

Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Three months ended June 30, 2010 and 2009

(unaudited)

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Balance Sheets
(expressed in thousands)

	June 30, 2010 (unaudited)	March 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	\$ 6,067	\$ 10,608
Restricted cash equivalents and short-term investments (note 2(b))	37,240	37,240
Other short-term investments	7,840	7,678
Accounts receivable	17,691	17,707
Prepaid expenses	12,796	6,813
Inventories	18,185	18,040
Derivative assets	27	-
Regulatory assets (note 3)	4,775	4,775
	104,621	102,861
Property, plant and equipment (note 4)	1,637,390	1,644,069
Intangible assets (note 5)	31,556	26,406
Assets held for sale	200	200
Long-term land lease	33,323	33,437
	\$ 1,807,090	\$ 1,806,973
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 41,084	\$ 38,884
Interest payable on long-term debt	15,243	18,319
Accrued employee costs	47,551	48,644
Deferred revenue	18,119	16,023
Current portion of long-term debt (note 2)	10,875	9,000
Current portion of accrued employee future benefits	800	800
Current portion of obligations under capital lease	339	398
	134,011	132,068
Accrued employee future benefits	11,229	11,130
Regulatory liabilities (note 3)	3,170	4,325
Long-term debt (note 2)	1,346,546	1,348,183
Obligations under capital lease (note 7)	87	139
Other long-term liabilities	172	172
	1,495,215	1,496,017
Shareholders' equity:		
Share capital	75,478	75,478
Retained earnings	236,397	235,478
	311,875	310,956
Commitments (note 4)		
	\$ 1,807,090	\$ 1,806,973

See accompanying notes to consolidated financial statements.

On behalf of the Board:

"Donald P. Hayes"

Director

"Brian G. Kenning"

Director

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Statements of Earnings (Loss), Comprehensive Income and Retained Earnings (unaudited)
(expressed in thousands)

	For the three months ended	
	June 30, 2010	June 30, 2009
Revenue:		
Tariffs	\$ 118,212	\$ 108,043
Ferry service fees	38,531	38,234
Federal-Provincial Subsidy Agreement	6,731	6,731
Retail	20,090	19,889
Other income	6,675	5,358
	<u>190,239</u>	<u>178,255</u>
Expenses:		
Operations	103,617	100,460
Maintenance	23,851	23,702
Administration	7,517	7,446
Cost of retail goods sold	7,680	7,533
Amortization	28,688	26,955
	<u>171,353</u>	<u>166,096</u>
Earnings from operations	18,886	12,159
Gain on foreign exchange	75	3
Interest expense	(18,028)	(15,765)
(Loss) Gain on disposal of capital assets	(14)	1
Net earnings (loss)	<u>919</u>	<u>(3,602)</u>
Other comprehensive income (note 1(d))	-	-
Net earnings (loss) and comprehensive income	<u>919</u>	<u>(3,602)</u>
Retained earnings, beginning of period	235,478	238,094
Retained earnings, end of period	<u>\$ 236,397</u>	<u>\$ 234,492</u>

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Statements of Cash Flows (unaudited)
(expressed in thousands)

	For the three months ended	
	June 30, 2010	June 30, 2009
Cash provided by (used in):		
Operations:		
Net earnings(loss)	\$ 919	\$ (3,602)
Items not involving cash:		
Amortization	28,688	26,955
Other non-cash charges	389	(716)
Long-term regulatory costs deferred	(2,349)	2,725
Change in non-cash operating working capital (note 10)	(11,302)	(1,794)
	16,345	23,568
Financing:		
Proceeds from short-term loans	-	2,034
Repayment of capital lease obligations	(111)	(155)
	(111)	1,879
Investing:		
Proceeds from disposal of property, plant and equipment	26	4
Purchase of property, plant and equipment and intangible assets	(20,639)	(22,460)
Purchase of short-term investments	(162)	-
	(20,775)	(22,456)
(Decrease) increase in cash and cash equivalents	(4,541)	2,991
Cash and cash equivalents, beginning of period	10,608	12,402
Cash and cash equivalents, end of period	\$ 6,067	\$ 15,393

Supplemental cash flow information (note 10)

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to Consolidated Financial Statements (unaudited)

Three months ended June 30, 2010 and 2009

(columnar dollars expressed in thousands)

British Columbia Ferry Services Inc. (the "Company") was incorporated under the *Company Act* (British Columbia) by way of conversion on April 2, 2003, and now validly exists under the *Business Corporations Act* (British Columbia). The Company's primary business activity is the provision of coastal ferry services in British Columbia.

The interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the fiscal year ended March 31, 2010 except as disclosed below. The disclosures provided below are incremental to those included with the annual consolidated financial statements. The interim consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto for the year ended March 31, 2010.

The Company's business is seasonal in nature, with the highest activity in the summer (second quarter) and the lowest activity in the winter (fourth quarter), due to the high number of leisure travellers and their preference to travel during the summer months. The Company also takes advantage of the low activity during the winter months to perform a significant portion of the required annual maintenance on vessels and terminals.

1. Significant accounting policies:

(a) Basis of presentation:

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Pacific Marine Leasing Inc. ("PML"), BCF Captive Insurance Company Ltd. ("BCF Captive"), Pacific Marine Ventures Inc. ("PMV"), and BCF Global Services Inc. ("Global"). All inter-company balances and transactions have been eliminated on consolidation.

(b) Inventories:

Inventories, which consist of materials and supplies, catering stores and fuel, are valued at the lower of weighted-average cost and net realizable value.

(c) Embedded derivatives:

As at June 30, 2010, the Company has no embedded derivatives that meet the requirements of Section 3855 which would require that they be separated from host contracts and valued separately at fair value.

(d) Comprehensive income:

The Company has not recognized any adjustments through other comprehensive income for the three months ended June 30, 2010.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to Consolidated Financial Statements (unaudited)
Three months ended June 30, 2010 and 2009
(columnar dollars expressed in thousands)

1. Significant accounting policies (continued):

(e) Future accounting changes:

International Financial Reporting Standards ("IFRS"):

The Company's transition date for the conversion to IFRS is currently April 1, 2011, although recent developments related to rate-regulated operations may result in this transition date being postponed to April 1, 2013. Transition to IFRS will require the restatement for comparative purposes of amounts reported by the Company for the year prior to transition date. While the Company is continuing to assess the adoption of IFRS, the financial reporting impact of the transition cannot be reasonably estimated at this time.

The areas that have the highest potential to significantly impact the Company are rate-regulated operations; property plant and equipment; intangible assets and asset impairment; and initial adoption of IFRS under the provisions of IFRS 1 "*First-Time Adoption of IFRS*". The Company is monitoring any International Accounting Standards Board ("IASB") initiatives with the potential to impact rate-regulated accounting under IFRS.

On July 23, 2009, the IASB issued an exposure draft ("ED") addressing rate-regulated activities. The ED proposes new standards which define regulatory assets and regulatory liabilities, sets out criteria for their recognition, specifies how they should be measured and requires disclosures about their financial effect. The Company reviewed the 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. 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 and 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. The Company has assessed the impact of the options available as a result of this IFRS 1 amendment and has decided to adopt the exemption for all its intangible assets and the majority of its items of property, plant and equipment.

The IASB staff has performed significant research and analysis focusing 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. This issue was deliberated at the July 2010 meetings of the IASB but no decisions were made.

The IASB instructed its staff to continue the current research, analysis and deliberations on this project as time and resources permit. A revised timeline for completion of the rate-regulated activities project was not proposed. The IASB staff estimate indicated the issuance of a final standard during the second half of 2011 but the IASB did not discuss the appropriateness of this timing.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to Consolidated Financial Statements (unaudited)
Three months ended June 30, 2010 and 2009
(columnar dollars expressed in thousands)

1. Significant accounting policies (continued):

(e) Future accounting changes (continued):

On July 28, 2010, the Canadian Accounting Standards Board (AcSB) issued an exposure draft "Adoption of IFRSs by Entities with Rate-regulated Activities" proposing that qualifying entities with rate-regulated activities be permitted, but not required, to continue applying existing Canadian GAAP for an additional two years. A qualifying entity would be one that:

(a) Has activities subject to rate regulation, and

(b) In accordance with Accounting Guideline AcG-19, discloses that it has accounted for a transaction or event differently than it would have in the absence of rate regulation.

The Company meets these tests and would be a qualifying entity for the purposes of the AcSB proposal. It is the Company's intention to elect this deferral option if and when it is made available.

Comments on the exposure draft must be submitted by August 31, 2010 and the proposed amendment is expected no later than December 2010.

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 the Company's future financial position and results of operations with respect to differences, if any, in accounting for rate-regulated activities.

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Notes to Consolidated Financial Statements (unaudited)
 Three months ended June 30, 2010 and 2009
 (columnar dollars expressed in thousands)

2. Loans:

	June 30	March 31
	2010	2010
Long-term debt:		
5.74% Senior Secured Bonds, Series 04-1, due May 2014 (effective interest rate 5.92%)	\$ 250,000	\$ 250,000
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (effective interest rate 6.41%)	250,000	250,000
5.02% Senior Secured Bonds, Series 07-1, due March 2037 (effective interest rate 5.06%)	250,000	250,000
5.58% Senior Secured Bonds, Series 08-1, due January 2038 (effective interest rate 5.62%)	200,000	200,000
6.21% Senior Secured Bonds, Series 08-2, due December 2013 (effective interest rate 6.33%)	140,000	140,000
12 Year Loan, maturing March 2020		
Tranche A (effective interest rate 5.17%)	73,125	75,000
Tranche B (floating interest rate of CAD LIBOR plus 30 bps)	16,875	15,000
12 Year Loan, maturing June 2020		
Tranche A (effective interest rate 5.18%)	75,000	76,875
Tranche B (floating interest rate of CAD LIBOR plus 30 bps)	15,000	13,125
2.95% Loan, maturing January 2021 (effective interest rate 3.08%)	99,000	99,000
	1,369,000	1,369,000
Less: Deferred financing costs and unamortized bond discounts	(11,579)	(11,817)
Current portion	(10,875)	(9,000)
	\$ 1,346,546	\$ 1,348,183

(a) Credit facility:

There were no draws on the \$155 million credit facility as at June 30, 2010 or as at March 31, 2010. Interest expensed during the three months ended June 30, 2010 was \$0.1 million (June 30, 2009: \$0.1 million). Letters of credit outstanding against this facility at June 30, 2010 totalled \$0.3 million (March 31, 2010: \$0.3 million).

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Notes to Consolidated Financial Statements (unaudited)
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2. Loans (continued):

(b) Debt service reserves:

The Company is required to maintain debt service reserves for the Series 04-1, 04-4, 07-1, 08-1 and 08-2 bonds equal to not less than six months forecasted debt service, to be increased under certain conditions. Further debt service reserves are required to be maintained for the 4.98% and 2.95% loans equal to the first six months of debt service.

As at June 30, 2010, debt service reserves of \$37.2 million (March 31, 2010: \$37.2 million) were held in short-term investments and have been classified as restricted cash equivalents and short-term investments on the balance sheet.

3. Financial statement effect of rate regulation:

Accounting for the impacts of rate regulation has resulted in recording the following regulatory assets and liabilities in the consolidated balance sheets:

	June 30 2010	March 31 2010
Regulatory accounts		
First performance term accounts:		
Balance at March 31, 2008:		
Deferred fuel costs	\$ 18,501	\$ 18,501
Performance term submission costs	600	600
	19,101	19,101
Accumulated amortization	(10,744)	(9,550)
	8,357	9,551
Current portion (asset)	(4,775)	(4,775)
Long-term portion of first performance term accounts	3,582	4,776
Second performance term accounts:		
Deferred fuel costs		
Balance – beginning of period	(9,185)	1,213
Fuel costs deferred (including realized hedge gains and losses)	(352)	(16,082)
Rebates granted	3,242	6,298
Fuel price risk payments to (recoveries from) the Province	-	1,273
Other payments from the Province	(389)	(1,620)
Interest payable	(145)	(267)
Balance – end of period	(6,829)	(9,185)
Performance term submission costs	77	84
Long-term portion of second performance term accounts	(6,752)	(9,101)
Total long-term regulatory (liabilities) assets	\$ (3,170)	\$ (4,325)

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to Consolidated Financial Statements (unaudited)
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3. Financial statement effect of rate regulation (continued):

(a) Amortization expense:

During the three months ended June 30, 2010 the Company recognized \$1.2 million in amortization expense for first performance term accounts (June 30, 2009: \$1.2 million).

(b) Tariffs in excess of price cap:

The Coastal Ferry Act (the "Act") contains provisions which ensure that if tariffs charged by the Company exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. At June 30, 2010 and at March 31, 2010, tariffs charged to customers on all route groups were below established price caps.

If the Company was not a rate-regulated entity and did not record regulatory assets and liabilities, net earnings for the three months ended June 30, 2010, would have been \$1.2 million lower (2009: \$17.2 million higher) as detailed below:

Impact of regulatory accounts on net earnings	As at June 30,	
	2010	2009
First performance term accounts:		
Deferred fuel costs	\$ (1,156)	\$ (1,156)
Performance term submission costs	(38)	(38)
Second performance term accounts:		
Deferred fuel costs	2,356	(2,725)
Performance term submission costs	(7)	-
Unrealized fuel hedge gains and losses	-	(6,767)
Tariffs in excess of price cap	-	(6,498)
Total increase (decrease) in net earnings	\$ 1,155	\$ (17,184)

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4. Property, plant and equipment:

June 30, 2010	Cost	Accumulated amortization	Net book value
Property, plant and equipment			
Vessels	\$ 1,786,305	\$ 573,580	\$ 1,212,725
Berths, buildings and equipment	91,825	53,524	38,301
Berths, buildings and equipment under capital lease	604,244	261,286	342,958
Land	1,406	-	1,406
Construction-in-progress	42,000	-	42,000
	\$ 2,525,780	\$ 888,390	\$ 1,637,390

March 31, 2010	Cost	Accumulated amortization	Net book value
Property, plant and equipment			
Vessels	\$ 1,772,870	\$ 554,304	\$ 1,218,566
Berths, buildings and equipment	91,957	51,722	40,235
Berths, buildings and equipment under capital lease	598,154	256,822	341,332
Land	1,406	-	1,406
Construction-in-progress	42,530	-	42,530
	\$ 2,506,917	\$ 862,848	\$ 1,644,069

Capitalized financing costs during construction for property, plant and equipment and intangible assets for the three months ended June 30, 2010 totalled \$0.6 million (June 30, 2009: \$1.8 million).

Amortization expense for assets under capital lease for the three months ended June 30, 2010 totalled \$4.7 million (June 30, 2009: \$4.5 million).

In addition to the construction-in-progress referenced above, the contractual commitments at June 30, 2010 for capital assets to be constructed, totalled \$20.0 million (March 31, 2010: \$25.6 million).

During the three months ended June 30, 2010, the Company received \$0.3 million (June 30, 2009: \$0.2 million) of rental income earned from buildings held for leasing purposes. These buildings have a cost and accumulated amortization of \$13.5 million and \$1.4 million respectively, as at June 30, 2010.

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(columnar dollars expressed in thousands)

5. Intangible assets:

June 30, 2010	Cost	Accumulated amortization	Net book value
Intangible assets subject to amortization			
Acquired software and licenses	\$ 33,020	\$ 17,523	\$ 15,497
Internally developed software and website	23,131	15,237	7,894
Work-in-progress	8,165	-	8,165
	\$ 64,316	\$ 32,760	\$ 31,556

March 31, 2010	Cost	Accumulated amortization	Net book value
Intangible assets subject to amortization			
Acquired software and licenses	\$ 28,812	\$ 16,810	\$ 12,002
Internally developed software and website	22,531	14,831	7,700
Work-in-progress	6,704	-	6,704
	\$ 58,047	\$ 31,641	\$ 26,406

There was no impairment of intangible assets during the three months ended June 30, 2010 or the year ended March 31, 2010.

Included in the cost of intangible assets as at June 30, 2010 is \$0.7 million of unamortized training costs (March 31, 2010: \$0.7 million). If the Company was not a regulated entity, these training costs would be expensed in the period incurred.

During the three months ended June 30, 2010 intangible assets totaling \$5.2 million (June 30, 2009: \$2.9 million) were acquired and \$1.1 million (June 30, 2009: \$1.0 million) were internally developed. Amortization expense for the three months ended June 30, 2010 totalled \$1.1 million (June 30, 2009: \$1.4 million).

6. Accrued employee future benefits:

During the three months ended June 30, 2010 the Company recognized total defined benefit costs of \$0.3 million (June 30, 2009: \$0.3 million).

7. Obligations under capital lease:

During the three months ended June 30, 2010 the Company did not enter into any new capital lease agreements.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to Consolidated Financial Statements (unaudited)
Three months ended June 30, 2010 and 2009
(columnar dollars expressed in thousands)

8. Interest rate support:

During the quarter ended June 30, 2010 interest rate support received and recorded as a reduction of interest expense totalled \$0.1 million (June 30, 2009: \$1.3 million) and \$nil (June 30, 2009: \$0.6 million) as a reduction of capitalized interest.

The Company has no requirement to repay these funds, other than as a result of an event of default under the agreement with the Government of Canada.

9. Related party transactions:

In accordance with the Act, the Company is responsible for paying any expenses that are incurred by its parent, B.C. Ferry Authority ("the Authority") without charge. During the three months ended June 30, 2010, no such expenses were paid by the Company (June 30, 2009: \$nil).

The Province owns the Company's 75,477 non-voting preferred shares but has no voting interest in either the Company or the Authority.

10. Supplemental cash flow information:

	Three months ended June 30,	
(a) Changes in non-cash operating working capital:	2010	2009
Change in working capital		
Accounts receivable	\$ 16	\$ (2,171)
Prepaid expenses	(5,983)	(1,428)
Inventories	(145)	(1,601)
Accounts payable and accrued liabilities	2,200	(8,639)
Interest payable on long-term debt	(3,076)	(3,021)
Accrued employee costs	(1,093)	(1,402)
Deferred revenue	2,096	2,991
Regulatory liabilities	-	6,498
Change in non-cash working capital	(5,985)	(8,773)
Change attributable to capital asset acquisitions	(5,317)	6,979
Change in non-cash operating working capital	\$ (11,302)	\$ (1,794)
(b) Cash paid during the period for interest	\$ 21,367	\$ 21,617