shops, sales of quality apparel increased more than 20% while, following the industry trend, sales of books and magazines declined. The *Coastal Celebration* was in service during fiscal 2010 for a full year, adding more lounge seating capacity and increasing revenue from usage of the seating lounge by more than 15%.

Fees for reservations and assured loading revenue increased, mainly as a result of higher traffic levels. Parking revenue increased mainly due to expansion at the Departure Bay terminal.

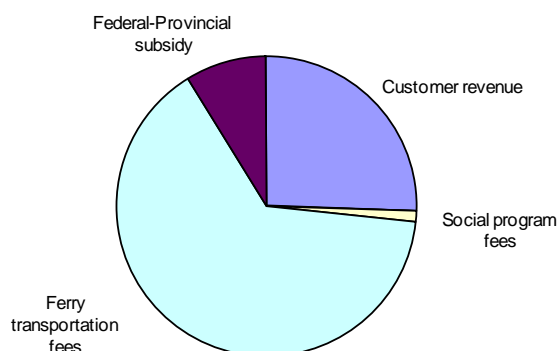
Other revenue increased¹ mainly as a result of hostling¹ fees from our new drop-trailer service for commercial customers.

¹ Loading and unloading of commercial trailers that are dropped off for transportation on a ferry route

Northern Routes

Direct Route Revenue (\$ thousands)	Fiscal year ended March 31			
	2010	2009	Increase (Decrease)	
Vehicle traffic (volume)	31,139	31,739	(600)	(1.9%)
Vehicle tariff	8,006	8,253	(247)	(3.0%)
Passenger traffic (volume)	88,190	93,964	(5,774)	(6.1%)
Passenger tariff	7,106	7,233	(127)	(1.8%)
Social program fees	874	565	309	54.7%
Catering & on-board	2,375	2,237	138	6.2%
Stateroom rental	1,064	783	281	35.9%
Hostling & other	238	280	(42)	(15.0%)
Total Direct Route Revenue	19,663	19,351	312	1.6%
Indirect Revenue				
Ferry transportation fees	47,590	25,283	22,307	88.2%
Federal-Provincial subsidy	6,660	6,505	155	2.4%
Total Route Revenue	73,913	51,139	22,774	44.5%

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



Fiscal 2010 revenue from our Northern Routes consisted of 26% from customers and 74% from the Province (1% social program fees, 64% transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

Total direct revenue on our Northern Routes increased marginally from the prior year.

Both vehicle and passenger traffic decreased from fiscal 2009. The average tariff revenue per vehicle decreased \$2.92 or 1.1% while the average passenger tariff revenue increased \$3.60 or 4.7%. These changes in average tariff revenue reflect lower tourist traffic which pays a higher fare than local travellers. The lower traffic and changes in average tariff rates resulted in a total tariff revenue decrease of \$0.4 million.

Included in fiscal 2009 tariff revenue is \$0.3 million (\$0.2 million for vehicles and \$0.1 million for passengers) in funding provided by the Province to allow a 33% reduction of fares on all Northern Routes during the months of December 2008 and January 2009 and for our Prince Rupert-Skidegate route during February 2009.

Social program fees increased as a result of higher fares, increased program usage and a \$0.1 million billing adjustment in fiscal 2009.

Northern Routes, cont'd

The *Northern Expedition* commenced operating on our northern route through the Inside Passage from Port Hardy to Prince Rupert on May 18, 2009. Stateroom rental increased with the additional capacity provided (50 additional staterooms) and catering and on-board revenue increased with the provision of additional services.

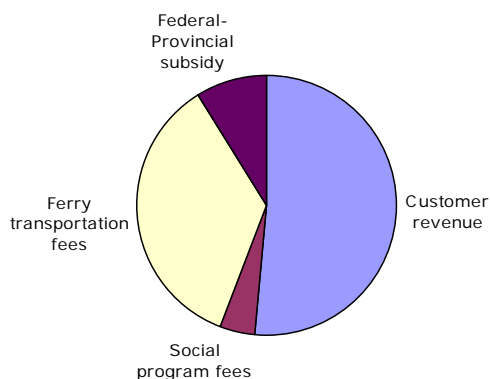
We receive ferry transportation fees for these routes under the Coastal Ferry Services Contract, which relate, in part, to the capital cost of the vessels serving these routes. The fees have increased as a result of the capital cost of the new *Northern Expedition*.

The total Federal-Provincial subsidy has increased by the Consumer Price Index (Vancouver).

Other Routes

Direct Route Revenue (\$ thousands)	Fiscal year ended March 31			
	2010	2009	Increase (Decrease)	
Vehicle traffic (volume)	4,484,535	4,402,295	82,240	1.9%
Vehicle tariff	63,646	57,638	6,008	10.4%
Passenger traffic (volume)	10,142,618	9,969,371	173,247	1.7%
Passenger tariff	39,523	35,129	4,394	12.5%
Social program fees	10,411	8,780	1,631	18.6%
Catering & on-board	11,395	11,128	267	2.4%
Reservation fees	1,333	1,198	135	11.3%
Parking & other	490	421	69	16.4%
Total Direct Route Revenue	126,798	114,294	12,504	10.9%
Indirect Revenue				
Ferry transportation fees	79,858	79,950	(92)	(0.1%)
Federal-Provincial subsidy	20,264	19,789	475	2.4%
Total Route Revenue	226,920	214,033	12,887	6.0%

Our Other Routes consist of 19 regulated routes and eight small unregulated routes primarily serving the northern and southern Gulf Islands and the 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 service on the unregulated routes, which are included in the ferry transportation fees in the above table.



Fiscal 2010 revenue from our Other Routes consisted of 51% from customers and 49% from the Province (5% social program fees, 35% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

Other Routes, cont'd

Both vehicle and passenger traffic increased from the prior year. The increase in average tariff revenue per vehicle was \$1.10 or 8.4% while the average passenger tariff revenue increase was \$0.37 or 10.6%.

In fiscal 2009, we eliminated the sale of prepaid paper tickets on most of our Other Routes. Redemptions and exchanges of paper tickets to electronic media exceeded the liability set up at March 31, 2008, by \$3.7 million. In addition, we established a liability of \$0.6 million at March 31, 2009, to provide for further redemptions of prepaid paper tickets that may be outstanding. This resulted in a total reduction in fiscal 2009 tariff revenue of \$4.3 million relating to prepaid paper tickets.

The increased average fares, the increase in traffic levels, and the reduction in fiscal 2009 caused by prepaid ticket redemptions and exchanges resulted in a total tariff revenue increase of \$10.4 million.

Included in tariff revenue in fiscal 2009 is \$4.3 million (\$2.7 million for vehicles and \$1.6 million for passengers) in funding provided by the Province to allow a 33% reduction of fares on these routes during the months of December 2008 and January 2009.

Reimbursements from the Province for social program fees increased as a result of higher usage, higher fares and a \$0.7 million billing adjustment in fiscal 2009.

Revenue from catering and on-board services, fees for reservations, and parking increased primarily as a result of higher traffic levels.

Year to Year Comparison of Revenues 2009 – 2008

Major Routes

Direct Route Revenue (\$ thousands)	Fiscal year ended March 31			
	2009	2008	Increase (Decrease)	
Vehicle traffic (volume)	3,696,322	3,912,269	(215,947)	(5.5%)
Vehicle tariff	203,192	182,280	20,912	11.5%
Passenger traffic (volume)	10,664,158	11,304,042	(639,884)	(5.7%)
Passenger tariff	117,617	104,292	13,325	12.8%
Social program fees	9,907	8,790	1,117	12.7%
Catering & on-board	62,302	63,785	(1,483)	(2.3%)
Reservation fees	12,038	14,035	(1,997)	(14.2%)
Parking	3,229	3,110	119	3.8%
Assured loading	2,040	2,662	(622)	(23.4%)
Other revenue	1,538	1,209	329	27.2%
Total Direct Route Revenue	411,863	380,163	31,700	8.3%

Both vehicle traffic and passenger traffic decreased in fiscal 2009 from the prior year. The impact on total tariff revenue of these lower traffic levels was more than offset by the increase in average tariffs. The increase in average tariff revenue per vehicle was \$8.38 or 18.0% while the increase in average tariff revenue per passenger was \$1.80 or 19.5%. Most of this increase represents fuel surcharges previously paid by customers and credited to fuel cost deferral accounts, which are now included in tariff revenue by order of the Commissioner. During fiscal 2008, these surcharges paid by customers amounted to \$24.1 million. The April 1, 2008 price cap increase on the Major Routes was 7.3% starting from a level which included fuel surcharges in place at March 31, 2008. The higher average fares, partially offset by the decrease in traffic resulted in a total increase of \$34.2 million in tariff revenue.

Included in tariff revenue is \$15.0 million (\$9.6 million for vehicles and \$5.4 million for passengers) in funding provided by the Province to allow a 33% reduction of fares during the months of December 2008 and January 2009.

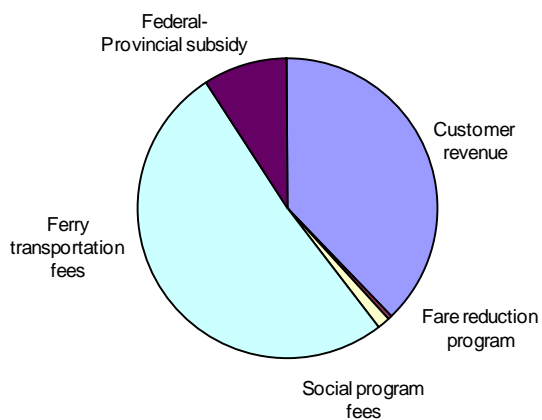
Social program fees have increased mainly as a result of higher fares.

In fiscal 2009, the average spending per passenger for food services increased by 4.2% while the average spending per passenger for gift shop items remained at the same level. The increase in average spending per passenger was more than offset by the reduction in revenue caused by lower traffic levels.

Fees for reservations and assured loading revenue also declined as a result of lower traffic levels. Parking revenue increased while other revenue decreased as a result of reduced video and vending revenues partially offset by retail commissions.

Northern Routes

Direct Route Revenue (\$ thousands)	Fiscal year ended March 31			
	2009	2008	Increase (Decrease)	
Vehicle traffic (volume)	31,739	33,789	(2,050)	(6.1%)
Vehicle tariff	8,253	7,053	1,200	17.0%
Passenger traffic (volume)	93,964	101,751	(7,787)	(7.7%)
Passenger tariff	7,233	6,282	951	15.1%
Social program fees	565	581	(16)	(2.8%)
Catering & on-board	2,237	2,324	(87)	(3.7%)
Reservation fees	69	80	(11)	(13.8%)
Stateroom rental	783	964	(181)	(18.8%)
Hostling & other	211	210	1	0.5%
Total Direct Route Revenue	19,351	17,494	1,857	10.6%
Indirect Revenue				
Ferry transportation fees	25,283	27,350	(2,067)	(7.6%)
Federal-Provincial subsidy	6,505	4,389	2,116	48.2%
Total Route Revenue	51,139	49,233	1,906	3.9%



Fiscal 2009 revenue from our Northern Routes consisted of 36% from customers and 64% from the Province (1% fare reduction agreement, 1% social program fees, 49% transportation fees, and 13% from payments under the Federal-Provincial subsidy agreement).

Both vehicle traffic and passenger traffic decreased from the prior year. The impact on total tariff revenue of these lower traffic levels was more than offset by the increase in average tariffs. The average tariff revenue per vehicle increased \$51.29 or 24.6%. The average passenger tariff revenue increase was \$15.24 or 24.7%. Most of this increase represents fuel surcharges previously paid by customers and credited to fuel cost deferral accounts, which are now included in tariff revenue by order of the Commissioner. During fiscal 2008, these surcharges paid by customers amounted to \$2.2 million. The April 1, 2008 price cap increase on the Northern Routes was 4.0% starting from a level which included fuel surcharges in place at March 31, 2008. The higher average tariff, partially offset by lower traffic, resulted in a total tariff revenue increase of \$2.2 million.

Included in tariff revenue is \$0.3 million (\$0.2 million for vehicles and \$0.1 million for passengers) in funding provided by the Province to allow a 33% reduction of fares on all Northern Routes during the months of December 2008 and January 2009 and for our Prince Rupert-Skidegate route during February 2009.

Northern Routes, cont'd

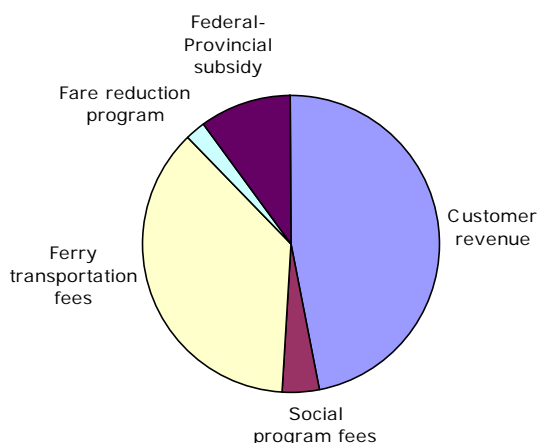
Reimbursements from the Province for social program fees, revenue from catering and on-board services, fees for reservations, and stateroom rental have all decreased primarily as a result of lower traffic levels.

The decrease in ferry transportation fees reflects, in part, the reduction in the capital cost of the *Northern Adventure* as a result of the import duties remission and related GST obtained on that vessel. The Province paid \$1.7 million, an amount equal to the fee reduction related to the duty remission, which was applied to the deferred fuel cost accounts of the Other Routes.

The Federal-Provincial subsidy increase was a result of a redistribution of the subsidy between the Northern and Other Routes. The total subsidy increased by the Consumer Price Index (Vancouver).

Other Routes

Direct Route Revenue (\$ thousands)	Fiscal year ended March 31			
	2009	2008	Increase (Decrease)	
Vehicle traffic (volume)	4,402,295	4,632,645	(230,350)	(5.0%)
Vehicle tariff	57,638	51,319	6,319	12.3%
Passenger traffic (volume)	9,969,371	10,382,668	(413,297)	(4.0%)
Passenger tariff	35,129	31,004	4,125	13.3%
Social program fees	8,780	7,877	903	11.5%
Catering & on-board	11,128	11,276	(148)	(1.3%)
Reservation fees	1,198	1,388	(190)	(13.7%)
Parking & other	421	361	60	16.6%
Total Direct Route Revenue	114,294	103,225	11,069	10.7%
Indirect Revenue				
Ferry transportation fees	79,950	78,151	1,799	2.3%
Federal-Provincial subsidy	19,789	21,467	(1,678)	(7.8%)
Total Route Revenue	214,033	202,843	11,190	5.5%



Fiscal 2009 revenue from our Other Routes consisted of 47% from customers and 53% from the Province (2% fare reduction agreement, 4% social program fees, 38% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

Other Routes, cont'd

Both vehicle traffic and passenger traffic decreased from the prior year. The impact on total tariff revenue of these lower traffic levels was more than offset by the increase in average tariffs. The increase in average tariff revenue per vehicle was \$2.01 or 18.1% while the average passenger tariff revenue increase was \$0.53 or 17.7%. Most of this increase represents fuel surcharges previously paid by customers and credited to fuel cost deferral accounts, which are now included in tariff revenue by order of the Commissioner. During fiscal 2008, these surcharges paid by customers amounted to \$13.1 million. The April 1, 2008 price cap increase on our other regulated routes was 4.0% starting from a level which included fuel surcharges in place at March 31, 2008.

In fiscal 2009, we eliminated the sale of prepaid paper tickets on most of our Other Routes. Redemptions and exchanges of paper tickets to electronic media exceeded the liability set up at March 31, 2008, by \$3.7 million. In addition, we established a liability of \$0.6 million at March 31, 2009, to provide for further redemptions of prepaid paper tickets that might have been outstanding. This resulted in a total reduction in tariff revenue of \$4.3 million relating to prepaid paper tickets.

The increased average fares, partially offset by the reduction in traffic levels and the reduction caused by prepaid ticket redemptions and exchanges, resulted in a total tariff revenue increase of \$10.4 million.

Included in tariff revenue is \$4.3 million (\$2.7 million for vehicles and \$1.6 million for passengers) in funding provided by the Province to allow a 33% reduction of fares on these routes during the months of December 2008 and January 2009.

Reimbursements from the Province for social program fees increased primarily as a result of higher fares.

Revenue from catering and on-board services and fees for reservations decreased primarily as a result of lower traffic levels.

The increase in parking and other income is mainly a result of higher retail commissions.

Ferry transportation fees are higher as a result of the renegotiated fees from the Province for the provision of service on our Northern and Other Routes.

The Federal-Provincial subsidy decrease was a result of a redistribution of the subsidy between the Northern and Other Routes. The total subsidy increased by the Consumer Price Index (Vancouver).

Expenses

Expenses for the past three fiscal years are summarized in the tables below:

Operating expenses (\$ millions)	Year ended March 31		
	2010	2009	2008
Operations	398.8	387.8	347.4
Maintenance	85.6	77.2	88.4
Administration	30.3	37.2	37.1
Total operations, maintenance & administration	514.7	502.2	472.9
% Increase	2.5%	6.2%	6.4%
Cost of retail goods sold	30.1	28.9	29.9
Amortization	115.2	93.1	66.8
Total operating expenses	660.0	624.2	569.6
% Increase	5.7%	9.6%	7.8%

Interest and other (\$ millions)	Year ended March 31		
	2010	2009	2008
Interest expense			
Bond interest	63.3	56.9	45.3
KfW bank group (KfW) loans	11.2	9.0	0.6
Short-term loans	0.3	0.8	0.6
Interest on deferred accounts	0.3	0.1	(0.9)
Structured Financing Facility Program	(4.7)	(2.4)	(2.1)
Capitalized interest	(2.8)	(14.3)	(10.4)
Total interest expense	67.6	50.1	33.1
(Gain) on foreign exchange	(0.1)	(0.3)	(0.1)
Loss (gain) on disposal of capital assets	1.4	(1.2)	1.0
Total interest and other	68.9	48.6	34.0

Restructuring

In response to the decline in traffic levels and resulting revenues in fiscal 2009, we determined the need to restructure our business to align expenses with reduced revenues while continuing to ensure that safety remains our top priority. This restructuring was in addition to our other cost savings measures that included deferral of filling staff vacancies and reduction of discretionary expenditures. Approximately 77 positions were eliminated. This included termination or early retirement of 28 non-union staff, including several vice-presidents, senior management and director-level employees and 7 union staff. The remaining positions were eliminated through attrition. In fiscal 2010, these proactive measures, along with other initiatives, reduced our operating expenditures by approximately \$14 million from previously planned levels.

Year to Year Comparison of Expenses 2010 – 2009

The \$11.0 million increase in fiscal 2010 operations expenses consists of:

- \$10.0 million increase in wages and benefits, including:
 - Approximately \$6.3 million in wage rate increases averaging about 3% in accordance with the existing Collective Agreement; \$1.8 million increase in incentive compensation; and \$1.2 million increase in long-term disability premiums; and
- \$3.1 million increase consisting of \$0.8 million in credit card service fees; \$0.6 million in property taxes; and a further \$1.7 million in a number of miscellaneous items.

These increases were partially offset by:

- \$2.1 million or 2.2% decrease in fuel expense as a result of the operation of the fuel pricing mechanism approved by the Commissioner (see “Deferred Fuel Cost Accounts” below), partly offset by a 1.7% increase in fuel consumption, reflecting new vessels in service being larger than the vessels they replaced.

The \$8.4 million increase in maintenance costs reflects variations in vessel refit scheduling and \$2.0 million of unanticipated maintenance on the *Queen of Burnaby* to replace a damaged propeller. We completed 18 refits in fiscal 2010 and had a further three in progress at March 31, 2010.

Administration expenses decreased \$6.9 million mainly as a result of:

- \$4.4 million decrease in wages and benefits, including:
 - \$2.0 million additional restructuring costs incurred in fiscal 2009;
 - \$1.9 million reduction in fiscal 2010 reflecting the lower number of exempt positions from the restructuring;
 - \$0.5 million in reduced incentive compensation; and
- \$2.5 million mainly due to transition costs incurred in fiscal 2009 to move IT systems support to an in-house model and reductions in discretionary expenditures.

Amortization increased a total of \$22.1 million, mainly as a result of additional assets coming into service, including:

- \$7.2 million due to the *Northern Expedition* commencing service in May 2009;
- \$7.0 million due to the *Coastal Inspiration* and the *Coastal Celebration* entering service in June 2008 and November 2008, respectively;
- \$3.7 million due to the \$52 million *Queen of New Westminster* upgrade completed in April 2009; and
- \$2.3 million due to the *Island Sky* commencing service in February 2009.

Interest expenses increased \$17.5 million primarily due to:

- \$6.4 million additional interest relating to our \$140 million bond series issued in December 2008;
- \$2.2 million additional interest relating to our \$108 million KfW loan received in January 2009, to partially finance the purchase of the *Northern Expedition*;
- \$11.5 million less interest capitalized reflecting the completion of our vessel replacement program for our Major and Northern Routes; partially offset by;
- \$2.3 million in additional interest rate support through the Structured Financial Facility (SFF) program offered by the Government of Canada, reflecting the fiscal allocation relating to the purchase of the *Island Sky* and the life extension of the *Queen of New Westminster*. In October 2009, we received approval for up to \$1.0 million of interest rate support payments through the SFF program relating to the life extension of the *Quinsam*.

In the third quarter of fiscal 2010, we wrote down the book values of the three vessels held for sale, the *Queen of Saanich*, the *Queen of Vancouver* and the *Queen of Prince Rupert*. The write-downs totalled \$2.9 million, reflecting market conditions and management expectations. In the fourth quarter, the *Queen of Saanich* and the *Queen of Vancouver* were sold for nominal proceeds. The loss on write-down of these vessels was partially offset by a \$1.8 million gain on sale of surplus land adjacent to our ship repair facility in Richmond, BC. Results in the prior year included a \$1.2 million gain from the sale of the *Queen of Esquimalt* and a \$0.7 million loss from the sale of the *Queen of Tsawwassen*.

Year to Year Comparison of Expenses 2009 – 2008

The \$40.4 million increase in fiscal 2009 operations expenses consists of:

- \$40.9 million increase in fuel expense as a result of higher set prices and the operation of the fuel pricing mechanism as ordered by the Commissioner, totalling \$42.4 million, partially offset by \$1.5 million in lower fuel consumption;
- \$4.6 million increase in wages and benefits, including:
 - Approximately \$6.9 million in wage rate increases averaging about 3% in accordance with the existing Collective Agreement;
 - \$2.2 million increase in benefit costs;
 - \$0.5 million in training and familiarization; less
 - \$5.0 million from reductions of management and other shore-based positions, in incentive compensation and costs of illness and other paid leave; and
- \$5.1 million decrease reflecting \$1.2 million in funding from the Province for reimbursement of costs to reinstate previously eliminated off-peak sailings and lower discretionary expenditures from cost reduction initiatives.

The \$11.2 million decrease in maintenance costs reflects variations in vessel refit scheduling and the reduced costs of maintaining a newer fleet, partially offset by increased maintenance on our terminals. We completed 16 refits in fiscal 2009 and had a further two in progress at March 31, 2009.

Administration expenses increased \$0.1 million as a result of costs of restructuring and transition of IT systems support to an in-house model, mainly offset by reduced consulting, travel, marketing, advertising and other discretionary expenditures.

Amortization increased a total of \$26.3 million mainly as a result of additional assets coming into service, including \$16.4 million due to the *Coastal Renaissance*, the *Coastal Inspiration*, and the *Coastal Celebration* entering service in March 2008, June 2008 and November 2008, respectively; and \$4.6 million in amortization of deferred fuel cost balances. The Commissioner has included \$18.5 million of deferred performance term one fuel costs in determining the price caps for the four-year second performance term commencing April 1, 2008.

Interest expenses increased \$17.0 million primarily due to:

- \$11.2 million additional interest relating to our \$200 million and \$140 million bond series issued in January 2008 and December 2008 respectively; and
- \$8.4 million additional interest relating to our two KfW loans which partially financed the purchase of the *Coastal Inspiration* and *Coastal Celebration*; and partially offset by
- \$3.9 million of additional interest capitalized reflecting our investment in revitalizing our fleet and terminal facilities.

During the third quarter of fiscal 2009, agreements were completed that would provide us with a further \$10.7 million of interest rate support through the SFF program, relating to the purchase of the new intermediate vessel, the *Island Sky*, and the life extension of the *Queen of New Westminster*. During fiscal 2009, \$2.4 million of this amount was recorded as a reduction in interest expense and \$3.6 million as a reduction of capitalized interest.

Deferred Fuel Cost Accounts

In September 2004, the Commissioner issued an order authorizing our use of deferred fuel cost accounts to mitigate the effect of volatility in fuel oil prices on our earnings.

Commencing April 1, 2004, the Commissioner established set prices for fuel for each of the years until March 31, 2008. At the start of each fiscal year, the set prices increased by the Consumer Price Index (Vancouver). On March 30, 2007, the Commissioner authorized the continued use of inflation-adjusted set prices and deferred fuel cost accounts for the second performance term beginning April 1, 2008.

For the Northern Routes, the per litre cost of fuel included in the determination of price caps (the set price) and one-half of the first 5 cents per litre of difference between the actual price paid per litre (including realized hedge gains and losses) and the set price are recorded in expense. The remaining one-half of the first 5 cents per litre of difference is recorded in the deferred fuel cost accounts. Any difference beyond 5 cents per litre is recovered from or paid to the Province. The total to be paid to the Province relating to fuel costs on the Northern Routes was \$1.3 million for fiscal 2010 (\$2.4 million recovered from the Province in fiscal 2009).

For all other routes, differences in fuel costs arising from our actual price paid per litre (including realized hedge gains and losses) being higher or lower than the set price included in base tariffs less one-half of the first 5 cents per litre of difference are charged or credited to the deferred fuel cost accounts.

There is a mechanism in place to allow price cap adjustments to provide for implementation of fuel surcharges or rebates when appropriate. Throughout fiscal 2010, fares on many of our routes, with the exception of our Major and Northern Routes, were reduced by fuel rebates ranging from 2% to 10% on average. There are no fuel surcharges or rebates on our Northern Routes. In fiscal 2010, we refunded \$6.3 million in fuel rebates to customers. In fiscal 2009, we collected \$16.5 million in fuel surcharges, net of rebates. These amounts were applied to the outstanding deferred fuel cost account balances.

Under an agreement reached during fiscal 2008, the Province agreed to pay \$1.3 million for fiscal 2008, \$1.7 million for fiscal 2009, and \$1.6 million for fiscal 2010, which was applied to the deferred fuel cost accounts. These benefits are equal to the amount by which annual ferry transportation fees payable by the Province were reduced as a result of the lower cost of the *Northern Adventure* due to remission and refund of import duties paid. These reductions in the deferred fuel cost accounts benefit our customers through reduced fuel surcharges or earlier fuel rebates.

The Commissioner considered \$18.5 million of unrecovered first performance term deferred fuel costs in determination of the price caps set for the four years beginning April 1, 2008, for which recovery will occur over this four year period. The actual closing balance in the deferral accounts at March 31, 2008 was \$11.9 million. The difference in these amounts, a credit of \$6.6 million, formed the opening balances of the deferred fuel cost accounts for the second performance term.

The balances in our deferred fuel cost accounts totalled less than \$0.1 million at March 31, 2010 (\$16.0 million, including \$0.9 million in unrealized fuel hedge losses at March 31, 2009).

All of the Commissioner's Orders can be viewed at www.bcferrycommission.com.

LIQUIDITY AND CAPITAL RESOURCES

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. With the receipt of the \$108 million KfW loan in January 2009, our major financing requirements are complete. Our ongoing capital expenditures are expected to be significantly lower than in the previous few years. Over the next five years, we expect our cash requirements will be met through operational cash flows and by accessing our credit facility from time to time. At March 31, 2010, our unrestricted cash and cash equivalents totalled \$11 million.

We target maintaining a strong investment-grade credit rating to allow capital market access at reasonable interest rates. At March 31, 2010, DBRS assessed our credit rating as A and Standard & Poor's assessed our rating as A+, both with a stable trend.

Long-Term Debt

In May 2004 we entered into a master trust indenture. This indenture established common security and a set of common covenants for the benefit of our lenders. Our financing plan encompasses an ongoing program capable of accommodating a variety of corporate debt instruments and borrowings ranking *pari passu*. We do not currently view common share equity as a potential source of capital and have no present intention of offering common shares to the public or other investors.

In the last three years, we completed two private placements of senior secured bond offerings. These bonds bear interest payable semi-annually. The details of each are:

- \$200 million issued January 2008 with interest at 5.58%, due January 2038; and
- \$140 million issued December 2008 with interest at 6.21%, due December 2013.

The net proceeds of these offerings were used to fund capital expenditures, the related debt service reserve and for general corporate purposes.

We are also party to a credit agreement with a syndicate of Canadian banks that is secured under the master trust indenture. Under this agreement, we have available a revolving facility in the amount of \$155 million. The facility, maturing May 12, 2013, is available to fund capital expenditures and other general corporate purposes. At March 31, 2010, there were no draws on this credit facility.

In fiscal 2006 we executed two loan agreements with KfW. These agreements are secured under the master trust indenture. The agreements allow us to borrow up to \$90 million per loan, with the net proceeds to be used for partial financing of the purchase of two of the three Super C-class vessels. In February 2008, to coincide with conditional acceptance of the *Coastal Inspiration*, we received \$90 million in proceeds under the loan agreements. In May 2008, to coincide with conditional acceptance of the *Coastal Celebration*, we received a further \$90 million in proceeds under the loan agreements. These are 12-year amortizing loans at a fixed interest rate of 4.98%, payable quarterly. The agreements defer the principal payments for the first three years to a second tranche on which interest is payable at a floating rate and the principal is due at maturity.

In January 2009, to coincide with conditional acceptance of the *Northern Expedition*, we received \$108 million in proceeds under a further loan agreement with KfW. This is a 12-year amortizing loan at a fixed interest rate of 2.95%, payable semi-annually. The proceeds were applied toward the purchase of the new vessel.

Our long-term debt is summarized below:

(\$millions)	Effective interest rate	Amount outstanding as at March 31		
		2010	2009	2008
Senior Secured Bonds				
5.74%, Due May 2014	5.92%	250	250	250
6.25%, Due October 2034	6.41%	250	250	250
5.02%, Due March 2037	5.06%	250	250	250
5.58%, Due January 2038	5.60%	200	200	200
6.21%, Due December 2013	6.33%	140	140	-
12 Year KfW Loans				
Tranche A, Due March 2020	5.17%	75	82	90
Tranche B, Due March 2020	Floating*	15	8	-
Tranche A, Due June 2020	5.18%	77	84	-
Tranche B, Due June 2020	Floating*	13	6	-
2.95% KfW Loan, Due January 2021	3.08%	99	108	-
		1,369	1,378	1,040
* CAD LIBOR plus 30 basis points at March 31, 2010				

Terminal Leases

We entered into a master agreement with the BC Transportation Financing Authority (BCTFA) effective March 31, 2003, as part of the restructuring of our company. In return for the transfer of ownership interest in all ferry terminals from the former British Columbia Ferry Corporation to the BCTFA at the time of the corporate restructuring, we received recognition of prepayment of rent under terminal leases.

The leases grant us exclusive access and use of ferry terminal properties for a period of 60 years commencing April 1, 2003. The leases are renewable for an additional period of 20 years at a total cost of \$20 per lease provided the Coastal Ferry Services Contract is renewed. We must manage, maintain and develop the terminals at our own cost.

Since the original transfer, a total of \$11.7 million of additional lands at Horseshoe Bay, Swartz Bay and Departure Bay have been added to the existing terminal leases in exchange for highway improvements.

If we fail to meet our obligations under the terminal leases or default under the Coastal Ferry Services Contract, the BCTFA may at its option re-enter and take possession of the ferry terminal properties and at its option terminate the leases. The BCTFA has entered into an acknowledgement agreement with the Trustee under the master trust indenture, which sets out certain limitations on the use of this option.

In addition to the above, we have entered into a 40-year lease agreement with the Town of Sidney, BC, to manage an existing ferry terminal owned by the town. This terminal is the western end of a Washington State Ferries route connecting Vancouver Island with Anacortes, WA.

Other Long-Term Liabilities

Other long-term liabilities consist primarily of accrued post-retirement and post-employment benefits.

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 interest payments on our long-term debt.

Sources and uses of cash and cash equivalents for fiscal 2010 and 2009 are summarized in the table below.

(\$ millions)	Year ended March 31	
	2010	2009
Net earnings	3.4	9.0
Items not involving cash:		
Amortization	115.2	93.1
Other non-cash charges	1.8	(0.3)
Regulatory costs deferred	10.3	(6.0)
Change in non-cash operating working capital	(9.4)	(6.8)
Cash provided by operating activities	121.3	89.0
Cash (used) provided by financing activities	(33.5)	339.3
Cash used in investing activities	(89.6)	(532.2)
Total (decrease) in cash	(1.8)	(103.9)

In fiscal 2010, cash provided by operating activities included an increase in non-cash working capital of \$9.4 million. This increase in working capital was primarily due to:

- \$3.3 million reduction in accrued employee costs;
- \$2.8 million reduction in regulatory liabilities reflecting the return to customers through discount fare promotions tariff revenues collected in excess of price caps in the last quarter of fiscal 2009;
- \$2.4 million reduction in payables and accrued liabilities relating to refit and maintenance and other operating activities;
- \$1.6 million increase in accounts receivable, mainly due to social program fees receivable; and
- \$1.2 million increase in total inventories.

The above items, which increased working capital, were partially offset by:

- \$1.3 million reduction in prepaid expenses mainly due to a \$1.5 million lower fuel prepayment; and
- \$0.6 million increase in deferred revenue.

Cash used in financing activities reflects the \$9.0 million principal repayment on the 2.95% KfW loan, the \$18.0 million repayment of draws on our \$155 million credit facility, and payment of the \$6.0 million dividend on preferred shares.

Cash used in investing activities consists mainly of \$84.2 million used to purchase capital assets and \$7.5 million used to purchase short-term investments, partially offset by \$2.2 million in proceeds from the disposal of land and vessels. The significant capital transactions are described below in "Investing in Our Capital Assets".

FOURTH QUARTER RESULTS

The following provides an overview of our financial performance for the three months ended March 31, 2010, compared to the three months ended March 31, 2009.

The fourth quarter reflects a seasonal reduction in traffic levels which we utilize to perform upgrades and major maintenance and refit programs as well as to undertake mandatory inspections on the majority of our vessels.

(\$ millions)	Three months ended March 31			
	2010	2009	Variance	
			\$	%
Total revenue	142.3	128.5	13.8	10.7%
Expenses	161.8	153.6	(8.2)	(5.3%)
Loss from operations	(19.5)	(25.1)	5.6	22.3%
Interest and other	17.3	13.3	(4.0)	(30.1%)
Net loss	(36.8)	(38.4)	1.6	4.2%

Revenue

Our total revenues have increased as shown in the following table.

Revenue (\$ millions)	Three months ended March 31		Increase(Decrease)	
	2010	2009	\$	%
Direct Route Revenue				
Vehicle traffic (volume)	1,588,875	1,628,626	(39,751)	(2.4%)
Vehicle tariff	53.4	49.9	3.5	7.0%
Passenger traffic (volume)	3,955,789	3,870,171	85,618	2.2%
Passenger tariff	30.9	27.6	3.3	12.0%
Social program fees	4.9	3.1	1.8	58.1%
Catering & on-board	14.6	14.0	0.6	4.3%
Other revenue	3.7	3.3	0.4	12.1%
Total Direct Route Revenue	107.5	97.9	9.6	9.8%
Indirect Route Revenue				
Ferry transportation fees	27.2	22.8	4.4	19.3%
Federal-Provincial subsidy	6.7	6.6	0.1	1.5%
Total Route Revenue	141.4	127.3	14.1	11.1%
Other general revenue	0.9	1.2	(0.3)	(25.0%)
Total Revenue	142.3	128.5	13.8	10.7%

Total tariff revenue increased \$6.8 million in the last quarter of fiscal 2010 compared to the prior year. The effect of higher average fares and increased passenger traffic was partially offset by lower vehicle traffic. A significant contributing factor to the variation in traffic was the 2010 Winter Olympics in Vancouver in February 2010. In February 2010, our passenger traffic was up 52,959 or 4.5% while vehicle traffic was down 38,125 or 7.6% compared to February 2009. The fourth quarter increase in average tariff revenue per vehicle was \$2.97 or 9.7% while the increase in average tariff revenue per passenger was \$0.68 or 9.5%.

Included in tariff revenue in the prior year is \$8.6 million in funding provided by the Province to allow a 33% reduction of fares on all routes during January 2009 and for our Prince Rupert-Skidegate route during February 2009.

The social program fee increase was mainly as a result of a \$1.4 million billing adjustment recorded during the fourth quarter of fiscal 2009.

Catering and on-board revenues increased mainly as a result of higher passenger traffic.

Other revenue reflects a \$0.2 million increase in reservation fees and \$0.2 million additional parking revenue.

Ferry transportation fees were higher on the Northern Routes, reflecting the increase in fees related to the capital cost of the new *Northern Expedition*.

Expenses

Expenses are shown in the following table:

(\$ millions)	Three months ended March 31			
	2010	2009	(Increase)Decrease	
			\$	%
Operations	93.0	87.2	(5.8)	(6.7%)
Maintenance	25.0	21.5	(3.5)	(16.3%)
Administration	8.0	12.2	4.2	34.4%
Cost of retail goods sold	5.8	5.7	(0.1)	(1.8%)
Amortization	30.0	27.0	(3.0)	(11.1%)
Total operating expenses	161.8	153.6	(8.2)	(5.3%)
Interest & other	17.3	13.3	(4.0)	(30.1%)
Total expenses	179.1	166.9	(12.2)	(7.3%)

The increase in operations costs reflects wage rate increases averaging about 3%, higher incentive compensation, increased operating costs of vessels used on the Northern Routes, extra early morning and late night sailings during the Olympics, advertising costs of new travel products and venue, and other miscellaneous cost increases.

The increase in maintenance costs reflects variations in vessel refit scheduling.

Administration costs decreased from the same period in the prior year due to \$3.6 million lower wages and benefits and reductions in discretionary expenditures. Wage costs in the fourth quarter of fiscal 2009 included a charge for \$3.1 million in restructuring costs.

Amortization increased as a result of additional assets that came into service in fiscal 2010, including \$2.1 million for the *Northern Expedition* which entered service in May 2009.

Interest expenses increased primarily due to \$2.7 million lower capitalized interest reflecting the completion of our asset renewal program for the Major and Northern Routes and \$0.4 million lower funding under the SFF program.

INVESTING IN OUR CAPITAL ASSETS

Capital expenditures in the three and twelve months ended March 31, 2010, totalled \$30.4 million and \$81.4 million, respectively. This level of expenditure reflects the significant reduction in our capital program compared to previous years. Total capital expenditures were:

Capital expenditures (\$ millions)	March 31, 2010	
	3 Months	12 Months
New vessels, vessel upgrades and modifications	12.3	28.3
Terminal marine structures	12.2	22.5
Terminal and building upgrades and equipment	0.6	15.1
Information technology	5.3	15.5
Total capital expenditures	<u>30.4</u>	<u>81.4</u>

New Vessels, Vessel Upgrades and Modifications

Capital expenditures for new vessels, vessel upgrades and vessel modifications in the three and twelve months ending March 31, 2010, included the following:

New vessels, vessel upgrades and modifications (\$ millions)	March 31, 2010	
	3 Months	12 Months
<i>Quinsam</i> upgrade and betterment (Phase 2)	6.9	10.2
New northern vessel, the <i>Northern Expedition</i>	0.1	4.6
Sewage treatment upgrade program	1.6	3.9
Voyage Data Recorders and navigational aids and upgrade of vessel connectivity	0.4	1.8
Bow thruster replacement on the <i>Spirit of British Columbia</i>	0.9	1.7
Vessel security upgrades	-	1.3
Other projects	2.4	4.8
	<u>12.3</u>	<u>28.3</u>

The second and final phase of the upgrade and betterment of the *Quinsam* includes new lifesaving systems, new electrical switchboard and generators, new right-angle drives, upgrades to the engines, and various interior improvements. This phase (\$12 million) of the project is expected to be complete by the end of the first quarter of fiscal 2011. In October 2009, we received approval for up to \$1.0 million of interest rate support payments through the SFF program relating to the life extension of the *Quinsam*. The first phase (\$5 million) was completed in the prior fiscal year.

On April 13, 2010, we received approval for up to \$1.8 million of additional interest rate support payments through the SFF program relating to the life extension of the *Quadra Queen II* expected to be completed in fiscal 2011.

On May 18, 2009, the new *Northern Expedition* made its inaugural voyage on our northern route through the Inside Passage from Port Hardy to Prince Rupert. This 150-metre vessel, which replaced the 43-year-old *Queen of Prince Rupert*, has 55 staterooms and has a capacity of up to 130 vehicles and 600 passengers. A \$133 million contract with Flensburger Schiffbau-Gesellschaft to build this new vessel was signed in July 2006 and completed on schedule and on budget. The import duties and taxes on this contract total approximately \$44 million while the import duties and taxes on the contract to build the *Coastal Renaissance*, the *Coastal Celebration* and the *Coastal Inspiration* were \$99 million. We are seeking a remission of import duties and related GST of approximately \$119 million on these contracts, but are uncertain as to the outcome of our applications.

Implementation of a multi-year sewage and waste water treatment program to upgrade 20 vessels and eight terminals for treatment of sewage generated by the vessels is underway. The program involves major modifications and upgrades to ensure that all vessels comply with new *Canada Shipping Act, 2001* sewage regulations, which will apply effective July 1, 2012. Wherever possible, the vessels will convey sewage to a terminal through pump-ashore infrastructure. In all other cases, the vessels will be fitted with compliant marine sanitation devices. We have received approval from the local government to connect the Swartz Bay terminal to their existing infrastructure and we are working with the remaining local governments to seek approval to pump effluent into their systems at our cost. Modification of the first two vessels, the *Skeena Queen* and the *Kwuna*, is complete. As part of the Federal government's Infrastructure Stimulus Fund program, we estimate we will receive \$7.5 million to assist with sewage pump-ashore projects and other major terminal projects.

The two-year program to install Voyage Data Recorders and navigational aids and upgrade vessel connectivity is complete. The remaining few vessels will be completed as they undergo their planned refits.

Terminal Marine Structures

Capital expenditures for terminal marine structures in the three and twelve months ending March 31, 2010, included the following:

Terminal marine structures (\$ millions)		March 31, 2010	
Terminal	Description	3 Months	12 Months
Tsawwassen	Major berth replacement and refurbishment	4.8	7.3
Quathiaski Cove	Replacement of ramp, wingwalls, towers and waiting shelter	3.5	3.8
Langdale	Replacement of wingwall	0.1	1.7
Fulford Harbour	Replacement of two dolphins and maintenance walkway	-	1.6
Tsawwassen	Restoration of the concrete transfer deck	0.8	1.5
Horseshoe Bay	Berth upgrades	0.9	1.0
Campbell River	Replacement of wingwalls and dolphins	0.7	0.7
Prince Rupert	Addition of a tie up dolphin for the <i>Northern Expedition</i>	-	0.6
Denman Island	Apron replacement and wingwall refurbishment	-	0.5
Skidegate	New pontoon, ramp, ramp abutment and two dolphins	-	0.5
Various	Other projects	1.4	3.3
		<u>12.2</u>	<u>22.5</u>

The \$39 million replacement and refurbishment of one of the berths (Berth 4) at Tsawwassen terminal is a multi-year project to replace all 13 dolphins, the port wingwall and the lower ramp. The lower ramp will be replaced with a new multi-apron ramp with two-lane commercial vehicle capacity and the foundations and ramp supports will be upgraded and a new hydraulic lift system installed.

Terminal and Building Upgrades and Equipment

Capital expenditures for terminal and building upgrades and equipment in the three and twelve months ending March 31, 2010, included the following:

Terminal and building upgrades and equipment (\$ millions)	March 31, 2010	
	3 Months	12 Months
Terminal security upgrades	0.8	8.6
Less: federal funding	(5.8)	(9.1)
Departure Bay terminal	0.8	5.7
Vehicles, machinery & equipment	1.6	4.1
Swartz Bay waste water program	0.9	1.3
Vacations centre	0.8	1.0
Other terminal projects	1.5	3.5
	<u>0.6</u>	<u>15.1</u>

At nine terminals, mainly serving our Major and Northern Routes, we continued our multi-year project to upgrade security. This project primarily involves fencing, gating, lighting, access controls, and closed circuit television, as well as upgrades to foot passenger ticketing areas and baggage screening. We expect to receive \$9.1 million of federal funding through the Transport Canada Marine Security Contribution Program to help offset our costs of perimeter security, access control measures, and training. The program requires us to apply for reimbursement of 75% of the eligible costs of security enhancements on approved projects as capital expenditures are incurred. As of March 31, 2010, we had submitted claims for reimbursement of the full \$9.1 million available to us of which \$5.9 million was received. The remaining \$3.2 million was approved for reimbursement.

At Departure Bay terminal, the new waiting room is complete and in use. Also, waste management facilities have been consolidated and employee parking has been expanded and paved. To complete this project, the holding compound and short-term parking will be expanded. This is a continuation of the master plan for improvements at this terminal that began last fiscal year and is expected to be completed in fiscal 2011.

The costs incurred for vehicles, machinery, and equipment include the purchase of five additional hostling units in the fourth quarter (20 for the year) to support our new drop-trailer service. These units will be used to move commercial trailers to and from our holding compounds. We also continued with our planned replacement of certain vehicles and baggage carts and replaced machinery at our shipyard.

As part of the multi-year sewage and waste water treatment program for treatment of sewage generated by the vessels, connection of Swartz Bay terminal to the existing municipal infrastructure has been completed.

Information Technology

Capital expenditures for information technology in the three and twelve months ending March 31, 2010, included the following:

Information technology (\$ millions)	March 31, 2010	
	3 Months	12 Months
Enterprise resource planning upgrade	1.3	5.6
Network for the operations centre	1.2	2.9
IT hardware replacement program	1.1	2.1
Data privacy projects	0.4	1.2
Automated ticketing software	0.3	0.9
Other projects	1.0	2.8
	<u>5.3</u>	<u>15.5</u>

The most significant information technology project has been our enterprise resource planning system upgrade, which includes financial and related operating systems. The first and largest phase of this project was implemented on August 30, 2009. The second phase, which included enhancements to enable reporting under International Financial Reporting Standards (IFRS) has since been completed. This upgrade will provide future opportunities for operational improvements through its advanced functionality.

Our new operations and security centre went into service in May 2009. This project included video terminals, wall displays, cameras, and computer hardware and software that allow for real-time situational awareness and monitoring of fleet operations. Work on expanding the network for the centre has been completed.

During the year \$1.2 million was spent as part of our ongoing initiatives to ensure the protection of privacy of our customers and others.

On December 1, 2009, we opened new self-ticketing kiosks at two of our major terminals. The self-ticketing system is designed to simplify and speed up the foot passenger ticketing process.

On December 17, 2009, we completed a website enhancement to allow our internet services to be more accessible to customers. Anyone using a handheld device with web connectivity can now view up-to-the-minute ferry travel information.

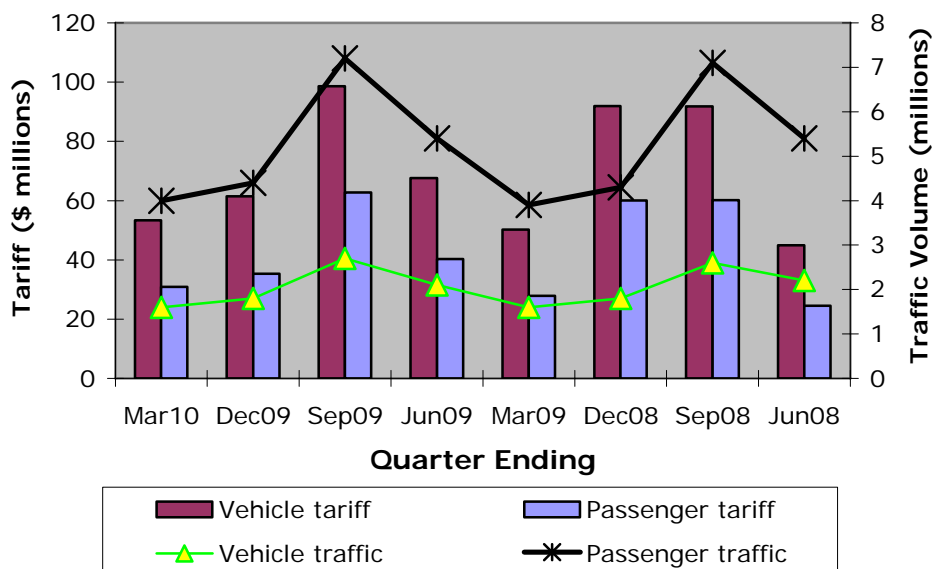
SUMMARY OF QUARTERLY RESULTS

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

(\$ millions)	Quarter Ended (unaudited)							
	Mar 10	Dec 09	Sep 09	Jun 09	Mar 09	Dec 08	Sep 08	Jun 08
Total revenue	142.3	159.9	251.8	178.3	128.5	149.4	232.1	171.9
(Loss) earnings from operations	(19.5)	(1.9)	81.5	12.2	(25.1)	(1.7)	66.2	18.4
Net (loss) earnings and comprehensive (loss) income	(36.8)	(20.4)	64.2	(3.6)	(38.4)	(14.6)	53.7	8.4

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:



OUTLOOK

Traffic Levels

Ferry traffic levels are affected by a number of factors, including the economy, weather, transportation costs, the value of the Canadian dollar, global security, tourism levels, disposable personal income, demographics and population growth.

The Canadian economy experienced turbulence in the financial markets and a recessionary period in fiscal 2009. This had a negative impact on our operations. While our ridership had been stable over several years, we experienced a downturn in traffic in fiscal 2009 which was at least partly due to the economic conditions. In fiscal 2009, British Columbia experienced fewer housing starts, reduced tourism, plant closures in the forest product industry, falling auto sales, rising unemployment, and generally reduced consumer confidence. These and other declining economic conditions all negatively impacted our commercial and discretionary travel markets.

In fiscal 2010, our vehicle and passenger traffic levels increased by 1.5% over the prior year as world and local economies began to recover.

Vehicle Traffic by fiscal year					
(thousands)	2010	2009	2008	2007	2006
Major routes	3,739.7	3,696.3	3,912.3	3,826.5	3,790.4
Other routes	4,484.6	4,402.4	4,632.6	4,669.6	4,715.8
Northern routes	31.1	31.7	33.8	25.8	37.1
Total	8,255.4	8,130.4	8,578.7	8,521.9	8,543.3
Increase (decrease)	1.5%	(5.2%)	0.7%	(0.3%)	(0.2%)

Passenger Traffic by fiscal year					
(thousands)	2010	2009	2008	2007	2006
Major routes	10,804.8	10,664.2	11,304.0	11,146.3	11,055.9
Other routes	10,142.6	9,969.3	10,382.7	10,440.5	10,556.7
Northern routes	88.2	94.0	101.8	78.2	117.0
Total	21,035.6	20,727.5	21,778.5	21,665.0	21,729.6
Increase (decrease)	1.5%	(4.8%)	0.5%	(0.3%)	(1.3%)

The Bank of Canada, in its Monetary Policy Report dated April 2010, is projecting growth in the world economy of 4.2% (3.7% in Canada) in 2010 and 4.0% (3.1% in Canada) in 2011.

Over the near term we anticipate a limited recovery in discretionary traffic levels, and over the next few years we anticipate a modest increase in overall traffic volume on all our routes.

Cable Ferry

We are continuing to review the feasibility of using cable ferry technology on one of our shortest routes with the expectation that this review will be complete in fiscal 2011. Cable ferry technology uses small engines in combination with drive and guide cables to move the vessel. Not only do cable ferries have a lower capital cost than conventional ferries, but there is also potential for a reduction in operating costs. It has been determined using a cable ferry is technically feasible, while detailed engineering and design work and a final cost assessment are required to determine if the concept is fully feasible. In addition, there are a number of regulatory and environmental issues that must be addressed before such a service could be implemented. Safety, reliability and quality of service will continue to be important considerations in the overall assessment of this concept. This initiative is part of our ongoing efforts to identify and pursue opportunities that have the potential to enhance our effectiveness in delivering safe, reliable, and quality ferry service.

Operating Cost Management

In response to the decline in traffic levels and resulting revenues in fiscal 2009, we determined the need to restructure our business to align expenses with reduced revenues while continuing to ensure that safety remains our top priority. We continue to regularly review and update our financial and operating plans to ensure appropriate alignment of expenses with revenues.

Market Opportunities

Notwithstanding the pressure on traffic volumes generally, we see opportunities for growth in certain segments of our business.

In March 2009, we launched our drop-trailer service on two of our Major Routes. Our commercial customers on these routes can now drop their trailers off at one terminal and pick them up at another. This drop-trailer service has been well received in the commercial market and improves our overall productivity by utilizing otherwise unused capacity. We expect to see slow growth in commercial traffic in the first half of fiscal 2011. Higher fuel prices and currency appreciation are expected to negatively impact lumber exports which will affect our business. We do expect to see some modest growth in the latter part of fiscal 2011 driven by an improvement of general economic conditions. We expect to see our overall commercial market share remain relatively stable.

On May 11, 2010, we officially opened our new vacations centre in downtown Vancouver. Using a 37-foot long interactive media wall display, customers are able to view route maps, vessel schematics, and destination images to help them choose from a variety of travel package options. The 2,675 square-foot travel centre in the new Fairmont Pacific Rim property is conveniently located to the tourist sector. Over 20 unique BC coastal vacation packages and more than 100 individual products that include extra hotel nights, activities and adventures are available for purchase at the centre, through our website or by telephone. We believe that this will expand our market reach and increase our profile in the Lower Mainland and within the tourism industry. This is expected to lead to increased traffic volumes as well as incremental non-tariff revenue.

We are constantly looking for innovative ways to serve our customers and have partnered with a local company to offer spa services on one of our Major Routes. This new service commenced May 13, 2010.

We have also expanded the number of cash dispensing machines available to our customers, as paying by debit card is not yet available on our vessels. We now have cash dispensing machines on all of our vessels and at all terminals on our Major Routes.

Alternative Service Providers

In an effort to reduce costs on our regulated routes and as mandated by the *Coastal Ferry Act*, we are exploring opportunities to have ferry services provided by additional or alternative service providers (ASP). While we maintain responsibility for the long-term delivery of ferry services, we are required to test the market to determine if another operator, under contract to us, could provide safe, reliable and high quality service that is more cost-effective.

We issued a Request for Proposal in June 2009 to identify a prospective ASP to provide service to the mid-coast ports of Ocean Falls and Shearwater on our Northern Routes. We performed an assessment of the responses received from the proponents and concluded that an ASP could provide the service on a more cost-effective basis. However, the Province was not in a position to confirm that we could proceed as per the Coastal Ferry Services Contract. Consequently, we cancelled this ASP initiative. We will continue to be the provider of the service to these ports, which is called for under the Coastal Ferry Services Contract.

Asset Renewal Program

We have one of the largest fleets in the world. The average age of our assets was among the oldest of major ferry operators worldwide. To address this, we instituted a major fleet and asset renewal program. The recent additions to our fleet have been:

- the *Northern Adventure* and the *Kuper* in March 2007;
- the Super C-class vessels: the *Coastal Renaissance*, the *Coastal Inspiration*, and the *Coastal Celebration* in March, June, and November 2008, respectively;
- the *Island Sky* in February 2009; and
- the *Northern Expedition*, a northern vessel, in May 2009.

The entry of these vessels into service has reduced the average age of our vessels and completes the most significant portion of our asset renewal program.

Upgrading and replacing a large share of our fleet through new vessel acquisitions and our revitalization program also assists in maintaining operational reliability.

We continue to reinvest our cash generated from operations into our asset renewal program. The entry of these new assets into service has resulted in an increase in amortization and financing costs, causing a significant decrease in our earnings. This reduced level of earnings is expected to continue over the near term.

Our vessel replacement program is now complete for the Major and Northern Routes. Our capital expenditures over the next few years are expected to be significantly lower as we transition into more of a maintenance mode. Our next significant vessel renewal program will commence for the Other Routes within the next five years.

Regulatory Changes

On April 29, 2010, the Province introduced legislation, Bill 20, to amend several statutes, including the *Coastal Ferry Act*. The amendments respond to the Comptroller General's Report on Review of Transportation Governance Models released November 6, 2009, and include changes to the governance and regulatory framework within which we operate.

The proposed changes impact a significant number of operational areas. We are currently evaluating what impact the changes could have on our results of operations and on our profitability. (See "Business Risk Management – Economic Regulatory Environment").

FINANCIAL RISKS AND FINANCIAL INSTRUMENTS

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.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment. Where the market prices are not available, fair values are estimated using discounted cash flow analysis based on our current borrowing rate for similar borrowing arrangements.

Credit Risk

We limit our exposure to credit risk on cash and investments by investing in liquid securities with high credit-quality counter-parties, placing limits on tenor of investment instruments and instituting maximum investment values per counter-party. We manage credit exposure related to financial instruments by dealing with high credit-quality institutions, in accordance with established credit-approval practices and by an ongoing review of our exposure to counter-parties. We do not expect any counter-parties to default on their obligations.

Our credit risk from trade customers is limited by having a large and diversified customer base and is managed through the review of third party credit reports, utilizing pre-authorized payment plans, monitoring of aging of receivables, and collecting deposits and adjusting credit terms for higher-risk customers. Amounts due from the Province and the Government of Canada are considered low credit risk. At March 31, 2010, 59% of our accounts receivable was comprised of amounts due from the Province and the Government of Canada.

Liquidity Risk

We target a strong investment-grade credit rating to maintain capital market access at reasonable interest rates. 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 deem this to be a low risk at this time as we do not foresee the need to access the capital markets for the next several years.

We manage liquidity risk through daily monitoring of cash balances, the use of long-term forecasting models and the maintenance of debt service reserves. At March 31, 2010, DBRS assessed our credit rating as A and Standard & Poor's assessed our rating as A+, both with a stable trend.

Market Risk

Interest Rate

Our exposure to interest rate risk is limited to our short-term borrowings and floating rate debt and interest rate movement beyond the term of the maturity of fixed rate short-term investments. To manage this risk, we maintain between 70% and 100% of our debt portfolio in fixed rate debt, in aggregate. A 50 basis point change in interest rates would not have had a significant effect on our fiscal 2010 earnings.

Foreign Currency

We are also exposed to risk from foreign currency prices on financial instruments, such as accounts payable denominated in currencies other than the Canadian dollar. To manage exposure on future purchase commitments, we review our foreign currency denominated commitments and hedge through derivative instruments as necessary. A 10% change in the US dollar or Euro foreign exchange rates would not have had a significant effect on our fiscal 2010 earnings.

Fuel Price

Our exposure to fuel price risk is associated with the changes in the market price of marine diesel fuel. Fuel costs have fluctuated significantly over the past few years and there is uncertainty of the cost of fuel in the future.

To mitigate the effect of volatility in fuel oil prices on our earnings, we use deferred fuel cost accounts. (See "Expenses – Deferred Fuel Cost Accounts" above for more detail).

High levels of fuel pricing could translate into significant fuel surcharges and result in unprecedented total tariff levels. There is uncertainty of the impact on future ferry traffic levels if fuel surcharges and therefore total tariff costs rise significantly. There is a risk of a decline in ferry traffic levels as a result of increasing customer costs resulting from the implementation of fuel surcharges. Throughout fiscal 2010, fuel rebates rather than surcharges were in place on many of our routes and further rebates were implemented on April 1, 2010. (See "Expenses – Deferred Fuel Cost Accounts" above for more detail).

We also may manage our exposure to fuel price volatility by entering into swap agreements in order to add a fixed component to the inherent floating nature of fuel prices. Fuel price hedging instruments are used solely for the purpose of reducing fuel price risk, not for generating trading profits. Our Commodity Risk Management Policy limits hedging to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period to March 31, 2011, and to a maximum of 90% of anticipated monthly fuel consumption for the 12 months thereafter to the end of the second performance term ending March 31, 2012. At March 31, 2010, we did not have any outstanding fuel swaps. Gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs.

Derivatives

We hedge our exposure to fluctuations in fuel prices and foreign currency exchange rates through the use of derivative instruments. At March 31, 2010, we had no derivative instruments in place while at March 31, 2009, we held 13 commodity fixed price swap instruments with both a carrying and fair value of \$0.9 million.

The commodity derivatives fair value reflects only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel. These fair values reflect the estimated amounts that we would receive or pay should the derivative contracts be terminated at the stated dates. Any gains or losses related to fuel commodity swaps are charged to our deferred fuel cost accounts. At March 31, 2009, we recorded a payable of \$0.9 million as the estimated loss to terminate the contracts as at that date.

Non-Derivative Financial Instruments

The carrying and fair values of non-derivative financial instruments at March 31, 2010, and 2009 are as follows:

(\$ millions)	2010		2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets				
Cash and cash equivalents	10.6	10.6	12.4	12.4
Restricted cash equivalents and short-term investments	37.2	37.2	37.2	37.2
Other short-term investments	7.7	7.7	0.2	0.2
Accounts receivable	17.7	17.7	13.2	13.2
	<u>73.2</u>	<u>73.2</u>	<u>63.0</u>	<u>63.0</u>
Financial Liabilities				
Accounts payable and accrued liabilities	38.9	38.9	41.8	41.8
Short-term debt	-	-	18.0	18.0
Interest payable on long-term debt	18.3	18.3	18.4	18.4
Accrued employee costs	48.6	48.6	51.9	51.9
Long-term debt, including current portion	1,357.2	1,458.1	1,365.2	1,344.0
Other long-term liabilities	0.2	0.2	0.2	0.2
	<u>1,463.2</u>	<u>1,564.1</u>	<u>1,495.5</u>	<u>1,474.3</u>

The fair value of all financial instruments included above, with the exception of long-term debt, approximate their carrying amounts due to the nature of the item and/or the short time to maturity.

The carrying value of long-term debt is measured at amortized cost using the effective interest rate method. Fair value is calculated by discounting the future cash flow of each debt issue at the estimated yield to maturity for the same or similar issues, or by using available quoted market prices.

BUSINESS RISK MANAGEMENT

We continue to employ a variety of commonly accepted methodologies to identify, assess and mitigate risks. We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business.

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 weather the economic downturn and we believe that we continue to have a viable future.

Customer Demand

Many factors affect customer demand, including current economic conditions, levels of tourism, and discretionary travel. The cost of fuel at the pump, the value of the Canadian dollar, disposable personal income, heightened global security and weather may have a negative effect on discretionary travel and levels of tourism.

We are uncertain as to the individual or cumulative impact these items may have on our revenue. We are also uncertain as to the cumulative impact that tariff rate increases and the implementation and removal of fuel surcharges may have on our traffic levels. No assurance can be given as to the level of traffic on our system and the resulting tariff revenue.

Risk mitigation: We actively manage our capacity in an efficient and effective manner to ensure we can react quickly to changing levels of demand. Vessel planning strategies are in place and we regularly review and update our short and long-term financial and operating plans to ensure appropriate alignment of expenses with revenue.

Security

Deliberate, malicious acts could cause death, injury or property damage. The occurrence of a major incident or mishap could negatively affect the propensity for the public to travel, reducing our ferry traffic levels. It could also lead to a substantial increase in insurance and security costs.

Any resulting reduction in tariff revenues and/or increases in costs could have a material adverse effect on our business prospects, financial condition and results of operations.

Risk mitigation: Security initiatives are in place to counter intentional attacks. We opened our 24-hour operations and security centre in May 2009 to provide enhanced situational awareness and assessments, increased security monitoring, and a coordinated response during any incidents.

We are committed to our multi-year project to upgrade security at our terminals. This project primarily involves fencing, gating, lighting, access controls, and closed circuit television, as well as upgrades to foot passenger ticketing areas and baggage screening.

We also have a sound conventional insurance program designed to mitigate the financial impact of a major incident. However, there can be no guarantee that the insurance coverage will be sufficient to cover all such accidents or disasters.

Safety

The safety of the public and our employees is our highest priority. However, there is a risk of compromised passenger or employee safety and/or property damage as a result of failure to meet regulatory requirements, mechanical failure, employee error, negligence and/or complacency.

We also have significant revenues from food sales, both on our vessels and at our terminals, and there is a risk of a foodborne illness contracted from consuming contaminated foods or beverages purchased from our food services.

An event of injury or illness could have a material adverse effect on our financial position and results of operations.

Risk mitigation: In fiscal 2007, we commissioned former BC Auditor General, George L. Morfitt to conduct an independent review of our safety policies, procedures and practices. We also plan to conduct a similar comprehensive operational safety review at a minimum of every five years as part of our ongoing commitment to ensuring the safety of our passengers and employees.

Some of the recommendations in the Morfitt report were put into practice in fiscal 2007 while others have been incorporated into our safety program, SailSafe, which was launched in fiscal 2008. SailSafe involves employees in identifying areas and methods for enhancing current safety practices and ensuring that safety is our first priority each and every day.

Our food storage, handling, preparation and cooking procedures are aligned with the hazard analysis critical control point (HACCP) methodology which is a preventive approach to food safety. HACCP is an industry-wide effort approved by the scientific community, as well as by regulatory and industry practitioners.

We also adhere to a program of internal and external safety audits designed to verify our compliance with our safety management system and have participated in a major multi-agency training exercise to test the coordinated response to a major marine disaster.

Performance Risk

The occurrence of a major incident or mishap could result in default under the Coastal Ferry Services Contract unless such accident or mishap qualified as an event of force majeure.

The occurrence of a default under the Coastal Ferry Services Contract could have consequences, including an adjustment to ferry transportation fees from the Province or the forced sale of our vessels to the Province for net book value and termination of the Terminal Leases.

Risk mitigation: We have an asset renewal program for our vessels and terminals, a major portion of which has already been completed. This program will revitalize our fleet and upgrade our terminals to support our on going operations and maintain service reliability.

We regularly update our vessel maintenance schedules to ensure that we provide the core service levels required under the Coastal Ferry Services Contract.

We continuously monitor our operations from our 24-hour operations and security centre. This provides enhanced situational awareness and assessments to identify and prevent potential incidents and provides a coordinated response to any incident that may occur.

Regulations - Environmental

Our operations are subject to various environmental laws and regulations dealing with the transportation, storage, presence, use, disposal and handling of hazardous materials and hazardous wastes, the discharge of storm water and the delivery of vessel fuel.

The provincial government has made a commitment to reduce greenhouse gas emissions by 33% by the year 2020, based on emissions in 2007. While the reduction targets have not yet been set, the transportation industry has been identified as a sector that will have emission limits.

If we were to be involved in an environmental accident or be found in material violation of applicable law and regulations, we could be responsible for material clean-up costs, property damage, and fines or other penalties.

Risk mitigation: We will continue to comply with environmental laws and regulations and to actively develop strategies to help us become an industry leader in environmental management.

We have a fuel reduction strategy that is designed to reduce fuel consumption and emissions on our vessels. To date, we have switched all of our vessels to biodiesel where the product is available, implemented a wide variety of fuel saving measures ranging from operating our vessels more efficiently to installing new, more fuel-efficient engines on some of our vessels and fuel monitoring systems on others and designing and building our new vessels to meet or exceed current environmental standards.

We have programs in place to protect the environment and reduce greenhouse gas emissions. Besides using biodegradable hydraulic oils, we recycle beverage containers, cardboard, newsprint, spent fluorescent tubes, batteries and used cooking oil. We have replaced chemical products with more environmentally friendly solutions and have replaced gasoline powered terminal vehicles with electric vehicles and gasoline powered baggage vans with propane powered tugger units.

We are also introducing new initiatives to further mitigate our environmental impact. Implementation of a multi-year sewage and waste water treatment program to upgrade 20 vessels and eight terminals for treatment of sewage generated by the vessels is underway. Wherever possible, the vessels will convey sewage to a terminal through pump-ashore infrastructure. In all other cases, the vessels will be fitted with compliant marine sanitation devices. (See "Investing in our Capital Assets" above for more detail)

We believe that we maintain adequate environmental insurance; however, there can be no guarantee that the insurance coverage will be sufficient to cover all such losses.

Economic Regulatory Environment

We cannot predict what changes the Province may make to the *Coastal Ferry Act* or to other legislation beyond those contained in Bill 20, nor can we predict how the present or future Commissioner's interpretation and administration of the *Coastal Ferry Act* may change over time. Such changes may impact our profitability. (See "Corporate Structure – Amendments to the *Coastal Ferry Act*" above regarding recent legislation).

The appointment term of the current Commissioner expires on June 30, 2010 and whether he will be re-appointed or replaced is unknown. We are currently developing our submission with respect to the third performance term price caps. This submission is due by law to the Commissioner by September 30, 2010. While there is inherent risk to any application to the Commissioner as to whether he will rule favourably, this risk is amplified by not knowing who the adjudicating Commissioner of this submission will be.

Risk mitigation: We strive to maintain regular and open communications and positive relationships, with the Province, the Commissioner, the Deputy Commissioner and local Ferry Advisory Committees that represent the interests of the communities we serve.

With respect to the expiring term of the Commissioner, the appointment term of the existing Deputy Commissioner does not expire until June 30, 2014, providing some continuity in the adjudication of our submission for the third performance term price caps.

Regulations - Other

Our operations are subject to a wide variety of national and local laws and regulations, all of which may change at any time.

There is the potential that the introduction of new safety or other regulations, including new taxes, or the interpretation of existing regulations, may impose a new, unexpected and significant cost burden and/or result in major disruptions to our operations.

Risk mitigation: We foster positive relationships with local officials and treat recommendations and advisories with respect and due consideration. Appeals are made to higher authorities as required.

We strive to lead the way in adopting new regulations. We were one of the first to adopt, prior to the mandatory compliance date, the new provincial *Public Health Act* regulation which restricts trans-fat in all food service establishments.

We continue to seek reasonable and cost effective solutions for compliance with new regulations through our planning processes and asset renewal initiatives. (See "Financial and Operational Overview" above for discussion on compliance with regulations of the *Canada Shipping Act, 2001*).

We have the opportunity to apply to the Commissioner under Section 42 of the *Coastal Ferry Act* for an extraordinary price cap increase if the introduction of new safety or other regulations imposes a new, unexpected and significant cost burden.

Vessel Repair Facilities

We have a vessel repair facility in Richmond where we perform maintenance and refit work on our vessels. Our facility, however, does not have a dry-dock. There are only two dry-docks in British Columbia that can accommodate large vessels. One of these facilities dominates the vessel repair market, especially for large vessels.

Our vessel repair requirements are also changing. We expect to have fewer but larger refit projects over time, with most requiring dry-dock space. This strategy is expected to reduce mobilization and vessel re-deployment costs. At the same time, the overall demand for ship repair and ship building facilities is expected to increase with the recently announced federal ship procurement strategy. As a result, we expect docking facilities will soon be over-subscribed and demand for ship repair capacity will outstrip supply, especially for large vessels.

The inability to acquire timely and cost effective ship repair services may cause operational disruption and may have an adverse effect on results of operations, cash flow and financial results.

Risk mitigation: We plan our vessel maintenance to maximize use of our vessel repair facility in Richmond. We are also developing a plan to upgrade the capabilities at our facility. Also, alternatives to using local facilities are being researched.

Labour Relations – Collective Agreement

The majority of our employees are members of the BC Ferry & Marine Workers' Union. On March 8, 2007, a final award was released by arbitrator Vince Ready, building on the October 2004 interim award. This is expected to provide us with labour stability until the end of the term on October 31, 2012.

The inability to maintain or to renew the collective agreement on acceptable terms could result in increased labour costs or service interruptions arising from labour disputes that are not provided for in approved rates and that could have an adverse effect on the results of operations, cash flow and financial results.

Risk mitigation: We work diligently to build productive relationships with our employees. The award has a mechanism in place that allows for the orderly transition to the next collective agreement without the ability to strike and provides a unique and innovative dispute resolution process to facilitate future collective bargaining.

Labour Relations – Application for Exclusions

We currently have an application in to Mr. Ready for the exclusion of several positions of authority onboard our vessels. Following an award by Mr. Ready, there is a risk that we are unable to implement in accordance with our desired timetable.

Risk mitigation: a comprehensive transition adjustment plan has been developed which provides for a gradual, phased implementation of the newly excluded positions over a longer timeframe so as to ensure the optimum retention of current staff and the orderly placement and orientation of staff into the new positions. This plan includes the assignment of leaders, employee mentors and a master overseer - ombudsperson.

Taxes

We received an advance income tax ruling from Canada Revenue Agency (CRA) that, provided the facts and other statements set out therein are accurate, we are a "Tax Exempt Corporation" described in paragraph 149(1)(d.1) of the *Income Tax Act*. This ruling was subject to a proposed amendment to subsection 149(1.3) of the *Income Tax Act* announced by the Department of Finance on December 20, 2002. The essential elements of this amendment were included in Bill C-10, which was cancelled when Parliament was dissolved before the 2008 federal election. However, there is no reason to believe that it will not be reintroduced. We have received a non-binding opinion from CRA that subsection 149(1.3), if amended as proposed on December 20, 2002, will not cause us to cease to be a Tax Exempt Corporation. There can be no assurance that subsection 149(1.3) of the *Income Tax Act* will be amended as proposed, or that we are and will continue to be a Tax Exempt Corporation.

The 12% HST will come into effect on July 1, 2010. As a result, we expect a significant increase in our tax cost as a number of items we currently purchase exempt from the Provincial Sales Tax will be subject to this new tax. We estimate the annual increase in our operating costs to be approximately \$5 to \$6 million. The HST is also expected to cause the selling price of our catering and certain other on-board services to increase. The additional cost to our customers may negatively impact their level of spending and in turn our revenue.

As the vast majority of ferry fares charged to our customers will be exempt from HST, we have limited opportunity to recover HST paid through input tax credits. The total effect of the upcoming HST on our financial position and results of operations is not yet known.

Risk mitigation: We will review and update our financial and operating plans in consideration of the increased costs resulting from the HST.

We have the opportunity to apply to the Commissioner under Section 42 of the *Coastal Ferry Act* for an extraordinary price cap increase if the introduction of new safety or other regulations imposes a new, unexpected and significant cost burden. We will also ensure that

the impact of this tax is formally included in our submission respecting our third performance term price caps.

Treaty Negotiations: Aboriginal Rights and Title

Much of British Columbia, including areas where we have operations and real property interests, is subject to claims of aboriginal use rights and/or aboriginal title. Canadian courts have recognized that aboriginal peoples may enjoy constitutionally protected rights, whether or not recognized in a treaty, in respect of land used or occupied by their ancestors. These rights vary from the right to use lands and waters to carry out traditional activities (for example, an aboriginal right to fish) to the right to exclusively occupy lands subject to aboriginal title. What kind of right might exist depends primarily upon the nature and extent of the prior aboriginal use and occupation.

At present, many aboriginal groups are seeking recognition of their right to use or occupy their traditional territories. They also expect to participate in government decision-making with respect to activities by third parties on those lands. Canadian courts have confirmed that provincial and federal governments have a duty to consult with and, if necessary, accommodate aboriginal groups asserting rights or title where these interests might be infringed by government action. Government approvals and licences, such as those required to operate existing terminal facilities or develop new ones, may trigger the government's duty to consult with any aboriginal groups whose interests might be detrimentally affected.

Risk mitigation: Under the master agreement, the Province retains its liability, to the extent any exists, for the acts and omissions of the Province that occurred prior to our possession of the ferry terminal properties leased under the Terminal Leases and will reimburse us for any damages we suffer as a result. The Province will reimburse us for damages suffered if there is a final court decision or a treaty settlement that recognizes or confers upon an aboriginal group a proprietary or other interest in the ferry terminal properties should that right or interest interfere with our quiet enjoyment of the ferry terminal properties as set out in the Terminal Leases.

ACCOUNTING PRACTICES

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with Canadian generally accepted accounting principles.

Our significant accounting policies are contained in note 1 to our 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 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.

We believe the following are the most critical accounting policies and estimates that we have used in the preparation of our financial statements:

Workers' Compensation Claims Liability

Our financial statements include an estimate of residual liability for workers' compensation claims arising from the Workers' Compensation Board (WCB) deposit class coverage system, in which our predecessor entity participated on or prior to March 31, 2003.

The WCB provided our predecessor company with an actuarial valuation of the unfinalized claims remaining to be paid that relate to incidents on or prior to March 31, 2003. This estimate totalled \$9.3 million at March 31, 2003, and is drawn down as claims are paid out. In fiscal 2007 we received an actuarial valuation estimating that the unfinalized claims remaining to be paid at March 31, 2006, totalled \$4.7 million. As a result we reduced the unfinalized claims liability and decreased expenses by \$1.8 million during fiscal 2007. The remaining balance at March 31, 2010, of \$1.7 million (\$2.1 million at March 31, 2009) is included in accrued employee future benefits in our financial statements.

Public Service Pension Plan

Our employees are members of the Public Service Pension Plan (the Plan), a defined benefit and multiemployer pension plan. The Plan is exempt from the requirements under the provincial *Pension Benefits Standards Act* to use the "solvency" method in conjunction with the "going concern" method for valuation purposes. As such, the Plan is currently valued solely by the going concern method. The most recent valuation of the total Plan, as at March 31, 2008, indicated a surplus of \$487 million.

Effective April 1, 2009, the Public Service Pension Board of Trustees increased contribution rates to the basic account for plan members and employers from 7.63% to 7.78% of pensionable earnings each, primarily due to the change in the investment return and salary increase assumptions. The contribution rates to the inflation adjustment account remain unchanged for members and employers at 1.5% and 2.5% respectively.

Retirement Bonus Liability

We sponsor a plan that provides a post-retirement benefit for eligible long service employees. The valuation of this plan is estimated based on complex actuarial calculations using several assumptions. These assumptions are determined by management with significant input from our actuary. The valuation of the obligation depends on such assumptions as discount rate, projected salary increases, retirement age and termination rates. An actuarial valuation of the plan at March 31, 2007, was obtained and the accrued benefit obligation estimated at \$13.4 million. The liability included in accrued employee future benefits in our financial statements at March 31, 2010, was \$10.0 million (\$10.4 million at March 31, 2009).

We have adopted the corridor method of recognizing actuarial gains and losses. Any gains and losses in excess of 10% of the obligation balance will be amortized over the average remaining service period of employees expected to receive benefits under this plan.

Rate Regulation

We follow generally accepted accounting principles which, as we are a regulated entity, may differ from those otherwise expected in non-regulated businesses. These differences occur when the regulator issues orders and generally involve the timing of revenue and expense recognition. The principles we follow ensure that the actions of the regulator, which create assets and liabilities, have been reflected in the financial statements.

The accounting for these items is based on an expectation of the future actions of the regulator. As of March 31, 2010, we have two regulatory assets or liabilities:

- Deferred fuel costs: the difference between amounts allowed by the regulator in operating expense and those actually incurred with settlement expected through future tariffs, surcharges or rebates;
- Performance term submission costs: costs for incremental contracted services relating to our second and third performance term submissions. Our regulator has approved recovery of the second performance term submission costs over the second performance term ending March 31, 2012, and recovery of the third performance term submission costs over the third performance term ending March 31, 2016.

If the regulator's future actions are different from our expectations, the timing and amount of the settlement of regulatory assets and liabilities could be substantially different from that reflected in our financial statements.

Amortization Expense

Our capital assets, including assets under capital leases, are amortized on a straight-line basis at varying rates. Amortization rates require the use of estimates of the useful lives of the assets and of salvage value to be realized upon asset retirement.

We periodically review asset lives in conjunction with our longer term asset deployment, replacement and upgrade strategies. When we determine that asset lives do not reflect the expected remaining period of benefit, we make prospective changes to the remaining period over which they are amortized. There are a number of uncertainties inherent in estimating our asset lives and changes in these assumptions could result in material adjustments to our financial statements.

As disclosed in note 1 to our financial statements, we review and evaluate our long-lived assets for impairment when events or changes in circumstances indicate that the related amounts may not be recoverable.

Hedging Relationships

We utilize derivative financial instruments to manage market risk against the volatility in foreign currency, interest rate, and fuel price exposures. We do not utilize derivative financial instruments for trading or speculative purposes. At the inception of each hedge, we determine whether or not to apply hedge accounting.

When applying hedge accounting, we document all relationships between hedging instruments and hedged items, as well as our risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. We also assess, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. Realized and unrealized gains or losses associated with derivative instruments which have been terminated or cease to be effective prior to maturity are recognized in the period in which they have been terminated or cease to be effective.

Asset Retirement Obligations

When it can be reasonably determined, we recognize the fair value of a liability for any legal obligations associated with the retirement of long-lived assets when those obligations result from the acquisition, construction, development or normal operation of the assets. A corresponding asset retirement cost is added to the carrying amount of the related asset and amortized to expense on a systematic and rational basis.

Certain of our vessels contain undetermined amounts of asbestos. Under certain circumstances, we may be required to handle and dispose of the asbestos in a manner required by regulations. It is our intention to sell decommissioned vessels into world markets to buyers who will keep them in active service. Under these circumstances asbestos remediation would become the responsibility of the new owner.

No amount has been recorded for asset retirement obligations relating to these assets as it is not possible to make a reasonable estimate of the fair value of any such liability due to the indeterminate magnitude, likelihood or financial impact, if any, of this issue. In addition, as our operations are regulated, there is a reasonable expectation that any significant asset retirement costs would be recoverable through future tariffs.

Adoption of New Accounting Standards

In fiscal 2010, we adopted the following CICA Handbook Sections:

- Effective April 1, 2009; section 3064, *Goodwill and Intangible Assets* did not substantively change the requirement pertaining to goodwill. The changes in requirements pertaining to intangible assets primarily relate to recognition criteria for purchased and internally developed assets which will result in fewer intangible assets being recognized on the balance sheet. Other than reclassifications and additional disclosure in Note 8, the adoption of this section has had no impact on our consolidated financial statements.
- Effective April 1, 2009; amendment to Section 1100 *Generally Accepted Accounting Principles* was adopted prospectively. With release of this amendment, a temporary exemption that permitted assets and liabilities arising from rate regulation to be recognized and measured on a basis other than in accordance with the primary sources of generally accepted accounting principles was removed.

As no specific guidance is provided in Canadian GAAP, we may consult other sources and, have determined that our regulatory assets and liabilities qualify for recognition under Canadian GAAP consistent with US Statement of Financial Accounting Standard Board's Accounting Standards Codification Topic 980 "Regulated Operations". Therefore, the adoption of this amendment has had no impact on our consolidated financial statements.

- In June 2009, amendments were issued to Section 3862, *Financial Instruments – Disclosures*. The amendments require additional disclosure regarding the fair value measurement of financial instruments and enhanced disclosure of liquidity risk. Other than the additional disclosures in Notes 1(h) and 3, the adoption of these amendments has had no impact on our consolidated financial statements.

Future Accounting Changes

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

- In 2006, the Canadian Accounting Standards Board (AcSB) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian generally accepted accounting principles with IFRS over an expected five year transitional period. Our transition date for the conversion to IFRS is April 1, 2011, and will require the restatement for comparative purposes of amounts reported by us for the year ended March 31, 2011. We are continuing to assess the financial reporting impacts of the adoption of IFRS and are monitoring ongoing standards development as issued by the International Accounting Standards Board and the AcSB as well as regulatory developments as issued by the Canadian Securities Administrators, which may affect the timing, nature or disclosure relating to our adoption of IFRS.

The transition to IFRS may materially affect our reported financial position and results of operations. As our analysis is still underway and accounting policy choices, as well as exemptions under *IFRS 1 First-Time Adoption of IFRS* (IFRS 1), have not yet been selected, we are unable to quantify the impact of IFRS on the future financial position and results of operations.

We commenced our IFRS transition project in 2007 and have established a formal project governance structure with regular reporting. We have also engaged a quality assurance advisor to assist in the project.

Our IFRS transition project consists of three phases:

1. Scoping and diagnostic phase, which has been completed, involved project planning and resourcing, high level impact assessment of differences between current Canadian GAAP and IFRS, and priority setting;
2. Analysis and development phase which involves detailed analysis and evaluation of options and alternative methodologies available under IFRS, and the financial impact of these options; and
3. Implementation and review phase which involves implementing and approving changes to accounting policies, information systems, business processes and training, and developing IFRS-compliant financial statements.

We are currently in either the analysis and development stage or the implementation and review stage, depending on the specific area.

The following table includes elements of our IFRS transition plan and an assessment of progress towards achieving the key milestones. We are working through a detailed IFRS transition plan and certain project activities and milestones could change. Further, changes in regulation or timing of standard development throughout the project could result in changes to the transition plan.

<p>Financial statement preparation</p> <p><i>Key activities</i></p> <ul style="list-style-type: none"> • Identify differences in Canadian GAAP/IFRS accounting policies • Select ongoing IFRS policies • Develop financial statement format • Select IFRS 1 exemptions for transition • Quantify effects of change at April 1, 2010 (for fiscal 2011 comparative financial statements) <p><i>Milestones</i></p> <ul style="list-style-type: none"> • Senior management review of policy decisions and illustrative IFRS financial statements and disclosures by June 30, 2010 • Audit & Finance Committee approval of policy decisions and IFRS financial statement format, in principle, by September 30, 2010 • IFRS 1 exemptions finalized and quantified by September 30, 2010 • Policies and procedures in place by March 31, 2011 <p><i>Status</i></p> <ul style="list-style-type: none"> • Scoping and diagnostic phase completed in fiscal 2009, with high-level review of the major differences between Canadian GAAP and IFRS • Highest areas of impact identified; review prioritized; and in-depth analysis complete in most areas • Accounting policy alternatives have been analyzed, recommendations made for the majority of key accounting policy decisions • IFRS 1 exemptions reviewed and analyzed with the exception of the IFRS 1 amendment published May 6, 2010, regarding property, plant and equipment and intangible assets used in operations subject to rate regulation • Preparation of illustrative financial statements and note disclosures substantially complete • Drafting of policies and procedures in progress
<p>Information technology infrastructure</p> <p><i>Key activities</i></p> <ul style="list-style-type: none"> • Confirm system upgrades required for IFRS reporting • Review/revise data gathering processes • Review/revise budgeting and forecasting processes <p><i>Milestones</i></p> <ul style="list-style-type: none"> • System configuration changes complete by March 31, 2010 • System reporting changes required to accommodate both current Canadian GAAP and IFRS complete by August 31, 2010 • Changes to budgeting and forecasting processes complete by September 30, 2010 <p><i>Status</i></p> <ul style="list-style-type: none"> • Detailed reporting requirements to accommodate the transition to IFRS identified and documented • Overall system approach selected • System configuration to accommodate both current Canadian GAAP and IFRS complete • Changes to accommodate reporting requirements in progress • Changes to budgeting and forecasting processes in progress

<p>Training, Education & Communication</p> <p><i>Key activities</i></p> <ul style="list-style-type: none"> • Determine required level of IFRS expertise within all areas of the company • Ensure appropriate training of key members within Finance • Provide appropriate education and communication to affected departments • Provide department specific training on revised policies and procedures • Provide timely communication to both internal and external stakeholders on impacts of the transition to IFRS <p><i>Milestones</i></p> <ul style="list-style-type: none"> • Topic-specific training for IFRS working committee complete prior to March 31, 2010 • Department-specific training completed by March 31, 2011 • Impacts of transition to IFRS communicated to external stakeholders by March 31, 2011 <p><i>Status</i></p> <ul style="list-style-type: none"> • Core IFRS project team members completed topic-specific training, and successfully completed the "IFRS Award Program, Certificate Level" through the Institute of Chartered Accountants in England and Wales • Interdepartmental workshops provided on specific topics, including property, plant and equipment; IFRS 1; and the IFRS Framework • Training requirements identified and training plan developed as implementation plans progress • Ongoing communications with key stakeholders, including direct communication with the Commissioner, our Agent Bank, rating agencies, our Board of Directors, and with investors indirectly through our website
<p>Control environment</p> <p><i>Key activities</i></p> <ul style="list-style-type: none"> • Accounting policy determination, documentation and implementation • MD&A ongoing communications <p><i>Milestones</i></p> <ul style="list-style-type: none"> • All internal control process descriptions updated by March 31, 2011 • Publish quantitative effects of conversion on April 1, 2010 opening balance sheet in December 31, 2010 MD&A (assuming decisions regarding regulatory assets and liabilities are known) <p><i>Status</i></p> <ul style="list-style-type: none"> • Analysis of control issues in progress as part of the detailed implementation plan • Documentation of policies and procedures in progress
<p>Business policy assessment</p> <p><i>Key activities</i></p> <ul style="list-style-type: none"> • Financial covenants assessment • Compensation arrangements assessment • Customer and supplier contract evaluation <p><i>Milestones</i></p> <ul style="list-style-type: none"> • Potential impact on compensation arrangements determined by December 31, 2010 • Impact on customer/supplier contracts determined by December 31, 2010 • Impact on financial covenants quantified by March 31, 2011 <p><i>Status</i></p> <ul style="list-style-type: none"> • All relevant GAAP-dependent covenants and contracts have been identified • Analysis to determine effects of IFRS on existing covenants and contracts in progress

A summary of progress in the review of areas identified to have the highest potential to impact us is as follows:

- Rate-regulated operations: IFRS does not currently provide specific guidance with respect to accounting for rate-regulated activities. However, in December 2008, the International Accounting Standards Board (IASB) initiated a project on accounting for rate-regulated activities that has an objective to develop a standard on rate-regulated activities that would clarify whether regulated entities could or should recognize assets or liabilities as a result of rate-regulation imposed by a regulatory body.

On July 23, 2009, the IASB published an Exposure Draft "Rate-regulated Activities" (ED) to define regulatory assets and regulatory liabilities, set out criteria for their recognition, specify how they should be measured and require disclosures about their financial effects. We reviewed this ED and responded to the IASB requesting clarification of scope as defined in the ED. More than 150 comment letters with significantly differing comments and views were received by the IASB.

At its February 2010 meeting, the IASB began discussions on the responses to the ED. They also discussed the logistical considerations impacting the rate-regulated activities project and reviewed the potential paths forward including a project timetable prepared by its staff. The IASB did not make any tentative decisions on specific aspects of the project, except to tentatively finalize an amendment to IFRS 1 to provide transition relief for first-time adopters. This amendment was published on May 6, 2010. It provides an exemption for property, plant and equipment and intangible assets used in operations subject to rate regulation. A first-time adopter may elect to use, on an item by item basis, the previous GAAP carrying amount of such items as deemed cost at the date of transition to IFRS. We are currently assessing the impact of the options available to us as a result of this IFRS 1 amendment.

The IASB directed the staff to continue its research and analysis on this project and to focus on the key issue of whether regulatory assets and liabilities exist in accordance with the current Framework for the Preparation and Presentation of Financial Statements and whether they are consistent with other current IFRS standards.

The IASB plans to continue its deliberation of this project at a future meeting and expects to issue a new standard by the end of June, 2011.

The continued uncertainty regarding IFRS treatment of regulatory assets and liabilities has resulted in an inability to reasonably estimate and conclude the impact of IFRS on our future financial position and results of operations with respect to differences, if any, in accounting for rate-regulated activities.

- Property, plant and equipment:
 - *Inspections and major overhauls:* The capitalization of inspections and major overhauls of our vessels is the largest change affecting us. A process to track these items has been finalized and necessary system configuration changes have been completed. We are currently in the process of:
 - ▶ defining and identifying inspection and major overhaul items for each class of vessel;
 - ▶ quantifying those inspections and major overhauls for reclassification of property, plant and equipment at transition date; and
 - ▶ determining the best solution for reporting of these costs.As the analysis is in progress, the effect on our consolidated financial statements of the adoption of this guidance cannot be quantified at this time.
 - *Valuation subsequent to transition:* We have a choice under IFRS to value our property, plant and equipment using either a historical cost model or a revaluation model. We plan to defer this decision until we have completed our impact assessment of the recently published IFRS 1 amendment discussed above.

- IFRS 1 *First-Time Adoption of IFRS*: With the exception of the May 2010 amendment, which provides transition relief for rate-regulated entities, the elections and exemptions under IFRS 1 have been reviewed. The exemptions that are expected to apply to us upon adoption are summarized as follows:
 - *Employee Benefits*: There is a choice to either recognize all cumulative actuarial gains and losses of defined benefit plans through opening retained earnings or recalculate the actuarial gains and losses under IFRS from the inception of the defined benefit plans. We have elected to recognize all cumulative actuarial gains and losses through opening retained earnings at April 1, 2010.
 - *Property, plant and equipment and Intangible assets*: There is a choice of valuation of property, plant and equipment and intangible assets at April 1, 2010, either to retrospectively apply IFRS to the valuation of the assets or to revalue items, on an asset by asset basis, at fair value and use that fair value as deemed cost. The IFRS 1 amendment published May 6, 2010, provides a further option to use previous GAAP carrying amounts at transition as the deemed cost for assets used in rate-regulated operations. We are continuing with our review and analysis of the available options.

As actuarial valuations of our defined benefit plans at April 1, 2010 have not yet been completed and the amendment relating to rate-regulated entities has not yet been fully reviewed, the effect on our consolidated financial statements of the adoption of IFRS 1 cannot be quantified at this time.

- Intangible assets: There is substantially no change in IFRS from Section 3064, *Goodwill and Intangible Assets*, which we adopted April 1, 2009. The adoption of this guidance is not expected to have any significant effect on our consolidated financial statements.
- Asset impairment: We are currently defining indications of impairment. Processes to track any asset impairment and potential subsequent reversals have been determined. The adoption of this guidance is not expected to have any significant effect on our consolidated financial statements.

CORPORATE STRUCTURE AND GOVERNANCE

National Instrument 58-101 *Disclosure of Corporate Governance Practices* (the "Instrument") and a related National Policy 58-201 *Corporate Governance Guidelines* (the "Guidelines") issued by the Canadian Securities Administrators require reporting issuers to disclose annually their approach to corporate governance with reference to specific matters. See Schedule A for the disclosure in accordance with this Instrument.

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, financial markets, demographics, import duties remission, GST reduction, and the requirements of the Coastal Ferry Services Contract.

Forward looking statements included in this document include statements with respect to our short and long-range business plans, estimates of future customer demand, asset renewal programs for vessels and terminals, vessel maintenance plans, expectations regarding how our cash requirements will be met, and expectations regarding the impacts of Bill 20 and IFRS. 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 customer demand, safety and security, accident risk, tax risk, environmental risk, regulatory risk, labour disruption risk, limitations of vessel repair facilities, risk of default under material contracts and aboriginal land 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.

SCHEDULE A

Corporate Structure and Governance

Board of Directors

The Board has responsibility for the stewardship of British Columbia Ferry Services Inc. (BCF or the Company) by overseeing the conduct of the business, supervising management, which is responsible for the day-to-day conduct of the business, and endeavouring to ensure that all major issues affecting the business and affairs of the Company are given proper consideration.

At March 31, 2010, the Board was comprised of the following directors:

Chair: Elizabeth J. Harrison, Q.C.

Members: Mark L. Cullen, Christopher C. Gardner, David L. Hahn, Holly A. Haston-Grant, Donald P. Hayes, Brian G. Kenning, Gordon R. Larkin, A. Daniel Miller, Jane L. Peverett, Stephen E. Smith, Wayne H. Stoilen, and Graham M. Wilson

Effective April 1, 2010, Donald P. Hayes became Chair of the Board and Mark L. Cullen ceased to be a director of the Board.

The Board Governance Manual articulates the governance framework under which the Board fulfills its stewardship responsibilities. The manual assembles in one document the essential elements for providing an appropriate level of governance for the organization. It includes, among other things, terms of reference for the Board, Chair, directors, Committees, and Committee Chairs, and serves as a practical guide for the Board and management in fulfilling their respective duties and responsibilities. The Governance Manual is a product and responsibility of the Board.

Subsequent to March 31, 2010, the Province introduced legislation amending the *Coastal Ferry Act*, which includes changes to the governance structure of the B.C. Ferry Authority (BCFA) and the Company. This is discussed further below.

The Board is committed to the principles of independence and accountability. The Board has adopted policies and practices that ensure it has the capacity, independent of management, to fulfill the Board's responsibilities, make objective assessments of management, and assess the merits of management initiatives. The Governance & Nominating Committee has an ongoing responsibility to ensure that the governance structures and processes continue to enable the Board to function independently.

The Board and management recognize that there is a regular need for the Board to meet without management in attendance. It is general practice to conduct a portion of every Board meeting with only independent directors present.

The Board and its Committees each have the authority to retain any outside advisor, at the Company's expense, that it determines to be necessary to permit it to carry out its duties.

The recruitment of directors is undertaken with the objective of ensuring the Board is composed of a majority of strong, qualified, independent directors. The Board supports the concept that the role of the Board Chair is separate from that of the President & CEO and that the Board Chair should be an independent director. These principles are reflected in the Board Governance Manual.

The Board has adopted a definition of an independent director for members of the Audit & Finance Committee consistent with the definition of independence in Multilateral Instrument 52-110. This definition, with some modification that is consistent with Multilateral Instrument 52-110, also applies to determining the independence of other members of the Board.

The Board is responsible for determining whether directors are independent pursuant to the definition of independence adopted by the Board. To do this, the Board requires members to disclose their relationships with the Company and its subsidiaries. These disclosures are reviewed by the Corporate Secretary, the Chair of the Governance & Nominating Committee, and the Chair of the Board. Any director who is deemed independent, and whose circumstances change such that he or she might be considered to no longer be an independent director, is required to promptly advise the Board of the change in circumstances. Directors are required annually to attest to their independence in writing.

Mr. David L. Hahn, President & CEO, is the only director who is a member of management of the Company. By virtue of his being a member of management, Mr. Hahn is not independent. The other directors of the Company, including the Chair of the Board, have been determined by the Board to be independent pursuant to the definition of independence adopted by the Board.

Directorships

The following were directors of a reporting issuer (or the equivalent) in Canada or a foreign jurisdiction, other than BCF:

<i>Brian G. Kenning:</i>	<i>Director, MacDonald Dettwiler & Associates Inc.</i>
<i>Jane L. Peverett:</i>	<i>Director, Canadian Imperial Bank of Commerce</i>
	<i>Director, EnCana Corporation</i>
	<i>Director, Northwest Natural Gas Company</i>
<i>Graham M. Wilson:</i>	<i>Director, ITRON Inc.</i>
	<i>Director, Naikun Wind Energy Group Inc.</i>
	<i>Director, Daylight Energy Limited</i>
	<i>Trustee, Hardwoods Distribution Income Trust</i>

Orientation and Continuing Education

The Company has a variety of orientation and education programs in place for directors. These programs are aimed at increasing the directors' familiarity with the operation of the Company and its governance practices.

All new directors are provided with the opportunity to participate in an orientation program. The orientation program is tailored to the individual director's needs and areas of interest. The program generally involves a half to full day session, usually held prior to a new director attending his/her first BCF Board meeting, during which the new director is briefed by members of senior management, and receives written information about the business and operations of BCF and Board governance practices, including the duties and obligations of directors. A copy of the Board Governance Manual is made available to all directors. This manual provides a comprehensive overview of the roles and responsibilities of the Board, its committees, and the contributions expected by each director. The Board recognizes the importance of ongoing director education and the need for each director to take personal responsibility for this process.

Responsibility for ensuring that orientation and ongoing education are provided to directors rests with the Chair of the Board. The Governance & Nominating Committee has responsibility for reviewing the orientation and education programs to ensure they are effective and meet the needs of directors.

Ethical Business Conduct

The Board of Directors approved and adopted a Code of Business Conduct and Ethics (Code) in November 2004; the Code was subsequently reviewed and amended by the Board in November 2009. Notice of adoption, and subsequent amendment of the Code as Company policy, was communicated to the Company's personnel by intra-Company information bulletin and BCF's newsletter for personnel. In addition, the Code has been posted on the Company's intranet website for Company personnel, and on the Company's internet site. The Code was filed on SEDAR on March 1, 2006; the amended Code was filed on November 24, 2009. The Board has also adopted a Corporate Disclosure and Securities Trading Policy, which is also posted on the Company's intranet and internet sites.

As part of the Company's disclosure controls process, in conjunction with quarter-end financial reporting, appropriate managers are required to make representations regarding compliance with the Code and the Corporate Disclosure and Securities Trading Policy.

As part of the communication process for the reporting of questionable accounting and auditing matters, a secure telephone line and a secure e-mail address, each monitored by the Executive Director of Internal Audit, as well as a secure e-mail address monitored by the Chair of the Audit & Finance Committee of the Board of Directors, have been established and this has been communicated to Company personnel by intra-Company information bulletin and BCF's newsletter for personnel. The contact particulars are also posted with the Code on the Company's intranet site.

The Board, through the Audit & Finance Committee, monitors compliance with the Code through review of compliance reports received quarterly from management, the external auditors, and the internal auditors.

Directors and officers review the Code, and acknowledge their support and understanding of the policy by signing an annual disclosure statement.

The Code requires that directors and officers disclose potential conflicts of interest at the time of their appointment and immediately upon a situation of a conflict of interest or potential conflict of interest arising. Such disclosures are communicated to and reviewed by the Corporate Secretary, the Chair of the Governance & Nominating Committee, and the Chair of the Board.

Nomination of Directors

The Governance & Nominating Committee has responsibility for the director nomination process. The Committee is composed entirely of directors who are independent, pursuant to the definition of independence adopted by the Board of BCF, and operates under terms of reference adopted by the Board.

Each year, the skill sets and experience of the incumbents and any retiring directors of BCF are reviewed by the Governance & Nominating Committee in the context of the skills and experience profile adopted by the BCF Board and the ongoing governance needs of BCF. Any gaps are identified. Potential conflicts of interest and other extenuating circumstances are also identified.

The Governance & Nominating Committee makes recommendations to the BCF Board of Directors on suitable candidates for appointment to the BCF Board. These recommendations take into account the talents of the existing BCF Board, and the talents of all nominees, taking the skills and experience profile established for BCF directors into account.

The BCF Board makes its decision on prospective directors and forwards its recommendations to the BCFA Board. The BCFA Board then determines the directors of BCF and causes BCFA, as the sole holder of the single voting share of BCF, to appoint such directors to the Board of BCF.

Compensation

Each year, the Governance & Nominating Committee reviews the compensation of directors, and the Human Resources & Compensation Committee reviews the compensation of the President & CEO and members of executive management. The Committees engage an external compensation advisor to research and provide independent advice on the level and types of compensation for directors, the President & CEO, and members of executive management. In making their recommendations to the Board, the Committees take into account the types of compensation and the amounts paid by other comparable companies.

Board Committees

The Board has developed guidelines for the establishment and operation of Committees of the Board. Each Committee operates according to a specific mandate approved by the Board. The Committee structure is set out below. The Board Chair is an ex-officio (non-voting) member of each of the Committees.

Audit & Finance Committee:

Voting members at March 31, 2010:

Chair: Graham M. Wilson

Members: Christopher C. Gardner, Donald P. Hayes, Brian G. Kenning, and Stephen E. Smith

Voting members effective April 1, 2010:

Chair: Brian G. Kenning

Members: Christopher C. Gardner, Elizabeth J. Harrison, and Graham Wilson

The Audit & Finance Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities. The Committee has the mandate to:

- review the financial reports and other financial information provided by the Company to its security holders;
- review the annual operating and capital budgets, modifications thereto, and details of any proposed financing;
- monitor the integrity of the financial reporting process and the system of internal controls that the Board and the Company's management have established;
- monitor the management of the principal risks that could impact the financial reporting of the Company, and the Company's compliance with legal and regulatory requirements as they relate to the Company's financial statements;
- review and approve the audit plan, process, results, and performance of the Company's External Auditors and the Internal Audit department (the Internal Auditor) while providing an open avenue of communication between the Board, Management, External Auditors, and the Internal Auditor; and
- assess the qualifications and independence of the External Auditors, and recommend to the Board the nominations of the External Auditors and the compensation to be paid to the External Auditors.

The Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the External Auditors as well as anyone in the organization. The Committee has the authority to retain special legal, accounting, and other advisors or experts it deems necessary in the performance of its duties.

Each of the members of the Committee has been determined by the Board of Directors to be independent, that is, without any direct or indirect relationship with the Company that could reasonably interfere with the exercise of the member's independent judgment.

All members of the Committee are financially literate within the meaning of Multilateral Instrument 52-110, that is, each has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the Company's financial statements.

Since April 2, 2003, all recommendations of the Committee to nominate or compensate an External Auditor have been adopted by the Board.

The aggregate fees billed by the Company's External Auditor in each of the last two fiscal years were:

External Auditor billings (\$ thousands)	Year ended March 31	
	2010	2009
Audit and audit related	151.3	136.7
Tax services	4.5	2.0
All other fees		
Advisory services (IFRS and environmental pre-assessment)	44.1	32.1
	<u>199.9</u>	<u>170.8</u>

Pursuant to its terms of reference, the Committee must pre-approve retaining the External Auditors for any non-audit service to be provided to the Company or its subsidiaries, provided that no approval shall be provided for any service that is prohibited under the rules of the Canadian Public Accountability Board or the Public Company Accounting Oversight Board, or the Independence Standards of the Canadian Institute of Chartered Accountants.

Before retaining the External Auditors for any non-audit service, the Committee must consider the compatibility of the service with the External Auditors' independence. The Committee may pre-approve retaining of the External Auditors for the engagement of any non-audit services by establishing policies and procedures to be followed prior to the appointment of the External Auditors for the provision of such services. To date, no such policies and procedures have been established. In addition, the Committee may delegate to one or more members the authority to pre-approve retaining of the External Auditors for any non-audit services to the extent permitted by applicable law.

Safety, Health, Environment & Security Committee:

Voting members at March 31, 2010:

Chair: A. Daniel Miller

Members: Holly A. Haston-Grant, Donald P. Hayes, Gordon R. Larkin, and Wayne H. Stoilen

Voting members effective April 1, 2010:

Chair: Wayne H. Stoilen

Members: Holly A. Haston-Grant, Gordon R. Larkin, and Stephen E. Smith

The Safety, Health, Environment & Security Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities. The Committee has the mandate to:

- exercise due diligence over the safety, health, environmental, and security operations of the Company;
- develop, review, and make recommendations, as required, on matters related to the Company's safety, health, environmental, and security policies and practices; and
- monitor compliance with Government regulations and with the Company's commitment to these issues.

Governance & Nominating Committee:

Voting members at March 31, 2010:

Chair: Brian G. Kenning

Members: Mark L. Cullen, Christopher C. Gardner, Holly A. Haston-Grant, Gordon R. Larkin, Jane L. Peverett, and Graham M. Wilson

Voting members effective April 1, 2010:

Chair: A. Daniel Miller

Members: Christopher C. Gardner, Elizabeth J. Harrison, Holly A. Haston-Grant, Brian G. Kenning, and Jane L. Peverett

The Governance & Nominating Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities with respect to ensuring that the corporate governance system of BCF is effective. The Committee has the mandate to:

- review, assess, and make recommendations regarding the effectiveness of the policies and practices of the Board;
- ensure the Board's continuing ability to fulfill its legislative mandate;
- implement effective due diligence over the operations of the Company;
- ensure that the Board of BCF is comprised of Board members that collectively and individually have the skills, experience, and backgrounds to appropriately lead the organization;
- establish and implement effective processes for identifying and recommending suitable candidates for appointment as directors of BCF; and
- review and recommend the compensation plan for directors.

Human Resources & Compensation Committee:

Voting members at March 31, 2010:

Chair: Mark L. Cullen

Members: Brian G. Kenning, A. Daniel Miller, Jane L. Peverett, Stephen E. Smith, and Wayne H. Stoilen

Voting members effective April 1, 2010:

Chair: Jane L. Peverett

Members: Brian G. Kenning, Gordon R. Larkin, A. Daniel Miller, Stephen E. Smith, and Graham M. Wilson

The Human Resources & Compensation Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities regarding the human resources and compensation strategies and policies of BCF. The Committee has the mandate to:

- regularly review, at a strategic level, the approach taken to manage the Company's human resources, including the recruitment, retention, motivation, and engagement of employees in the interests and success of the Company;
- regularly review with the President & CEO his plans for the structure, development, and succession of executive management; and
- review and recommend to the Board a total compensation philosophy for the President & CEO and executive management that attracts and retains executives, links total compensation to financial performance, and the attainment of short and long term strategic, operational, and financial performance, and provides competitive total compensation opportunities at a reasonable cost, while enhancing the ability to fulfill the Company's overall strategies and objectives.

Assessments

As part of its dedication to best governance practices, the Board is committed to regular assessments of the effectiveness of the Board, the Board Chair, Committees, Committee Chairs, and individual directors.

The Governance & Nominating Committee annually reviews and makes recommendations to the Board on the method and content for annual evaluations.

The Board has engaged an independent governance consultant to coordinate the evaluation. The evaluation undertaken in the year ended March 31, 2010, involved individual discussions between each director and the consultant on matters related to Board effectiveness. The consultant presented the results of the evaluation, together with recommendations for action to the Board. The Board will consider the recommendations in the upcoming year.

The Board also regularly assesses the performance of individual directors. This occurs through discussions between the individual directors and the Board Chair.

Government Review

On April 29, 2010, the Province introduced legislation (*Bill 20 - Miscellaneous Statutes Amendment Act (No.3), 2010*) to amend several statutes, including the *Coastal Ferry Act*. The amendments respond to the Comptroller General's Report on Review of Transportation Governance Models, released November 6, 2009. Bill 20 sets out changes to the governance and regulatory framework within which BCFA and BCF operate. The governance changes include: a broadening of the mandate of BCFA to include responsibility for the compensation plans for the directors and certain executive officers of BCF, such compensation plans to be comparable to public sector organizations; and, a requirement that effective September 30, 2010, a director of BCFA cannot also be a director of BCF. Changes to the General Bylaws of BCFA and the Articles of BCF will be required should the legislative amendments be brought into force, and the existing directors of BCF will be replaced on September 30, 2010.