This report contains historical information and may contain certain forward-looking statements which relate to future events or future performance. These forward-looking statements are based upon management’s current expectations and assumptions as to a number of factors, including, the risks, uncertainties and other factors as described in BC Ferries’ Management’s Discussion and Analysis herein and certain of the other BC Ferries documents available at www.sedar.com. These forward-looking statements are made as of today’s date and are based upon information currently available to management, and BC Ferries assumes no obligation to update or revise them to reflect new events or circumstances. If management’s expectations and assumptions prove to be incorrect or factors change, then actual results could differ materially from the forward-looking information contained in this report.
2005/06 proved to be a time of extraordinary challenge, as well as a time of renewal and rebuilding for BC Ferries.

Together with British Columbians everywhere, the Directors were shocked and saddened to hear of the loss of the Queen of the North and her two missing passengers early on March 22, 2006.

Yet in the ensuing hours and days, we were filled with pride as we learned of the professional competence of our captain and crew in coordinating the quick and orderly evacuation of the ship. I know I speak for all of BC Ferries when I extend our thanks to the residents of Hartley Bay and Prince Rupert, as well as the Coast Guard, for their generous assistance to BC Ferries and our passengers.

Looking back on the year, we once again achieved solid progress in renewing our ferry system. We met our revenue targets and continued to invest our earnings back into the infrastructure for our ferry system. While our day-to-day focus remains on safety, customer service and operational excellence, we are also committed to a capital improvement program that will revitalize our fleet and terminals in the course of the next few years.

Our strong performance this past year reflects the tremendous dedication and hard work of all of our employees. On behalf of the Boards of B.C. Ferry Authority and British Columbia Ferry Services Inc., I extend our gratitude for their efforts throughout the year.

I also acknowledge and thank the Directors for their ongoing commitment. I look forward to continuing our work ensuring that we provide safe and improved ferry services for the coastal communities of British Columbia.

Elizabeth J. Harrison, QC
Chair
A MESSAGE FROM THE PRESIDENT & CEO

This past year, we continued to make significant progress towards building a better BC Ferries by revitalizing our fleet and terminals, acquiring new vessels and focusing on providing an ever-improving experience for our customers.

Strong net earnings enabled us to advance the terminal and vessel renewal programs that are critical to the ongoing success of BC Ferries.

While we acknowledge our successes this past year, all of us at BC Ferries were deeply saddened by the devastating loss of the Queen of the North and her two missing passengers on March 22, 2006.

I commend the captain and crew of the vessel for their calm and skilled evacuation of the ship during difficult circumstances. In the face of adversity, their professionalism and expertise was exemplary.

On behalf of all employees, I extend our deepest appreciation to the captain and crew of the coast guard vessel Sir Wilfrid Laurier and to the residents of Hartley Bay, the City of Prince Rupert and the surrounding communities for their assistance, generosity and ongoing support.

We also appreciated the response by the many agencies that helped us implement our comprehensive environmental plan immediately after the incident. We remain committed to maintaining our environmental response and are currently negotiating with specialized salvage firms to remove the remaining fuel from the vessel.

In addition to investigations into the incident by Transport Canada, the Transportation Safety Board, the RCMP and BC Ferries, we have since hired British Columbia’s former auditor general, George Morfitt, to conduct an independent review of our safety system to ensure that we operate the safest marine transportation system in the world. We will conduct an audit of this nature every five years.

We understand the vital importance of ferry service to the north coast and are committed to acquiring a replacement vessel that will enable us to restore full service on our northern routes by next summer. I want to thank the north coast mayors, residents and tourism operators for their patience and cooperation as we work to restore full service as quickly as possible.

This past year, we purchased a ferry from the State of Utah that will operate as a relief vessel on our minor routes, signed a letter of intent with the Washington Marine Group for the construction of a 125-car ferry, completed the detailed design phase for our three Super C-class vessels that began construction in August 2006, and awarded a contract to Flensburger Schiffbau-Gesellschaft for the construction of a new northern vessel to replace the Queen of Prince Rupert in 2009.
In addition to these investments, a number of our vessels underwent refits this past year that included significant mechanical and safety improvements, as well as extensive upgrades to passenger amenities. We completed a mid-life upgrade on the Queen of Oak Bay, which was the third C-class vessel to undergo this work, and began an extensive six-month upgrade on the Queen of Surrey, which returned to service in June 2006.

Operating between Alliford Bay and Skidegate, the Kwuna returned to service in November 2005 after receiving new engines and generators to increase fuel economy and reliability. In January 2006, the Queen of Nanaimo was back in service on the Southern Gulf Islands routes after a major overhaul that included the installation of a new life-saving system and expanded passenger amenities. The Spirit of Vancouver Island, which operates on the Tsawwassen – Swartz Bay route, returned to service in March 2006 after a refit that included upgrades to life-saving equipment, an overhaul of all four engines and comprehensive passenger-service improvements, complementing the work completed on the Spirit of British Columbia in 2005.

During the year, we also made improvements to our terminals and marine structures. In June 2005, we opened the new $7.3 million retail building at Tsawwassen, our largest terminal. Tsawwassen Quay now offers 16 food, beverage, service and retail outlets to more than four million passengers each year. In addition, we invested more than $42.0 million in terminal improvements throughout the company, including upgrades and replacements to marine structures at Buckley Bay, Kuper Island, Saltery Bay, Port McNeill, Swartz Bay, Tsawwassen and Horseshoe Bay.

While our revitalization programs continued as planned, we faced a significant financial challenge this year as a result of the escalating cost of fuel. Despite extensive fuel conservation measures, our annual fuel cost rose to $74.9 million, compared to $57.2 million the previous year. In response, and with authorization from the British Columbia Ferry Commissioner, we implemented two fuel surcharges last year and a third surcharge in June 2006.

As I look back on the year, I want to thank our employees who worked hard each day to meet our customers’ needs and provide a world-class travel experience for every one of our passengers. I am proud of their enthusiasm, dedication and commitment to safety, and I look to the future with confidence as we continue to provide the best and safest ferry system in the world.

David L. Hahn
President & CEO
CORPORATE PROFILE

BC FERRIES is an independent marine transportation company operating a complex coastal ferry system providing vehicle and passenger transportation and related services in British Columbia's coastal waters. We are one of the largest ferry operators in the world and provide frequent year-round services on 25 routes, supported by 34 vessels and 47 terminals. Our company is governed by an independent Board of Directors appointed by the B.C. Ferry Authority.

OUR VISION
To provide a continuously improving west coast travel experience that consistently exceeds customer expectations and reflects the innovation and pride of our employees.

OUR MISSION
To provide safe, reliable and efficient marine transportation services which consistently exceed the expectations of our customers, employees and communities, while creating enterprise value.

OUR VALUES

SAFETY
Ensure that the safety and security of our customers and staff is a primary concern in all aspects of doing business.

QUALITY
Be motivated by customer expectations in providing quality facilities and services.

INTEGRITY
Be accountable for all our actions and ensure we demonstrate integrity in our business relations, utilization of resources, treatment of our customers and staff, and in the general conduct of our business.

PARTNERSHIPS
Work openly and constructively with our various business and community stakeholders to exceed the expectations of our customers and advance each other’s interests.

ENVIRONMENT
Ensure that environmental standards are maintained.

EMPLOYEES
Always deal from a position of honesty, integrity and mutual respect, and ensure that our employees develop to their full potential.
2005/06 KEY ACCOMPLISHMENTS

IMPROVING OUR CUSTOMERS’ TRAVEL EXPERIENCES...

➜ Carried over 8.5 million vehicles and 21.7 million passengers on more than 186,000 sailings.
➜ Improved our on-time performance from 84.3 per cent to 85.3 per cent and achieved an overall customer satisfaction rating of 86 per cent.
➜ Launched a new brand campaign featuring Life on the coast. The campaign positioned BC Ferries as a symbol of coastal living and recognized our customers’ choice to live, work, travel to and thrive in British Columbia’s coastal communities.
➜ Provided real-time information to our customers on ferry sailings via new electronic message signs on the highway approaches to Swartz Bay and Tsawwassen.
➜ Introduced new pricing promotions for seniors, families and commercial and seasonal traffic.
➜ Developed new partnerships with the BC Lions, BC Experience and the Royal BC Museum.
➜ Launched our new stored value Coast Card for assured loading tickets.
➜ Enhanced our food, beverage and retail offerings at our terminals and onboard our vessels.

INVESTING IN OUR VESSELS AND TERMINALS...

➜ Enhanced long-range maintenance plans and standards for all vessels in the fleet.
➜ Completed a mid-life upgrade on the Queen of Oak Bay and a life extension on the Queen of Nanaimo, with both vessels receiving new marine evacuation systems.
➜ Returned the Spirit of Vancouver Island to service after a refit that included a complete engine overhaul, upgrades to life-saving equipment and extensive improvements to passenger areas.
➜ Finalized the detailed design for our three Super C-class vessels currently under construction and selected the names Coastal Renaissance, Coastal Inspiration and Coastal Celebration.
➜ Signed a letter of intent for the construction of a new 125-car ferry to replace the Queen of Tsawwassen.
➜ Purchased the John Atlantic Burr, which was disassembled and transported from Utah to Vancouver. We are adding another lane to the vessel and upgrading it to meet our standards before it enters service as a relief vessel on our smaller routes.
➜ Completed a passenger-area upgrade at Horseshoe Bay, replaced Berth 2 at Tsawwassen and began construction of a new berth at Swartz Bay using an innovative floating concrete design.
➜ Completed Terminal Master Plans for Alert Bay, Denman West, Buckley Bay and Departure Bay.
➜ Developed a fuel and emissions reduction program and implemented two effective fuel reduction trial projects.
➜ Launched an organic waste composting program on the Departure Bay – Horseshoe Bay vessels and implemented a potable water management program at our terminals and onboard our vessels.
BUILDING A BETTER BC FERRIES...

› Developed new and improved programs for all employees focusing on safety, security and career development.
› Launched a comprehensive, multiphase strategy for improved security on our vessels and at our terminals.
› Established an extensive program of management development and succession planning.
› Secured up to $16.0 million in grants from Industry Canada through the Structured Finance Facility Program to reduce interest costs associated with the acquisition and upgrade of our vessels.
› Negotiated a new property tax assessment program with the BC Assessment Authority that will result in savings of at least $4.0 million annually.
› Entered into loan agreements for up to $180.0 million with the German Export Bank, KfW, to finance the purchase of two Super C-class vessels.

CONNECTING WITH THE COMMUNITIES WE SERVE...

› Consulted regularly with our 12 Ferry Advisory Committees and established a new Departure Bay Terminal Liaison Committee.
› Continued to help children and adults in coastal communities participate in organized sport through the joint BC Ferries – Sport BC Sporting Life on the Coast travel assistance program, and through fundraising efforts and proceeds from KidSport meals onboard our vessels fleet-wide.
› Developed a BC Ferries Community Investment Program.
› Formed an Accessibility Advisory Committee with the BC Coalition of People with Disabilities to improve access onboard our vessels and at our terminals for persons with disabilities.
› Continued consultation with First Nations regarding our Terminal Master Plans.
OPERATING HIGHLIGHTS AND PERFORMANCE MEASURES

Years ended March 31

<table>
<thead>
<tr>
<th>OPERATING INFORMATION</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of vessels</td>
<td>34</td>
<td>35</td>
</tr>
<tr>
<td>Mean age of vessels</td>
<td>32.4 years</td>
<td>32.5 years</td>
</tr>
<tr>
<td>Average age of terminals (marine)</td>
<td>16.1 years</td>
<td>16.6 years</td>
</tr>
<tr>
<td>Average age of terminals (uplands)</td>
<td>15.7 years</td>
<td>15.9 years</td>
</tr>
<tr>
<td>Passengers carried</td>
<td>21.7 million</td>
<td>22.0 million</td>
</tr>
<tr>
<td>Vehicles carried</td>
<td>8.5 million</td>
<td>8.6 million</td>
</tr>
<tr>
<td>Vessel emissions</td>
<td>5.79</td>
<td>6.25</td>
</tr>
<tr>
<td>On-time performance</td>
<td>85.3%</td>
<td>84.3%</td>
</tr>
<tr>
<td>Full-time equivalent employees</td>
<td>3,406</td>
<td>3,375</td>
</tr>
<tr>
<td>Overall customer satisfaction</td>
<td>86%</td>
<td>88%</td>
</tr>
<tr>
<td>Annual passenger traffic growth</td>
<td>– 1.3%</td>
<td>3.1%</td>
</tr>
<tr>
<td>Annual vehicle traffic growth</td>
<td>– 0.2%</td>
<td>3.2%</td>
</tr>
</tbody>
</table>

(1) Number of vessels does not include two owned vessels that are chartered to other operators. (2) Millions of kg of NOx.

(3) Full-time equivalent employees are calculated by dividing actual labour hours worked by the standard hours in a work year (1,827).

<table>
<thead>
<tr>
<th>FINANCIAL RESULTS ($ IN MILLIONS)</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenue</td>
<td>$579.2</td>
<td>$564.5</td>
</tr>
<tr>
<td>Net earnings</td>
<td>$49.9</td>
<td>$39.8</td>
</tr>
<tr>
<td>Total assets</td>
<td>$833.7</td>
<td>$763.4</td>
</tr>
<tr>
<td>Long-term debt</td>
<td>$499.6</td>
<td>$499.6</td>
</tr>
<tr>
<td>Shareholders’ equity</td>
<td>$175.0</td>
<td>$131.2</td>
</tr>
<tr>
<td>Return on assets</td>
<td>6.24%</td>
<td>5.72%</td>
</tr>
<tr>
<td>Debt service coverage ratio</td>
<td>5.1x</td>
<td>4.6x</td>
</tr>
<tr>
<td>Leverage ratio</td>
<td>74.1%</td>
<td>79.2%</td>
</tr>
</tbody>
</table>
STRATEGIC PLAN

The cornerstone for building a better BC Ferries is our long-term strategic plan. The plan sets the priorities, objectives and performance targets that guide the development of the company. Our strategic plan is a dynamic document that is reviewed annually and updated on a regular basis to address new opportunities that may arise in BC Ferries’ changing business environment. The targets and initiatives contained in the strategic plan provide the framework for the company’s more detailed annual business plan.

THE STRATEGIC PLAN IS BASED ON SIX OBJECTIVES:

- Ensure a safe, secure and environmentally responsible marine transportation system.
- Establish a company-wide commitment to customer service.
- Foster a highly motivated, committed and flexible workforce.
- Establish proactive and constructive relationships with communities and government.
- Respond to and develop market demand to increase revenue.
- Maximize enterprise value.

OUR YEARLY BUSINESS PLAN FOCUSES ON FOUR KEY AREAS, EACH WITH A SPECIFIC GOAL:

01 Productivity
Achieve a competitive advantage by operating efficiently and effectively.

02 Asset Management
Have the right people with the right skills in the right jobs—and operate world-class vessels, terminals and systems.

03 Customer Service and Market Development
Achieve high customer satisfaction and loyalty.

04 Financial Management
Achieve our financial targets, ensuring we have the resources available to revitalize our fleet and facilities.

In the pages that follow, we capture the key activities that were undertaken in 2005/06 to achieve our business plan goals.
ACHIEVE A COMPETITIVE ADVANTAGE BY OPERATING EFFICIENTLY AND EFFECTIVELY

While safety always comes first at BC Ferries, we constantly strive to improve how we operate our business. Last year, we provided over 186,000 sailings, carrying more than 8.5 million vehicles and 21.7 million passengers. We made significant improvements to our operational management, improved on-time performance and reduced our fuel consumption. Throughout the year, we worked closely with the office of the British Columbia Ferry Commissioner and our regulating agencies.

BUILDING ON OUR TECHNOLOGY INVESTMENTS

This past year, we made investments in technology to provide better service to our customers, improve our productivity and reduce our costs. We replaced our paper-based crew-scheduling system with new crew-scheduling software that not only improves the productivity of our crewing staff, but also provides employees with longer-term work schedules so they can better manage their time.

We also upgraded our communications infrastructure to enhance ship-to-shore data communications and provide a more stable, more secure and faster network for internal business needs and for our customers. In addition, to ensure the efficiency of our onboard and terminal sales, our manual inventory system was replaced with a computerized catering and retail system to more accurately track inventory and reduce the amount of time required to process sales for our customers.

During the year, we introduced new online corporate incident management and occupational safety and health systems. The new programs streamline the process for reporting incidents and investigating causes, and enable departments to take proactive steps to prevent a recurrence.

STRENGTHENING OPERATIONAL MANAGEMENT

Our operations model ensures that safety is our number one priority and that we are providing world-class service for our customers, together with long-term career development for our employees. Clear lines of accountability and responsibility enable our frontline managers to make key business decisions and our operations teams to maintain our high safety standards, achieve our financial targets and improve on-time performance. During the year, we also conducted three pilot projects to help our operations management teams and senior ship personnel refine their processes to better manage services for passengers.

DEAS PACIFIC MARINE INC.

A significant portion of BC Ferries’ maintenance, vessel refit and upgrade work is conducted at Deas Pacific Marine Inc., our wholly owned subsidiary. The efficiency and productivity of the firm continues to show improvement, achieving more than $50 million in revenue last year.
REDUCING FUEL CONSUMPTION AND EMISSIONS

BC Ferries has developed a fuel and emissions reduction program to reduce the volume of actual fuel consumption by 1 per cent in each of 2006/07 and 2007/08. Over the past four years, our fuel consumption has steadily decreased from 125.1 million litres of fuel in 2002/03 to 118.0 million litres in 2005/06.

This past year, we implemented two new fuel reduction measures. On a six-month trial basis, we installed an electronic speed pilot (ESP) on the Queen of Alberni. With this system, which continuously monitors vessel performance and fine-tunes throttle and pitch settings to ensure the most efficient conversion of horsepower to thrust, we achieved a significant reduction in fuel consumption. As a result of the success of this project, we are extending the ESP system to an additional eight vessels in 2006/07.

We also upgraded two of the main engines on the Queen of New Westminster, resulting in a reduction in fuel consumption, as well as a substantial reduction in emissions of nitrogen oxides, carbon monoxide and carbon dioxide. The two remaining engines on this vessel will be overhauled during the next refit later in 2006.

EXPLORING THE USE OF ALTERNATIVE SERVICE PROVIDERS

The Coastal Ferry Act requires us to seek additional or alternative service providers on designated routes through fair and open competitive processes. In support of this process, on June 15, 2005, the BC Ferry Commissioner organized a seminar, hosted by the Western Transportation Advisory Council (WESTAC), for interested alternative service providers. A number of local ferry operators and other interested parties attended the event.
In July 2005, we submitted and had approved by the Commissioner a Supplement to the BC Ferries’ Additional or Alternative Service Providers (ASP) Plan filed the previous year. The supplement identifies three clusters of routes where we intend to evaluate alternative service delivery options: the northern routes (Routes 10, 11, 26, 40); the Mill Bay – Brentwood Bay route (Route 12); and the Powell River – Comox and Powell River – Texada routes (Routes 17 and 18). Progress to date:

➜ In the summer of 2005, we issued a Request for Expressions of Interest for the northern routes. Three proponents expressed interest, but by year-end, only one interested proponent remained involved in the process.

➜ In the fall of 2005, we initiated a Request for Expressions of Interest for the Mill Bay – Brentwood Bay route. Two proponents have expressed an interest and we expect to issue the Request for Proposals for this route in the second half of 2006.

➜ After extensive community consultation, we submitted a vessel and service strategy to the Ministry of Transportation for the Powell River routes. At year-end, we were awaiting the ministry’s response.

In February 2006, we successfully filed a further amendment to our ASP Plan with the Commissioner that reflected a refinement in timelines and procurement processes. We expect that our ASP Plan will require further modifications as a result of the Queen of the North incident and the expedited timelines to find a replacement vessel.

ACHIEVING REGULATORY EFFICIENCIES

Throughout the year, BC Ferries worked closely with Transport Canada and other regulatory agencies to minimize the uncertainty around proposed regulatory changes. Such consultation allows us to better coordinate regulatory improvements with other refit and maintenance work.
This past year, we placed even greater emphasis in our people and the principles of teamwork, growth, productivity, effectiveness and innovation. We continued to reinvent our people policies and practices to better fit and support our values and strategic direction. We also materially restructured our company to create a leaner and more integrated organization that is focused on new vessel construction, operational effectiveness and corporate development.

Investing in our assets is critical to the long-term success of BC Ferries. Over the year, we made significant investments to revitalize and improve our fleet and terminals to ensure we operate at a world-class standard.

DEVELOPING OUR EMPLOYEES

The dedication and commitment of our employees to excellence and continuous improvement is essential for us to achieve our goals. This past year, we introduced several new succession and career development initiatives in support of all employees and, in particular, the professional growth of our licensed personnel.

We launched a comprehensive Career Development Program, which is a vital component of the company’s succession planning, to identify managerial and supervisory potential in all employees. Our complementary best-in-class Management Development Program provides comprehensive training in all aspects of management to current and potential managers and supervisors.

BUILDING OUR CORPORATE CULTURE

Fostering a highly motivated, committed and flexible workforce is fundamental to the success of BC Ferries. This past year, we continued with regular consultation between the company and the Union. Together, we developed more flexible work schedules for operational employees, enhanced the opportunities for casual and seasonal employees, and improved our at-work attendance from 93 to 94 per cent last year.

We also launched our Respect in the Workplace program to support and educate all employees on the fundamental values at BC Ferries, introduced new programs to formally recognize our employees’ successes, and provided financial assistance through our enhanced Education Refund Program.

OUR SAFETY MANAGEMENT SYSTEM

We have voluntarily adopted and implemented a safety management system based on the International Maritime Organization’s International Safety Management Code and have chosen Lloyd’s Register, widely considered to be the foremost world authority on marine safety, to be our external auditors and advisors regarding our safety practices. Due to the size of our fleet, Lloyd’s audit program operates on a continuous basis. BC Ferries complies with Lloyd’s Register and holds all required certifications. In addition, we have an internal safety management system audit department that inspects and audits each vessel and terminal at least once per year.

BC Ferries meets or exceeds all Transport Canada requirements regarding vessel and crew regulations, including training. Transport Canada inspects each vessel and tests our crews’ safety proficiency at least once per year.

HAVE THE RIGHT PEOPLE WITH THE RIGHT SKILLS IN THE RIGHT JOBS—AND OPERATE WORLD-CLASS VESSELS, TERMINALS AND SYSTEMS

Together with our 3,400 employees, we operate and manage one of the largest, most complex and safest marine transportation systems in the world.
FOCUS ON TRAINING
The skill and dedication of our employees is critical to our successful operation. During the year, we developed a number of new and improved programs for all employees and offered 8,100 days of safety and operational training to our staff.

We delivered an extensive array of formal training programs to employees on a wide range of safety and operational topics, including marine emergency duties, the safe evacuation of passengers, first aid, occupational safety and health, and the transportation of dangerous goods.

We also began plans for the creation of our own training academy. With a focus on seamanship, the academy will broaden the training BC Ferries is able to deliver.

EMERGENCY RESPONSE AND MARINE RESCUES
Our highly skilled crews are trained to respond to a wide range of emergencies. This year, they assisted with 22 marine rescues, 391 marine medical emergencies and nine heart attacks. To prepare for these situations, our employees train regularly, with each crew member participating in hands-on fire and boat drills twice a month. Man-overboard drills are conducted monthly, and training for specific scenarios, such as oil spills, is conducted quarterly and semi-annually. In addition, all of our major vessels and seven of our terminals have been equipped with automatic external defibrillators, with 755 crew members trained to use the equipment.

REVITALIZING OUR FLEET
Revitalizing our fleet is crucial to the achievement of our goals. We completed several vessel renewal projects, including refitting 28 vessels at a cost of $43.4 million, and enhanced our long-range maintenance plans for all vessels in the fleet.

Over the year, we completed a $35.1 million mid-life upgrade on the Queen of Oak Bay and began a similar upgrade on the Queen of Surrey, which was completed in June 2006. The upgrades, which are designed to extend the vessel’s useful life by 20 years, included extensive engine and electrical upgrades, the installation of new emergency evacuation equipment, updated washrooms, expanded and remodelled gift shops, and new and improved food service facilities and passenger seating areas.

In addition, we completed a $15.4 million life extension on the Queen of Nanaimo that included installing a new life-saving system, replacing structural steel and upgrading the passenger accommodation areas. The Spirit of Vancouver Island received a $13.5 million refit that included an overhaul of the main engines, upgrades to life-saving equipment and numerous customer-service improvements. The vessel’s sister ship, the Spirit of British Columbia, underwent a similar upgrade the previous year.

The Kwuna, which provides service between Alliford Bay and Skidegate, underwent a $4.2 million upgrade to increase fuel economy and reliability. The project included installing new engines, replacing the generators and upgrading the hydraulic system for the ship’s ramps. We also replaced the generator on the North Island Princess, reconfigured the snack bar on the Bowen Queen and began plans to refurbish the car deck on the Powell River Queen.

During the year, we purchased the John Atlantic Burr, which we had disassembled and transported from Salt Lake City, Utah, to Vancouver, B.C. The vessel is currently undergoing a major reconstruction to increase its carrying capacity and upgrade it to our standards. When the vessel enters service this fall, it will fill a key role in providing backup capacity on the smaller routes, which is particularly helpful in the summer and on long weekends.

NEW VESSEL CONSTRUCTION
This past year, we made significant progress on our aggressive fleet renewal plan that will see seven new vessels added to the fleet by 2009.

The detailed design phase was completed for our three new Super C-class vessels, with steel cutting beginning in August 2006. With a total project budget of $542 million, the 160-metre ships will serve on our busy Horseshoe Bay – Departure Bay and Tsawwassen – Swartz Bay routes. With the project on budget and on schedule, we expect to take delivery of the Coastal Renaissance, our first Super C-class vessel, in late 2007, with the Coastal Inspiration and Coastal Celebration arriving in 2008.

We signed a letter of intent for the construction of a 125-car ferry to replace the 45-year-old Queen of Tsawwassen. In July 2006, we finalized the contract and expect the new vessel to be in service by the summer of 2008.

We also accelerated the procurement of a new vessel for our northern routes to replace the Queen of Prince Rupert and, in August 2006, awarded a contract to Flensburger Schiffbau-Gesellschaft for the construction of a 600-passenger, 130-vehicle ferry.
IMPROVING OUR TERMINALS
We invested $44.2 million to upgrade our terminals and improve amenities for our customers. In June 2005, we opened a $7.3 million, 16,000 square foot retail building at Tsawwassen, our largest terminal. With a contemporary design and extensive food and retail offerings, Tsawwassen Quay reflects our exciting new vision for our terminals. We also completed several other improvements at Tsawwassen terminal, including the replacement of marine and vehicle ramp structures, and the construction of a new foot passenger waiting lounge, tower and access walkway.

At Horseshoe Bay, we invested $2.0 million to enhance the passenger waiting areas, walkways and washrooms and $1.3 million to upgrade marine structures. In addition to completing an improved highway approach to Swartz Bay terminal, we also began a $25.7 million project at the terminal to replace the trestle, ramp and other marine structures at Berth 2. This work is expected to be completed by the end of the summer of 2006.

At our smaller terminals, we invested $7.5 million to replace the marine structures at Buckley Bay, Kuper Island, Saltery Bay and Port McNeill. In addition, we are upgrading the ramps at Alliford Bay, Sturdies Bay, Skidegate and Langdale and improving access for pedestrians at our Otter Bay terminal.

This past year, we completed Terminal Master Plans for Departure Bay, Alert Bay, Denman West and Buckley Bay.

AN INCREASED EMPHASIS ON SECURITY
As part of our ongoing commitment to the safety and welfare of our customers and employees, we are introducing a comprehensive, multiphase strategy for tighter security on our vessels and at our terminals. As part of this strategy, we are working closely with other Canadian ferry operators and Transport Canada in the development of security regulations for domestic ferry operations.

In the course of the past year, we completed a security vulnerability assessment at several major terminals and on selected vessels, added security personnel at a number of locations and implemented photo ID cards for all employees to ensure appropriate access. Security provisions have also been incorporated in all terminal and vessel master plans.

At BC Ferries, we continue to meet or exceed all existing legislative requirements regarding the security of our vessels and terminals. We consult regularly with the RCMP, Transport Canada Marine Security and other intelligence agencies, and participate in a provincial critical infrastructure security intelligence and information network. Membership in this group includes law enforcement agencies, E-Comm (911), security and emergency planners for Ports Canada, regional districts and other transportation and emergency-response organizations. We also remain in contact with security and emergency planners of other northwest coast ferry operators regarding the exchange of security information. Security is a high priority for us and one that will require a significant investment over the next 10 years.

OUR ENVIRONMENTAL COMMITMENT
BC Ferries meets or exceeds all applicable local, national and international regulations regarding the prevention of pollution. This year, we put in place a number of measures to reduce our environmental footprint.

Our organic waste composting program was launched on the Departure Bay to Horseshoe Bay vessels in response to the Regional District of Nanaimo’s Zero Waste program. During the initial one-month trial, we successfully removed 6.5 tonnes of organic material from the waste stream for composting. This composting program is expected to grow to an estimated 15 to 20 tonnes of material during the peak summer months.

With the support of Health Canada, we implemented a potable water management program that includes regular testing of drinking water quality at our terminals and on our vessels. We also developed a new Environmental Standards Manual that details the policies and procedures required to ensure we meet or exceed all environmental regulatory requirements.

COMPLYING WITH ENVIRONMENTAL REGULATIONS
Substantial changes in environmental legislation were enacted in the past year, including Bill C-15 in May 2005. This legislation imposed increased penalties, including fines and imprisonment, with respect to the discharge of substances harmful to migratory birds. At BC Ferries, we have taken the necessary steps to ensure that any discharges from our vessels are in compliance with all applicable environmental legislation.

Also in May 2005, Annex VI of the International Convention for the Prevention of Pollution from Ships came into effect. This regulation places international limits on emissions of sulphur dioxide and nitrogen oxides from ships. In the spring of 2007, these limits will apply to all new Canadian ships. As a result, all of our vessels currently under construction are being designed in compliance with the forthcoming regulations.
CUSTOMER SATISFACTION SURVEY
To ensure that we are meeting the needs of our customers, every year we measure our customers’ satisfaction with our full range of services. In addition, we place electronic research kiosks at select terminals and vessels to ensure that we are gathering customer feedback on a regular basis.

Our 2005 Customer Satisfaction Survey reported that 86 per cent of customers are satisfied with their BC Ferries travel experience. Year over year, customer satisfaction with on-time departures increased. In particular, customers gave our company high marks for staff courtesy and professionalism, operational safety, efficiency of ticket purchases, ease of using online reservations, usefulness of the website, highway signage, tourist information and washroom availability, and the cleanliness of passenger waiting area seating.

IMPROVING CUSTOMER SERVICE
Over the year, we implemented significant enhancements to our food, beverage and retail offerings. Onboard the renovated Spirit of Vancouver Island, customers are enjoying new seating, expanded menu choices including a wide variety of new hot and cold offerings, a larger gift shop, four flat-screen televisions, an interactive Kid Zone play area, an enclosed pet area and a new Seawest Lounge. In addition to receiving significant mechanical and safety improvements, the recently upgraded Queen of Surrey and Queen of Nanaimo now provide improved passenger areas, including updated washrooms, expanded and remodelled gift shops, new and improved food service facilities, and new flooring, lighting and furniture.

This past year, we formed a new partnership with La Collina of Victoria, B.C., to provide fresh pastries and baked goods to the Land’s End Café at Swartz Bay terminal and to our Spirit-class vessels operating between Swartz Bay and Tsawwassen. La Collina joins a distinguished list of companies that provide food and beverage items onboard our vessels and at our terminals.

To provide our customers with up-to-date sailing information, we installed changeable, electronic message signs on the highway approaches to Swartz Bay and Tsawwassen. In July 2006, a similar sign was installed north of Nanoose Bay to provide information on our Duke Point – Tsawwassen and Nanaimo – Horseshoe Bay routes.

INTRODUCING LIFE ON THE COAST
In May 2005, we launched our new Life on the coast brand advertising campaign through billboards, radio and television. The campaign positions BC Ferries as a symbol of coastal living and celebrates our customers’ choice to live, work, travel to and thrive in British Columbia’s coastal communities.

In the fall, we launched a contest to select names for our three new Super C-class vessels that will begin operating in B.C. in 2007. After reviewing the 7,602 entries submitted by customers and employees, a panel of local media and BC Ferries employees selected Coastal Renaissance, Coastal Inspiration and Coastal Celebration—names that reflect BC Ferries’ commitment to serving our coastal communities.

ACHIEVE HIGH CUSTOMER SATISFACTION AND LOYALTY
At BC Ferries, we work hard to continually improve our customers’ travel experience. This past year, we added a number of new products and promotions to increase our customer base, stimulate ferry travel and increase our revenues. We also focused on strengthening our relationships with the coastal communities we serve.
BUILDING OUR RELATIONSHIPS WITH COASTAL COMMUNITIES

We formed a partnership with Sport BC and developed Sporting Life on the Coast, a travel assistance program that helps children and adults in coastal communities participate in organized sport. Through this partnership, BC Ferries and Sport BC assist with ferry travel costs for athletes, coaches and officials. In support of KidSport, the charitable arm of Sport BC that provides grants to financially disadvantaged children to cover the costs of sport registration fees, BC Ferries donated the proceeds from various fundraising activities, including those from KidSport meals purchased onboard our vessels.

In addition, we were the presenting sponsor of the 47th annual All Native Basketball Tournament in Prince Rupert in February 2006, where more than 700 participants converged from the central and north coasts of British Columbia.

We successfully coordinated the refurbishment and repatriation of a totem from the Tsawwassen terminal to Campbell River, which was dedicated on June 16, 2005, and commissioned a Tsawwassen First Nation totem for Tsawwassen Quay, culminating in a dedication ceremony on June 23, 2005.

This past year, we created our new BC Ferries Community Investment Program and established guidelines that are available at www.bcferries.com. Through this program, we support a wide range of activities, from celebrations and festivals to boating safety, tourism and amateur sport, through sponsorship, donations and employee volunteerism in the coastal communities we serve.
CONSULTING WITH OUR STAKEHOLDERS

We are committed to public consultation and, during the past year, have reviewed our ferry advisory committee program and established two other consultative committees.

In 2005, BC Ferries and the BC Coalition of People with Disabilities formed an Accessibility Advisory Committee to review opportunities to increase accessibility for persons with disabilities at all BC Ferries facilities and onboard our vessels. While the work of the committee was largely research-oriented during the first year, together we identified opportunities for immediate action. For example, the new Super C-class vessels will be built to a higher standard of accessibility. Improvements are also being made at BC Ferries’ terminals as we carry out our terminal master planning and terminal reconstruction process.

Departure Bay is one of our busiest terminals. Early in 2006, we formed a Departure Bay Terminal Liaison Committee in conjunction with the Brechin Hill Community Association, the City of Nanaimo and the Ministry of Transportation. The committee will review the impact of the terminal on the neighbourhood and recommend actions to mitigate that impact.

We also meet regularly with local government and First Nations on matters of mutual interest. We have incorporated First Nations consultation into our service and terminal master planning, and we carry out archaeological assessments and consult with First Nations prior to development at our terminals.

EXPANDING OUR BUSINESS

To support our ongoing investment in refurbishing our fleet and upgrading our terminals, we are continually seeking opportunities to expand our business and provide additional services.

In an effort to attract new customers and encourage travel during off-peak times, we introduced several innovative pricing promotions this year targeted at seniors, families, commercial traffic and seasonal travel. We formed new partnerships with the BC Lions football club, BC Experience and the Royal BC Museum, and sponsored a number of events, including the World Curling Championships, the BC Seniors Games, the Tall Ships Festival and the Times Colonist Open.

We also investigated other business opportunities. For example, we began looking closely at the feasibility of providing overnight freight service on some of our major routes.
This past year, we met our financial targets and posted net earnings of $49.9 million, up from $39.8 million the previous year.

**INVESTING IN OUR ASSETS**

In 2005/06 our capital investment program in our fleet, terminals and information systems totalled $136.0 million. This included $82.1 million in vessel upgrades and modifications, $36.9 million in marine structures, $9.0 million in software development to enhance customer services and operational efficiency, and $7.3 million in terminal and building upgrades.

**MEETING THE CHALLENGE OF HIGH FUEL PRICES**

The escalating cost of fuel worldwide presented one of our biggest challenges this past year, with our annual fuel cost increasing from $57.2 million to $74.9 million. As a result, we filed two separate applications with the BC Ferry Commissioner to implement fuel surcharges on vehicle and passenger fares.

The Commissioner approved an extraordinary price cap increase of 4.0 per cent on major routes connecting Vancouver Island to the Lower Mainland and 6.0 per cent on most other routes, effective July 25, 2005. The Commissioner approved a second extraordinary price cap increase that averaged 1.5 per cent for major routes and 3.0 per cent for most other routes, effective February 1, 2006. In his second ruling, the Commissioner stated that a third fuel surcharge would be considered if certain conditions were met and required BC Ferries to submit a fuel savings plan by June 15, 2006.

On June 19, 2006, the Commissioner approved an additional extraordinary increase to offset the continued rising cost of fuel. The additional surcharge of 3.2 per cent for major routes connecting Vancouver Island to the Lower Mainland and 9.6 per cent for most other routes was implemented on June 22, 2006.

We are continuing our efforts to reduce our fuel consumption and will ask the Commissioner to eliminate the fuel surcharges if and when sustained fuel prices return to pre-surcharge levels.

Our capacity to serve the public depends on our ability to renew our aging infrastructure. As all of our earnings are reinvested in our terminals and vessels, we must continue to maintain strong financial performance.
LOOKING TO THE FUTURE WITH CONFIDENCE

At BC Ferries, we are dedicated to improving all areas of our business as we continually strive to build a better company for our customers, employees and the communities we serve.

We are committed to the long-term growth and success of our company and to our number one priority of ensuring a safe, secure and environmentally responsible marine transportation system for all of our customers.

In the years to come, we will work to deepen our relationships with our stakeholders who live, work and travel in coastal British Columbia, and continue to support our employees as we build a new corporate culture and explore opportunities to expand our business.

This is an exciting time for our company as we embark on a long-term plan to revitalize our fleet and renew our terminals. Over the next three years, we will introduce seven new vessels to our fleet and invest more than $200 million in our terminals to ensure the ongoing safety and reliability of our operations.

The future holds tremendous opportunities for BC Ferries, and we look forward with confidence as we continue our pursuit of excellence.
BC FERRIES’ FLEET

MAJOR VESSELS
Average Vessel Age 30.6 years

PASSENGERS • 450-2,052
CREW • 21-48
AUTOMOBILE EQUIVALENTS • 286-470

Spirit of British Columbia • 1993
Spirit of Vancouver Island • 1994
Queen of Alberni • 1976
Queen of Coquitlam • 1976
Queen of Cowichan • 1976
Queen of Esquimalt • 1963
Queen of New Westminster • 1964
Queen of Oak Bay • 1981
Queen of Saanich • 1963
Queen of Surrey • 1981
Queen of Vancouver • 1962

INTERMEDIATE AND SMALL VESSELS
Average Vessel Age 34.8 years

PASSENGERS • 133-977
CREW • 4-35
AUTOMOBILE EQUIVALENTS • 16-192

Queen of Burnaby • 1965
Queen of Nanaimo • 1964
Queen of Tsawwassen • 1960
Skeena Queen • 1996
Queen of Cumberland • 1992
Queen of Capilano • 1991
Mayne Queen • 1965
Bowen Queen • 1965
Powell River Queen • 1965
Quinsam • 1982
Quinitsa • 1977
Klitsa • 1972
Kahloke • 1973
Kwuna • 1975
Howe Sound Queen 1964
North Island Princess 1958
Quadra Queen II 1969
Tenaka • 1964
Nimpkish • 1973
Mill Bay • 1956

NORTHERN VESSELS
Average Vessel Age 34.0 years

PASSENGERS • 374-504
CREW • 26-40
AUTOMOBILE EQUIVALENTS • 80-115

Queen of Prince Rupert • 1966
Queen of Chilliwack • 1978

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AUTOMOBILE EQUIVALENTS • 286-470

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Queen of Prince Rupert • 1966
Queen of Chilliwack • 1978
The following is our discussion and analysis of the financial condition and results of operations for British Columbia Ferry Services Inc. This should be read in conjunction with the consolidated financial statements for the year ended March 31, 2006 (fiscal year 2006). This management's discussion and analysis has been prepared based on information available at May 17, 2006, except where otherwise indicated. Additional information relating to British Columbia Ferry Services can be found on SEDAR at www.sedar.com.

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, with 34 vessels operating on 25 routes. Our service is an integral part of British Columbia’s coastal transportation system, and has been designated by the Province of British Columbia 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 BC.

We are a versatile company, providing a wide range of ferry services for our customers. In fiscal year 2006, we provided over 186,000 sailings, carrying over 21 million passengers and 8 million vehicles. Although we carried 14 thousand (0.2%) fewer vehicles and 297 thousand (1.3%) fewer passengers than in fiscal year 2005 we had our second highest year ever for both vehicle and passenger traffic. Our customers travel on our ferries for business purposes and for leisure. Our traffic volumes are affected by a number of factors, including population growth, economic trends and tourism.

Significant events during or subsequent to fiscal year 2006 included the following:

- On March 22, 2006, the Queen of the North, operating on its regular route from Prince Rupert to Port Hardy, ran aground on Gil Island in Wright Sound and subsequently sank. Two passengers remain unaccounted for and are presumed to have perished. Eleven passengers and crew, with minor injuries, were transferred from the incident site by helicopter to Prince Rupert where they were treated and released from hospital. The remaining passengers and crew were transferred from the Queen of the North’s life boats to fishing vessels and to the Coast Guard vessel Sir Wilfred Laurier. The vessels transported their passengers to the Village of Hartley Bay where their needs were attended to by the community. From Hartley Bay, the passengers and crew were taken to Prince Rupert by the Coast Guard vessel.

A tug and barge service, as well as air service, was used as an interim measure to ensure that supplies reached the Queen Charlotte Islands and passengers requiring passage were accommodated. The Queen of Prince Rupert, which was undergoing refit at the time of the sinking, returned to service on the north coast route on April 19th. For this summer we intend to augment service provided by the Queen of Prince Rupert with additional tug and barge service.

- On July 25, 2005, we applied fuel surcharges to all fares, based on the British Columbia Ferries Commissioner’s approval of extraordinary price cap increases of 4% for major routes connecting Vancouver Island to the mainland and 6% on most other routes. Proceeds from the fuel surcharges are credited against balances in the deferred fuel cost accounts. As a result of continuing high fuel costs, a further extraordinary price cap increase was approved and fuel surcharges averaging 1.5% for major routes and 3% for most other routes became effective February 1, 2006. In his second order the Commissioner provided for additional fuel surcharges effective June 2006 if certain conditions are met. (See “Expenses – Fuel Deferral and Related Surcharge” for further detail.)
We maintain commercial insurance coverage for incidents of this nature. In accordance with generally accepted accounting principles, $6.6 million of the expected $67.9 million net hull and machinery insurance policy proceeds have been recorded as receivable to offset insurable losses (including our liability insurance deductible of $1.0 million) incurred to March 31, 2006. We received the $67.9 million proceeds in May 2006. These proceeds, less the aforementioned receivable, will be recognized in the first quarter of fiscal year 2007. Claims for loss of life, personal belongings of passengers, passenger automobiles, and other types of claims are in the process of settlement. We expect that substantially all third party claims in excess of our deductible will be paid by our liability insurer.

Our hull and machinery insurance policies have subsequently been renewed with an increase in annual premium costs of approximately $1.5 million. We expect that foregone passenger revenues resulting from the loss of the vessel will be largely offset by avoided operating costs and interest income on invested insurance proceeds. It is uncertain at this time what the impact of this incident will be on ferry service fees under the Coastal Ferry Services Contract.

We have not observed any measurable impact on traffic levels elsewhere in our system that we attribute to this unfortunate event.

We are conducting an international search to lease or purchase a replacement vessel. However, it is important to note that if we do find a replacement vessel for the Queen of the North, it will take several months to certify the vessel, implement a safety management system and train our crews. We also plan to accelerate the process for the construction of up to three new northern vessels for which the Provincial government has entered into an agreement to provide financial support.

In accordance with the terms of the Coastal Ferry Services Contract, we filed a notice of force majeure with the Province of British Columbia (the “Province”) and are in discussions with them as to the appropriate level of service to be provided until the acquisition of a replacement vessel.

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 the number of round trips that must be provided for each regulated ferry service route in exchange for specified fees. These fees are fixed over the first performance term of the contract, which ends March 31, 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 this 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 Vancouver Consumer Price Index.

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 regulates price caps for designated ferry route groups which, to the end of the first performance term, are specified in the Coastal Ferry Act. 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.

2006 FINANCIAL OVERVIEW

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

Our consolidated net earnings in fiscal year 2006 grew $10.1 million or 25.2% from the previous fiscal year. Our earnings in fiscal year 2005 grew $11.8 million or 42.3% from the fiscal year 2004.

<table>
<thead>
<tr>
<th>($millions)</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenue</td>
<td>579.2</td>
<td>564.5</td>
<td>533.7</td>
</tr>
<tr>
<td>% Growth</td>
<td>2.6%</td>
<td>5.8%</td>
<td>8.9%</td>
</tr>
<tr>
<td>Expenses</td>
<td>(504.1)</td>
<td>(499.5)</td>
<td>(481.7)</td>
</tr>
<tr>
<td>Earnings from operations</td>
<td>75.1</td>
<td>65.0</td>
<td>52.0</td>
</tr>
<tr>
<td>Interest and other</td>
<td>(25.2)</td>
<td>(25.2)</td>
<td>(24.0)</td>
</tr>
<tr>
<td>Net earnings (loss)</td>
<td>49.9</td>
<td>39.8</td>
<td>28.0</td>
</tr>
</tbody>
</table>

As at March 31

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets</td>
<td>833.7</td>
<td>763.4</td>
<td>629.8</td>
</tr>
<tr>
<td>Total long-term financial liabilities</td>
<td>516.5</td>
<td>516.6</td>
<td>443.3</td>
</tr>
</tbody>
</table>
Revenue

Our total revenues have increased steadily over the past three fiscal years, as shown in the table below. Year to year changes for the past two fiscal years are discussed separately below.

<table>
<thead>
<tr>
<th>Fiscal year ended March 31</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tariff – vehicles</td>
<td>221.5</td>
<td>216.5</td>
<td>201.2</td>
</tr>
<tr>
<td>Tariff – passengers</td>
<td>132.1</td>
<td>129.4</td>
<td>121.8</td>
</tr>
<tr>
<td>Ferry service fees</td>
<td>108.2</td>
<td>107.0</td>
<td>105.8</td>
</tr>
<tr>
<td>Federal-Provincial subsidy</td>
<td>24.9</td>
<td>24.3</td>
<td>24.0</td>
</tr>
<tr>
<td>Retail</td>
<td>68.8</td>
<td>67.8</td>
<td>63.2</td>
</tr>
<tr>
<td>Other income</td>
<td>23.7</td>
<td>19.5</td>
<td>17.7</td>
</tr>
<tr>
<td>Total Revenue</td>
<td>579.2</td>
<td>564.5</td>
<td>533.7</td>
</tr>
</tbody>
</table>

Year to Year Comparison of Revenues 2006 – 2005

Vehicle and passenger traffic both decreased marginally in fiscal year 2006 from fiscal year 2005, which was our strongest year ever for both types of traffic. A portion of the decrease is in the timing of the Easter weekend. In fiscal year 2005, we experienced two Easter weekends while fiscal year 2006 did not include any. We also witnessed a decrease in the number of tour buses which we believe is related to a decline in tourism.

This is more evident on our major routes which experience the greatest volatility from changes in tourism.

The improvement in tariff revenue is a result of annual average rate increases of 2.8% on our three major routes connecting Vancouver Island to the mainland and 4.4% on the remaining routes. These tariff increases are as permitted by the Coastal Ferry Act.

Ferry service fees are higher in fiscal year 2006 than in fiscal year 2005 due to an increase of $1.3 million (9.4%) in social program fees. These programs include discount fares for BC seniors, students traveling to and from school and persons traveling under the medical Travel Assistance Program. Ferry service fees, other than social program fees, are linked to the number of scheduled sailings which, except for emergency events, are essentially the same each year. Social program fees are based on usage.

Retail revenue, which includes food and other retail merchandise sales, grew $1.0 million in fiscal year 2006 compared to fiscal year 2005. Revenue from food sales grew $0.3 million or 0.7%, the majority of the increase reflecting a higher spend per customer partially offset by a decrease in passenger traffic. An increase of approximately $0.4 million resulted from the addition of a new paid seating lounge on the Spirit of British Columbia. We also experienced a $0.3 million increase in lease revenues from the new Tsawwassen Quay, a 16,000 square foot retail outlet which opened in June 2005. (See “Investing in Our Capital Assets” for more details about the Quay.)

Other income increased a total of $4.2 million in fiscal year 2006 compared to fiscal year 2005. Reservation fees were $1.4 million higher, mainly as a result of a $1.2 million increase on our major routes. Revenue from sales of assured loading tickets (“ALTs”) increased $0.4 million. An additional $2.0 million was recognized in fiscal year 2006, reflecting the reassessment of the deferred revenue liability relating to historical sales of paper ALTs. Sales of paper ALTs ceased in May 2005 upon the introduction of the “Coast Card”. (See “Investing in our Capital Assets”.) We also experienced an increase in parking and advertising revenues.
Year to Year Comparison of Revenues 2005 – 2004

The improvement in our tariff revenue in fiscal year 2005 compared to fiscal year 2004 was the result of higher traffic volumes, together with annual average rate increases of 2.8% on our three major routes connecting Vancouver Island to the mainland and 4.4% on the remaining routes. We experienced our strongest traffic levels ever in fiscal year 2005.

<table>
<thead>
<tr>
<th>Vehicle Traffic Volume</th>
<th>Increase</th>
<th>2005</th>
<th>2004</th>
<th>#</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Major routes</td>
<td></td>
<td>3,808,843</td>
<td>3,688,123</td>
<td>120,720</td>
<td>3.3%</td>
</tr>
<tr>
<td>Other routes</td>
<td></td>
<td>4,748,539</td>
<td>4,604,106</td>
<td>144,433</td>
<td>3.1%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>8,557,382</td>
<td>8,292,229</td>
<td>265,153</td>
<td>3.2%</td>
</tr>
</tbody>
</table>

Ferry service fees were higher in fiscal year 2005 compared to fiscal year 2004 due to an increase of $1.1 million (8.9%) in social program fees.

The Federal-Provincial subsidy is adjusted each year in accordance with changes in the Vancouver Consumer Price Index.

Retail revenue increased $4.6 million in fiscal year 2005 compared to fiscal year 2004. Revenue from food sales grew 2.6%, the majority of the increase reflecting a January 7, 2004 price increase of 3%. Other retail spending increased 13.4%. This increase was mainly attributable to positive customer response to our gift shop expansions on the Queen of Coquitlam, Queen of Cowichan, and the Spirit of Vancouver Island.

The increase in other income in fiscal year 2005 compared to fiscal year 2004 reflects increased usage of our reservation system. Reservation fees were $2.3 million higher, with $1.9 million more revenue from reservations on our major routes and the balance from the Horseshoe Bay-Langdale route. This increase is partially offset by reductions in foreign exchange and advertising revenues.

Expenses

Expenses for the past three fiscal years are summarized in the table below.

<table>
<thead>
<tr>
<th>Expenses ($millions)</th>
<th>2006</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operations</td>
<td>291.7</td>
<td>294.0</td>
<td>286.0</td>
</tr>
<tr>
<td>Maintenance</td>
<td>81.1</td>
<td>86.8</td>
<td>86.1</td>
</tr>
<tr>
<td>Administration</td>
<td>51.2</td>
<td>44.5</td>
<td>38.9</td>
</tr>
<tr>
<td>Total operations, maintenance &amp; administration</td>
<td>424.0</td>
<td>425.3</td>
<td>411.0</td>
</tr>
<tr>
<td>% Increase (decrease)</td>
<td>(0.3%)</td>
<td>3.5%</td>
<td>3.3%</td>
</tr>
<tr>
<td>Cost of retail goods sold</td>
<td>27.0</td>
<td>26.5</td>
<td>23.3</td>
</tr>
<tr>
<td>Amortization</td>
<td>53.1</td>
<td>47.7</td>
<td>47.4</td>
</tr>
<tr>
<td>Total</td>
<td>504.1</td>
<td>499.5</td>
<td>481.7</td>
</tr>
<tr>
<td>% Increase</td>
<td>0.9%</td>
<td>3.7%</td>
<td>0.7%</td>
</tr>
</tbody>
</table>

Loss (gain) on foreign exchange | (0.2) | 0.1 | (0.2) |
Interest expense               | 25.1 | 24.5 | 22.6 |
Loss on disposal of capital assets | 0.3 | 0.6 | 1.6 |
| Total                         | 25.2 | 25.2 | 24.0 |
Management’s Discussion & Analysis
Of Financial Condition and Results of Operations

Fuel Deferral and Related Surcharge
In September 2004, the British Columbia Ferries Commissioner issued an order authorizing us to maintain deferred fuel cost accounts to mitigate the effect on our earnings of unpredictable and uncontrollable price volatility in world fuel oil markets. The Commissioner established set prices for fuel oil for each of the years until March 31, 2008, at which time the Commissioner will decide on the continuation of the deferred fuel cost accounts. Differences in fuel costs arising from our actual price paid per litre being higher or lower than the unit set price are charged to the deferral accounts.

On June 13, 2005, we filed an application with the British Columbia Ferries Commissioner under section 42 of the Coastal Ferry Act for extraordinary price cap increases. We had experienced significantly higher prices for fuel oil than expected. At the time of the application, our annual cost of fuel was projected to be 45% higher than it was two years earlier, exceeding $72 million this fiscal year. As a result of the higher forecast costs, the deferred fuel cost account balances would be greater than originally expected. The application requested extraordinary price cap increases to allow for fuel surcharges in order to reduce or eliminate these balances.

The Commissioner’s ruling approved extraordinary price cap increases of 4% for major routes connecting Vancouver Island to the mainland and 6% on most other routes. The price cap increases allowed for fuel surcharges which took effect on July 25, 2005, to be applied to all fares. Proceeds from the fuel surcharges are credited against balances in the deferred fuel cost accounts.

As part of the Order, the Commissioner also increased the set prices established in a previous ruling by 5% effective July 24, 2005. In fiscal year 2006, this increase in set prices resulted in $1.6 million of additional expense. This change resulted in a 5% increase in fuel costs charged to expense for the balance of fiscal year 2006 and for the two succeeding years in addition to the increase established in the original order. This will reduce the projected amount added to the deferral account balances by an equal amount. The Order can be viewed on the Commissioner’s website at www.bcferrycommission.com.

As a result of continuing high fuel costs and a new annual fuel cost projection of $76 million for fiscal year 2006, we applied to the British Columbia Ferries Commissioner on November 28, 2005, for additional price cap increases to allow for further fuel surcharges.

On January 20, 2006, the Commissioner issued a further decision which was segregated into two parts:

1. The Commissioner granted additional price cap increases which allowed for the implementation of an incremental fuel surcharge on all fare types, averaging 1.5% for major routes connecting Vancouver Island and the Mainland and 3% for most other routes, effective February 1, 2006;

2. Another increase may be granted effective June 2006, if certain conditions are met. The Commissioner has developed a formula to determine the amount, if any, of the increase. Due to the continued high cost of fuel and despite $11.2 million in fuel surcharges collected in fiscal year 2006, the balance in the fuel deferral accounts has increased from $8.0 million at March 31, 2005 to $22.7 million at March 31, 2006. We anticipate that the Commissioner will grant a further increase.

In addition, the Commissioner has set an efficiency target requiring us to reduce fuel consumption by 1% in fiscal year 2007 and by an additional 1% in fiscal year 2008 and has included a requirement that we develop and file a plan to address fuel savings. This Order can also be viewed on the Commissioner’s website.

We are continuing to implement 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. For the year ended March 31, 2006, compared to the previous year, our fuel consumption was reduced by 3.4% (with a reduction in sailings provided of 0.4%). This reduction is primarily as a result of improvements in on-time performance, an engine upgrade on the Queen of New Westminster and a fuel monitor system installed on the Queen of Alberni. In both fiscal years 2006 and 2005, the large Spirit vessels, which carry vehicles and passengers between Vancouver Island and the Mainland, were out of service for maintenance for approximately the same time period. When the Spirit vessels are out of service, they are replaced by smaller vessels and we experience a savings in fuel consumption.

Year to Year Comparison of Expenses 2006 – 2005
The total decrease in operations expenses in fiscal year 2006 compared to fiscal year 2005 was $2.3 million. This reflects a $7.7 million net decrease in property tax expense. In January, 2006 the Property Assessment Appeal Board accepted an agreement we reached with the BC Assessment Authority to settle our 2004 and 2005 terminal property assessment appeals. Prior to becoming an independent company, we paid approximately $1.4 million per year in grants-in-lieu of property taxes. In 2004, we paid $8.9 million in property tax and $9.9 million in 2005. The settlement reduces our terminal property assessments by approximately 40% for 2004 and 47% for 2005 which resulted in a refund of $8.2 million. This reduction in property tax expense was partially offset by an increase in wages and benefits of $3.6 million, a $0.7 million increase in the total fuel costs due to a 7% increase in the set price as approved by the British Columbia Ferries Commissioner, partially offset by efficiency savings, $1.3 million increase in marine insurance and $1.6 million increase in major ad campaigns and travel agent fees. Costs not covered by third party insurance for the grounding of the Queen of Oak Bay totalled $1.5 million, with $1.2 million reflected in operations and $0.3 million reflected in maintenance expenses.
Maintenance expenses, which include expenditures for vessel refit and maintenance as well as terminal maintenance activities, were $5.7 million lower in fiscal year 2006 compared to fiscal year 2005. This was mainly due to the higher maintenance costs incurred in fiscal year 2005 for one-time costs required to meet Transport Canada requirements.

Administration expenses increased $6.7 million in fiscal year 2006 compared to the previous fiscal year. Increases include:

- $3.7 million for corporate information technology support. We have had many new initiatives and upgrades to our computer systems, including safety and security programs, a new catering and retail system and systems to improve customer service, which require increased support;
- $2.1 million resulting from our internal control certification project. We have initiated this project to document and test the effectiveness of internal controls on which management is relying to support certifications required by the Canadian Securities Administrators; and
- $2.1 million costs for severance and restructuring.

These increases were partially offset by administrative efficiencies.

The $0.5 million increase in cost of retail goods sold in fiscal year 2006 compared to fiscal year 2005 reflects the higher level of retail sales and the higher cost of premium products.

Amortization increased a total of $5.4 million in fiscal year 2006 compared to the previous fiscal year. This increase was a result of additional assets coming into service including:

- $1.7 million reflecting the Queen of Oak Bay $35.1 million upgrade;
- $1.7 million reflecting new information technology including our Coast Card, our new point of sale system, crew scheduling system and enterprise resource planning projects.

Interest expenses increased $0.6 million in fiscal year 2006 compared to fiscal year 2005 reflecting the overall increase in our average level of debt and the effect of interest rates payable on the debt instruments issued and in place as described in the “Liquidity and Capital Resources” section below. Increases in debt costs were partially offset by interest rate support recorded under the Structured Financing Facility Program offered by the Government of Canada for the Queen of Oak Bay and Queen of Nanaimo mid-life upgrades. A total of $5.6 million in support has been granted of which we have reflected $2.0 million as a decrease in bond interest costs for fiscal year 2006 and $0.6 million to offset interest costs previously capitalized on the upgrades. The remaining $3.0 million will be applied against future bond interest costs.

Year to Year Comparison of Expenses 2005 – 2004

The total increase in operations expenses in fiscal year 2005 compared to fiscal year 2004 was $8.0 million. The most significant increase of $5.8 million was due to the first complete calendar year of the change from paying grants-in-lieu to property taxes based on assessed value. Another $1.6 million was due to increased wage and training costs.

Maintenance expenses, which include expenditures for vessel refit and maintenance as well as terminal maintenance activities, were $0.7 million higher in fiscal year 2005 compared to the previous fiscal year. We experienced higher maintenance costs in fiscal year 2005 for one-time costs required to meet Transport Canada requirements, while in fiscal year 2004 we incurred one-time costs to repair the Queen of Surrey after a fire onboard.

Administration expenses increased $5.6 million in fiscal year 2005 compared to fiscal year 2004. The most significant increase was the cost of corporate information technology support of $4.3 million. We have had many new initiatives and upgrades to our computer systems which require increased support.

The increased cost of retail goods sold in fiscal year 2005 compared to the previous fiscal year reflects the higher level of retail sales. The expansion of our vessel gift shops with increased lines of merchandise has been very successful.

Amortization increased a total of $0.3 million in fiscal year 2005 compared to fiscal year 2004. This change was a combination of revisions to the estimates of vessel salvage value and increases from additional assets coming into service, partially offset by the Queen of Chilliwack being fully amortized at the end of March 2004.

Interest expenses increased a total of $1.8 million in fiscal year 2005 compared to the previous fiscal year reflecting the overall increase in our average level of debt and the effect of interest rates payable on the debt instruments issued and in place as described in the “Liquidity and Capital Resources” section below.

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. We expect operating cash flows to fund approximately one half of the capital expenditures over the next decade, with the balance funded by borrowings.
Long-Term Debt

In May 2004 we entered into a master trust indenture. This indenture established common security and a set of common covenants by us 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.

Under this indenture we completed two $250 million public offerings. A 5.74% Senior Secured Bonds, Series 04-1, due May 27, 2014 and a 6.25% Senior Secured Bonds, Series 04-4, due October 13, 2034. The net proceeds were used primarily to repay a portion of our indebtedness to the Province, to fund reserves required in connection with these bonds and for general corporate purposes. Interest on these bonds is payable semi-annually.

We also entered into a credit agreement with a syndicate of Canadian banks which is secured under the indenture. Under this agreement, at March 31, 2006 we had two credit facilities, a 364-day revolving operating facility with a one year term-out, in an amount of $77.5 million and a three-year revolving extendible facility in an amount of $77.5 million. The revolving term facilities were available for working capital purposes, to fund the upgrade and acquisition of vessels and terminal upgrades and other general corporate purposes. The credit facilities have subsequently been renegotiated and combined into a single revolving five year term facility in the amount of $155 million.

In October 2005 we finalized two loan agreements with KfW, a German export credit bank. 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 to finance the purchase of two of the three Super C-class vessels currently being built. These funds will not be advanced until the date upon which we accept delivery of the applicable vessel from the ship builder. The principal amount of each loan will be repaid over the twelve year term of the loan.

Terminal Leases

We entered into a master agreement with the British Columbia 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 if the Coastal Ferry Services Contract is renewed. We must manage, maintain and develop the terminals at our own cost.

In fiscal years 2006 and 2005, we added a total of $1.1 million and $3.9 million, respectively, of additional lands at Horseshoe Bay and Swartz Bay 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 Bondholders’ Trustee which sets out certain limitations of the use of this option.

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 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 years 2006 and 2005 are summarized in the table below.

<table>
<thead>
<tr>
<th>Fiscal year ended March 31</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income for the period</td>
<td>49.9</td>
<td>39.8</td>
</tr>
<tr>
<td>Items not involving cash:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amortization</td>
<td>53.1</td>
<td>47.7</td>
</tr>
<tr>
<td>Other non-cash charges</td>
<td>1.2</td>
<td>1.2</td>
</tr>
<tr>
<td>Fuel costs deferred</td>
<td>(14.8)</td>
<td>(8.0)</td>
</tr>
<tr>
<td>Change in operating working capital</td>
<td>9.0</td>
<td>21.3</td>
</tr>
<tr>
<td>Cash provided by operating activities</td>
<td>98.4</td>
<td>102.0</td>
</tr>
<tr>
<td>Cash (used) provided by financing activities</td>
<td>(6.7)</td>
<td>43.7</td>
</tr>
<tr>
<td>Cash used in investing activities</td>
<td>(130.9)</td>
<td>(122.1)</td>
</tr>
<tr>
<td>Total (decrease) increase in cash</td>
<td>(39.2)</td>
<td>23.6</td>
</tr>
</tbody>
</table>
Cash provided by operating activities was $98.4 million for fiscal year 2006. Included in these results was a decrease in non-cash working capital of $9.0 million. This working capital decrease was primarily due to:

- $13.7 million increase in payables and accrued liabilities, partially due to the higher level of capital projects and vessel refits done during the latter part of fiscal year 2006;
- $6.1 million increase in GST payable. Effective April 2, 2003, we became subject to GST but are limited in our ability to obtain input tax credits (“ITCs”) because certain of our services are exempt under the Excise Tax Act. In fiscal 2006, we reviewed the options available to us and filed an amended ITC claim for the period April 2, 2003 through June 30, 2005. Canada Revenue Agency (“CRA”) has completed an audit of our GST filings, including review of our amended claims. Although CRA determined the methods used in our revised filings to be generally fair and reasonable, they have denied us the ability to file the amended claim which totalled $3.2 million. In addition, CRA has taken the position that vessel fuel and lubricants used for propulsion supports only GST exempt lines of business resulting in denial of ITC claims of approximately $2.2 million for the period April 2, 2003 through March 31, 2006. In April 2006, we paid all amounts related to the denied ITC claims. However, we disagree with CRA’s interpretation of the law in this instance and intend to vigorously pursue recovery through the appeal process.

The working capital decrease was partially offset by:

- $6.6 million increase due to insurance proceeds receivable in connection with the Queen of the North incident described above; and
- $6.9 million increase in property tax receivable resulting from the favourable settlement of the 2004 and 2005 property tax appeals.

Cash used for financing activities was primarily $6.0 million dividends paid on preferred shares.

Cash used in investing activities was $130.9 million. This was primarily due to capital expenditures, on a cash basis, of $129.7 million and $1.1 million reflecting the increase in lands under long-term lease. The significant capital transactions this fiscal year are described below in “Investing in Our Capital Assets”.

**Investing in our Capital Assets**

Capital expenditures in fiscal year 2006 totalled $136.0 million. This level of expenditure reflects significant investments in our fleet, terminals and information systems to increase customer service and operating efficiency. Expenditures included:

- $82.1 million in vessel upgrades and modifications including:
  - $26.1 million of a $39.5 million mid-life upgrade which includes safety, structural and mechanical improvements to the Queen of Surrey;
  - $15.4 million for life saving and fire protection upgrades on the Queen of Nanaimo;
  - $13.5 million for life saving upgrades on the Spirit of Vancouver Island;
  - $11.9 million of a $35.1 million mid-life upgrade of safety, structural and mechanical improvements on the Queen of Oak Bay;
  - $4.2 million for upgrading systems to increase fuel efficiency and provide greater durability and reliability on the MV Kwuna;
  - $3.5 million on the Super C new vessel construction project; and
  - $2.8 million of the $11.8 million project to reconstruct Hull 259, formerly the MV John Atlantic Burr, for service;
- $7.3 million in terminal and building upgrades, including $2.0 million of the $7.3 million retail building completed this year at Tsawwassen terminal;
- $36.9 million in marine structures of which $17.7 million is for berth reconstruction at Swartz Bay terminal;
- $9.0 million in software development which will enhance customer service in areas such as reservations, provide improvements in retail and food service management and operational efficiencies in crew scheduling.

**Major vessel upgrades**

The Queen of Surrey, which provides service on our Langdale-Horseshoe Bay route, was removed from service on November 16, 2005, for an extensive $39.5 million mid-life upgrade. The 25-year-old vessel will undergo significant upgrades to prepare it for another 20 years of service. The upgrades include safety, structural and mechanical improvements as well as improved and expanded passenger amenities. The Queen of Surrey is the fourth of five “C-class” vessels identified for mid-life upgrade. The Queen of Coquitlam completed its mid-life upgrade in June 2003 and the Queen of Cowichan completed its mid-life upgrade in May 2004. The third C-class vessel, Queen of Oak Bay, which provides service on our Nanaimo-Horseshoe Bay route, completed its extensive, six-month upgrade at a total cost of $35.1 million and returned to service in June 2005. The mid-life upgrade on the remaining C-class vessel, the Queen of Alberni, will be completed in fiscal year 2008.

The Queen of Nanaimo, which provides service to the Southern Gulf Islands from Vancouver, returned to service on January 14, 2006 following a four month, $16.3 million refurbishment. This project is expected to add ten years to the life of this vessel. The project included installing a new life-saving system comprised of four marine evacuation slides and rafts; surveying and painting the hull; replacing structural steel; renewing the deck plating; updating structural fire protection; renewing and upgrading boilers; installing a new oily-water separator; and rebuilding the main propeller shafts and controllable pitch propellers. This project also included improvements to customer amenities.
MANAGEMENT’S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Spirit of Vancouver Island, which provides service on our Tsawwassen-Swartz Bay route, returned to service on March 23, 2006 following a $13.5 million upgrade. The improvements included new lifesaving equipment and passenger service improvements. These passenger service improvements, part of a major initiative to revitalize the fleet, included an upgraded cafeteria, a redesigned buffet, renovated washrooms, new seating, flooring and carpeting.

The MV Kwuna, which provides service between Alliford Bay and Skidegate, underwent a major $4.2 million betterment that focused on upgrading ship systems to increase fuel efficiency and provide greater durability and reliability. This included the installation of new engines, replacement of generators and upgrade of the hydraulic system for the ship’s ramps.

“Super C” Class new vessel construction

On September 17, 2004 we entered into contracts with Flensburger Schiffbau-Gesellschaft (“FSG”) of Germany to build three new major vessels. These contracts, with a total value of €206.4 million or approximately $325 million, form the majority of the total project budget of $542 million. The Coastal Renaissance, Coastal Inspiration and Coastal Celebration, scheduled for delivery in late 2007 through mid-2008, will replace aging vessels which currently provide service on our major routes. These are design-build, fixed price contracts that provide us with substantial guarantees related to delivery dates, performance criteria, cost certainty and quality of construction. The detailed design will continue until September 2006 when steel cutting starts for the first vessel, which is expected to be delivered in December 2007. Foreign currency based payments in this project have been hedged in Canadian dollars to manage the foreign exchange risk. We expect this project to be completed on schedule and within budget.

New intermediate vessel construction

On July 20, 2005, the British Columbia Ferries Commissioner issued a declaration that a new intermediate-class ferry to replace the 45-year-old Queen of Tsawwassen is reasonably required. We are currently discussing requirements with Vancouver Shipyards of the Washington Marine Group for the construction of a new 125-car ferry. Vancouver Shipyards is developing a new design that will undergo model testing and simulation demonstrations to satisfy certain manoeuvring criteria prior to contract award. Assuming final agreement and contract award by July 2006, the new vessel is expected to be in service by the summer of 2008.

Hull 259 – vessel yet to be named

In August 2005, we acquired a ferry from the State of Utah for $200,000 (US) through a competitive bid process. This vessel, originally the MV John Atlantic Burr, is similar in design to our three “K-class” vessels, the MV Kahloke, the MV Kitsa and the MV Kwuna. It was designed in Victoria in 1985 and was substantially upgraded with its hull and superstructure lengthened in 1996. The vessel was disassembled in Utah and trucked and barged in pieces to Vancouver. It is currently undergoing major reconstruction to upgrade it to our standards and the requirements of Transport Canada and to expand its vehicle carrying capacity. The new vessel, yet to be named, is expected to be ready for service in November 2006.

Tsawwassen Quay

In June 2005, the new $7.3 million, 16,000 square-foot retail building opened at Tsawwassen, our largest terminal. Tsawwassen Quay offers 18 food, beverage, service and retail outlets. In addition, there are new washroom facilities, bank machines, pay telephones, seven indoor mobile retail kiosks and four outdoor kiosks featuring seasonal crafts and gifts. The Tsawwassen terminal, on average, serves over four million passengers each year. The retail facility is managed by Lonsdale Quay Market Corp. under a 10-year lease agreement. This partnership is an example of the long-term business associations we seek to develop.

Tsawwassen Terminal Marine Structures

In fiscal year 2006, we spent $8.1 million to complete upgrades at our Tsawwassen terminal. This completes the projects at two berths which included replacing marine and vehicle ramp structures, constructing a new foot passenger waiting lounge, tower and access walkway as well as upgrading the electrical service at a total cost of $20.1 million. The design work on further upgrades at a third berth at Tsawwassen terminal is underway. This project will have an estimated cost of $13.2 million and includes the replacement of deteriorated marine structures and vehicle ramp as well as upgrades to the hydraulic system. This project is expected to be complete by the end of the first quarter of fiscal year 2008.

Swartz Bay Terminal Marine Structures

In fiscal year 2006, we spent $17.7 million of a total project estimated at $25.0 million for the construction of a new trestle and ramp at berth 2 at Swartz Bay terminal. This berth reconstruction is expected to be complete by the end of the first quarter of fiscal year 2007.

Information Technology

In June 2005, we launched our new stored value card on our major routes. The “Coast Card” is a plastic card with a magnetic strip, similar to a bank card. Assured loading tickets are the first product to be offered on the card. In the future other services may be available through this card. Our Coast Card introduces online account management features so customers can review travel activity, purchase new assured loading tickets and take advantage of other services including loss protection and automatic purchase or renewal options.

We have undertaken a new project to improve communications technology services, replace obsolete technology, reduce costs and manage growth as our business demands change. This project is expected to improve ship-to-shore data communications and provide a more stable, secure and faster network for internal business needs and for our customers.

We have implemented a new catering and retail system that will improve efficiency and reduce costs. This system replaces a manual inventory system and will provide additional information and improved controls. As a result, we will achieve better management of our food inventory and will be able to reduce waste.
To meet the increased need for enhanced public and employee security, we introduced a new employee photo identification program. The new cards have multi-function technology which will increase access control points on terminals and vessels and allow for expansion to other applications.

Further implementation of crew scheduling software was instituted, allowing efficiencies and providing more focus on longer term scheduling.

FOURTH QUARTER RESULTS

This section provides an overview of our financial performance for the three months ended March 31, 2006 compared to the three months ended March 31, 2005.

Our 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 earnings. The third and fourth quarters reflect a seasonal downturn 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.

Our consolidated net loss for the three months ended March 31, 2006 was a $6.5 million or 20.8% improvement over the net loss of the three months ended March 31, 2005.

<table>
<thead>
<tr>
<th>($ millions)</th>
<th>2006</th>
<th>2005</th>
<th>$</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenue</td>
<td>109.7</td>
<td>106.9</td>
<td>2.8</td>
<td>2.6%</td>
</tr>
<tr>
<td>Expenses</td>
<td>(128.4)</td>
<td>(130.7)</td>
<td>2.3</td>
<td>1.8%</td>
</tr>
<tr>
<td>Earnings from operations</td>
<td>(18.7)</td>
<td>(23.8)</td>
<td>5.1</td>
<td>21.4%</td>
</tr>
<tr>
<td>Interest and other</td>
<td>(6.1)</td>
<td>(7.5)</td>
<td>1.4</td>
<td>18.7%</td>
</tr>
<tr>
<td>Net loss</td>
<td>(24.8)</td>
<td>(31.3)</td>
<td>6.5</td>
<td>20.8%</td>
</tr>
</tbody>
</table>

Revenue

Our total revenues for the three months ended March 31, 2006 have increased over the three months ended March 31, 2005, as shown in the following table.

<table>
<thead>
<tr>
<th>($ millions)</th>
<th>2006</th>
<th>2005</th>
<th>Increase (Decrease)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tariff – vehicles</td>
<td>39.3</td>
<td>38.9</td>
<td>0.4</td>
</tr>
<tr>
<td>Tariff – passengers</td>
<td>21.5</td>
<td>21.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Ferry service fees</td>
<td>24.6</td>
<td>24.7</td>
<td>(0.1)</td>
</tr>
<tr>
<td>Federal-provincial subsidy</td>
<td>6.2</td>
<td>6.0</td>
<td>0.2</td>
</tr>
<tr>
<td>Retail</td>
<td>12.3</td>
<td>11.9</td>
<td>0.4</td>
</tr>
<tr>
<td>Other income</td>
<td>5.8</td>
<td>3.9</td>
<td>1.9</td>
</tr>
<tr>
<td>Total revenue</td>
<td>109.7</td>
<td>106.9</td>
<td>2.8</td>
</tr>
</tbody>
</table>
The improvement in vehicle tariff revenue in the three months ended March 31, 2006, compared to the three months ended March 31, 2005, is a result of higher tariff rates, partly offset by lower traffic volume on our major routes. Tariff revenue reflects an increase in our rates of an average of 2.8% and 4.4% as permitted by the Coastal Ferry Act.

### Three months ended March 31

<table>
<thead>
<tr>
<th>Vehicle Traffic Volume</th>
<th>2006</th>
<th>2005</th>
<th>#</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Major routes</td>
<td>725,119</td>
<td>728,883</td>
<td>(3,764)</td>
<td>– 0.5%</td>
</tr>
<tr>
<td>Other routes</td>
<td>989,753</td>
<td>981,804</td>
<td>7,949</td>
<td>0.8%</td>
</tr>
<tr>
<td>Total</td>
<td>1,714,872</td>
<td>1,710,687</td>
<td>4,185</td>
<td>0.2%</td>
</tr>
</tbody>
</table>

Passenger tariff revenue in the three months ended March 31, 2006, is equal to the three months ended March 31, 2005, is a result of higher tariff rates, offset by lower traffic volumes. Passenger traffic volumes decreased 1.6% on the major routes and 1.3% on the other routes. We believe that reduced levels of tourism, as well as the timing of Easter weekends, has contributed to this decline.

### Three months ended March 31

<table>
<thead>
<tr>
<th>Passenger Traffic Volume</th>
<th>2006</th>
<th>2005</th>
<th>#</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Major routes</td>
<td>1,951,018</td>
<td>1,983,203</td>
<td>(32,185)</td>
<td>– 1.6%</td>
</tr>
<tr>
<td>Other routes</td>
<td>2,109,200</td>
<td>2,137,534</td>
<td>(28,334)</td>
<td>– 1.3%</td>
</tr>
<tr>
<td>Total</td>
<td>4,060,218</td>
<td>4,120,737</td>
<td>(60,519)</td>
<td>– 1.5%</td>
</tr>
</tbody>
</table>

Other revenue in the three months ended March 31, 2006 increased compared to the three months ended March 31, 2005 due to inclusion of a $2.0 million write down of the deferred revenue liability relating to historical sales of paper assured loading tickets (“ALTs”). Sales of paper ALTs ceased in May, 2005 upon introduction of the “Coast Card”.

### Expenses

Expenses for the three months ended March 31, 2006 totalled $134.5 million, $3.7 million less than the three months ended March 31, 2005, as shown in the following table.

### Three months ended March 31

<table>
<thead>
<tr>
<th>($ millions)</th>
<th>2006</th>
<th>2005</th>
<th>$</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operations</td>
<td>63.3</td>
<td>70.9</td>
<td>7.6</td>
<td>10.7%</td>
</tr>
<tr>
<td>Maintenance</td>
<td>27.1</td>
<td>26.9</td>
<td>(0.2)</td>
<td>– 0.7%</td>
</tr>
<tr>
<td>Administration</td>
<td>18.7</td>
<td>14.5</td>
<td>(4.2)</td>
<td>– 29.0%</td>
</tr>
<tr>
<td>Cost of retail goods sold</td>
<td>5.1</td>
<td>4.8</td>
<td>(0.3)</td>
<td>– 6.3%</td>
</tr>
<tr>
<td>Amortization</td>
<td>14.2</td>
<td>13.6</td>
<td>(0.6)</td>
<td>– 4.4%</td>
</tr>
<tr>
<td>Loss (gain) on foreign exchange</td>
<td>0.0</td>
<td>(0.2)</td>
<td>(0.2)</td>
<td></td>
</tr>
<tr>
<td>Interest expense</td>
<td>5.8</td>
<td>7.4</td>
<td>1.6</td>
<td>21.6%</td>
</tr>
<tr>
<td>Loss on disposal of capital assets</td>
<td>0.3</td>
<td>0.3</td>
<td>0.0</td>
<td>0.0%</td>
</tr>
<tr>
<td>Total expense</td>
<td>134.5</td>
<td>138.2</td>
<td>3.7</td>
<td>2.7%</td>
</tr>
</tbody>
</table>

Operations reflects a $9.8 million decrease in property tax expense resulting from settlement of appeals as described above. This decrease was partially offset by an increase in administration costs, the majority of which represents increases in wages and benefits. These costs include additional pension costs due to past service purchases as well as severance and restructuring costs.
QUARTERLY FINANCIAL PERFORMANCE

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 downturn 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 table below compares earnings by quarter for the most recent eight quarters.

<table>
<thead>
<tr>
<th>($ millions)</th>
<th>Mar 06</th>
<th>Dec 05</th>
<th>Sep 05</th>
<th>Jun 05</th>
<th>Mar 05</th>
<th>Dec 04</th>
<th>Sep 04</th>
<th>Jun 04</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenue</td>
<td>109.7</td>
<td>126.0</td>
<td>198.3</td>
<td>145.2</td>
<td>107.0</td>
<td>122.7</td>
<td>194.4</td>
<td>140.4</td>
</tr>
<tr>
<td>Earnings (loss) from operations</td>
<td>(18.7)</td>
<td>5.4</td>
<td>67.3</td>
<td>21.1</td>
<td>(23.8)</td>
<td>3.6</td>
<td>67.9</td>
<td>17.3</td>
</tr>
<tr>
<td>Net earnings (loss)</td>
<td>(24.8)</td>
<td>(0.9)</td>
<td>61.2</td>
<td>14.4</td>
<td>(31.3)</td>
<td>(4.2)</td>
<td>63.0</td>
<td>12.3</td>
</tr>
</tbody>
</table>

Net losses in the quarters ended March 2006 and December 2005 and net earnings in the quarter ended June 2005 were better than the same quarter in the previous year ranging from $2.1 million to $6.5 million. In the quarter ended September 2005, compared to the quarter ended September 2004, net earnings were lower by $1.8 million. The average increase in net earnings for the latest four quarters was $2.5 million or 25.2%.

Total revenue in each of the latest four quarters was higher than the corresponding quarter from the previous fiscal year. The most significant contributing factors to the trend were higher tariff revenue as a result of increases in tariff rates and growth in retail and other income. As mentioned earlier in this report, the Coastal Ferry Act permits an annual average tariff increase of 2.8% on the three major routes and 4.4% on the remaining routes. Vehicle traffic decreased 2.5% in the quarter ended December 2005 compared to the quarter in the previous year. In all remaining quarters, we experienced a modest increase, resulting in a net four-quarter decrease of 0.2%. We believe that the lower than expected traffic levels are primarily due to reduced levels of tourism. The following graph shows the relationship of the quarters over the past three years.

Passenger traffic in all four quarters of fiscal year 2006 was lower than the corresponding quarters in the previous year. The average decrease was 1.3%. There has been a downwards trend this fiscal in the number of tour buses. As previously mentioned, we believe the decrease in passenger traffic is primarily due to reduced levels of tourism. Following is a graph showing the relationship of the quarters over the past three years.
OUTLOOK

Traffic
Although both passenger and vehicle traffic were lower in fiscal year 2006 than fiscal year 2005, they both are trending upwards.

Ferry traffic levels are affected by a number of factors including high fuel costs, a strong Canadian dollar, the public’s concerns regarding security and health, disposable personal income, the local economy and population growth. While we anticipate only modest traffic volume increases over the next few years, we do see opportunities for growth in our markets.

Market Growth
We see many opportunities for growth. We received approximately 2.4 million unique visitors to our website in fiscal year 2006, up 21% from the previous fiscal year. With the increasing use of the internet by travellers planning and booking trips, we are presented with an ongoing opportunity to maximize the role of our website as not only an information source, but also a sales point and distribution channel.

We have identified a market development opportunity with the growth in the volumes of commercial semi-trailer and container traffic. Container traffic to Vancouver Island is expected to expand as overseas container movements to the Vancouver Gateway increase and large “big box” retailers continue to locate on Vancouver Island.

We have experienced a steady growth in ancillary revenues. We see continuing opportunities to improve the revenue from our ancillary services including reservations, food and retail and assured loading.

Asset Renewal Program
Although we have one of the largest fleets in the world, the average age of our assets is currently among the highest of major ferry operators worldwide. To address this we will continue with our fleet and asset renewal program. We expect to spend more than $900 million over the next three years to upgrade and replace our aging assets. Until we are able to upgrade and replace a large share of our fleet through new vessel acquisitions and our revitalization program, we expect that reliability issues may continue to challenge our operations.

Regulation
Transport Canada regulates safety on our vessels by authority of the Canada Shipping Act. It is expected that a revised Act and new regulators will be introduced in the near future and will include more stringent regulations. Given the age of our fleet, these revised regulations may significantly affect the useful life of some of our vessels or drive the requirement for upgrades. We are addressing this changing regulatory environment through our planning processes and asset renewal initiatives. As always, the safety and security of our customers and employees remain priority one.

Our first performance term ends March 31, 2008. We must provide the British Columbia Ferries Commissioner with the information required under the Coastal Ferry Act in order for the Commissioner to set price caps for the next performance term. We expect to file our submission by September 30, 2006. This process will set the price caps for the second performance term ending March 31, 2011.

Competition
New competitors have emerged in both the passenger only market as well as the commercial traffic market in the past few years. To date, passenger only competitors have not been successful at sustaining operations. We expect competition may increase in these markets with the potential emergence of private sector vehicle and passenger ferry services. We remain mindful of these potential changes in the market, and we are constantly seeking ways to improve operational efficiency and customer service.

We are also exploring opportunities with additional or alternative service providers, in an effort to reduce costs and provide services on our regulated routes, as mandated by the Coastal Ferry Act. 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, can provide a more cost-effective service offering. We expect to issue a Request for Proposal to two proponents on the Brentwood Bay-Mill Bay route later this year. We also expect to issue a Request for Proposals regarding the operation of our four routes north of Port Hardy. However, due to the loss of the Queen of the North, the timing of this request is uncertain.
FINANCIAL INSTRUMENTS

Fair market 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.

Derivatives

We hedge our exposure to fluctuations in fuel prices and foreign currency exchange rates through the use of derivative instruments. The table below indicates the change in valuation of the derivative instruments for the year ended March 31, 2006.

<table>
<thead>
<tr>
<th></th>
<th>March 31, 2006</th>
<th>March 31, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number of swaps</td>
<td>Term to maturity</td>
</tr>
<tr>
<td>Commodity Fixed Price Swaps</td>
<td>9</td>
<td>Up to 0.4</td>
</tr>
<tr>
<td>Foreign Exchange Forward</td>
<td>26</td>
<td>Up to 2.1</td>
</tr>
<tr>
<td>Transactions</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*FMV (fair market value)

The commodity derivatives fair market 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 market values reflect the estimated amounts that we would receive or pay should the 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, 2006 we have recorded a receivable of $0.9 million as the estimated gain to terminate the contracts as at this date.

The foreign exchange derivative value reflects only the value of the foreign exchange derivatives and not the offsetting change in value of the underlying future purchase of currency. These fair market values reflect the estimated amounts we would receive or pay to terminate the contracts at the stated dates. These derivatives are accounted for using hedge accounting and therefore estimated gains and losses are not recorded in our financial statements.

We are exposed to credit risk in the event of non-performance by counterparties to derivative instruments. Because we deal with high credit quality institutions in accordance with established credit approval practices, we believe it to be unlikely that any counterparties will fail to meet their obligations.
RISK MANAGEMENT

We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business. We are implementing an Enterprise Risk Management program which will address risk management from an organization-wide perspective and will complement existing strengths. This will be a comprehensive approach that incorporates organization-wide awareness, prioritized risk identification and risk mitigation strategies that target the highest risk areas.

Understanding and managing risk are important parts of our business. The following are some of the risk factors that we have considered.

Safety

The safety of the public, our employees and the protection of the environment are our highest priorities. We were an early voluntary adopter of the International Safety Management (“ISM”) code that forms an international standard for the safe management and operation of ships and terminals and for pollution prevention. The ISM code places the responsibility for the safety of ships and the prevention of pollution within the company management structure. This means that the entire organization is responsible for safety, not just the ship’s master or shore based managers.

We provide extensive formal training for our employees on safety and operational topics in response to internal safety policies and practices and external regulations. These programs cover a wide range of topics including:

• marine emergency duties (survival craft, marine and vehicle fire fighting);
• shipboard fire and boat drills;
• safe evacuation of passengers (restricted proficiency in survival craft, marine evacuation systems, rescue shepherd boat, passenger control);
• occupational first aid (automatic external defibrillators, cardio pulmonary resuscitation for infants),
• occupational safety and health (asbestos contingency, confined space rescue, musculoskeletal injury prevention, prevention of violence in the workplace);
• transportation of dangerous goods; and
• terminal operations (small boat operator, safe forklift operations).

Besides shipboard drills, we have over 8,800 training days planned for safety and operational training in fiscal year 2007.

We are regulated by the provincial Workers’ Compensation Board and Transport Canada to ensure safety on our vessels and at our other facilities.

Accident/Casualty Loss

The occurrence of a vessel related accident or mishap could have a material adverse effect on our business prospects, financial condition or results of operations, and could result in a default under the Coastal Ferry Services Contract unless such accident or mishap qualified as an event of force majeure.

Due to the nature of our business, we may be subject to liability claims arising out of accidents or disasters involving vessels on which our customers are travelling, including claims for serious personal injury or death.

Apart from well established safety programs, we have a sound conventional insurance program to insure both our physical assets and legal liability for injuries and damage. This is designed to mitigate the financial impact of serious incidents. There can be no guarantee, however, that the insurance coverage will be sufficient to cover all such accidents or disasters.

In addition to conventional insurance, we have recently established our own wholly owned insurance subsidiary, BCF Captive Insurance Company Ltd., which commenced operations April 1, 2005. Its prime purpose is to absorb a large proportion of the deductibles payable under our commercial insurance programs. The objective is to spread the cost of random events among all routes and protect direct route financial results from unnecessary volatility.

Asset Risk

We operate in a capital-intensive industry that requires a substantial amount of capital expenditures. We plan to spend approximately $1.9 billion in capital expenditures over the next decade, with approximately 70% related to new vessel acquisitions, vessel upgrades and component replacement. Our plan is to replace approximately 25% of our vessels before the end of fiscal year 2011.

At March 31, 2006, we have total long-term debt of $500 million. Future indebtedness is subject to certain limitations. The level of indebtedness could increase our vulnerability to general adverse economic and industry conditions, and limit our flexibility in planning for, or reacting to, changes in business. Also, there can be no guarantee that we will have access to sufficient resources or will be able to maintain our fleet by extending the economic life of existing vessels through major refurbishment.

Fuel Price Risk

The risk of fuel price volatility is currently managed through fuel deferral accounts and partial fuel hedges. There remains a risk that all fuel costs may not be recovered. The Commissioner may not approve fuel surcharges sufficient to recover increases resulting from high fuel prices. High fuel surcharges may have an adverse impact on traffic levels. See Regulatory Risk and Traffic Level and Tariff Revenue Risk below.
Regulatory Risk
There is a risk that the British Columbia Ferries Commissioner will interpret the Coastal Ferry Act in a manner unfavourable to us.

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. There can be no guarantee that regulatory changes in the future will not have an adverse effect on us.

Traffic Level and Tariff Revenue Risk
Future vehicle and passenger traffic on our vessels will be affected by, among other things, population levels and economic conditions in British Columbia and also by tariff rates. No assurance can be given as to the level of traffic on our system and the tariff revenue that will result.

There is a risk that over the long term a general decline in travel (or a reduction in the growth rate) may occur as a result of compounding increases in tariffs. Under the Coastal Ferry Act, we are permitted to increase tariffs on major routes by 2.8% and on the remaining routes by 4.4% each year during the first performance term. In addition to these permitted annual increases, we have applied and may again apply to the Commissioner for other tariff increases, the need for which results from extraordinary situations. In fiscal year 2006, we applied to the British Columbia Ferries Commissioner for extraordinary price cap increases to allow for the implementation of fuel surcharges.

To date, the price increases we have implemented have not caused an obvious decrease in demand. However, elasticity could change as prices increase, thereby resulting in an increasing negative impact of tariff increases.

A relatively high percentage of our customers travel for leisure purposes - approximately 77% on major routes; 82% on northern routes and 63% for other routes. Traffic on our vessels may decline, or fail to increase as expected, if world or local events, including major health concerns, have a negative effect on tourism or other leisure travel.

Competition Risk
While there are significant barriers to entry, we face the risk of competitors entering the vehicle and passenger ferry market and potentially eroding our market share. This risk is greater on the most profitable routes, potentially from other ferry service providers in addition to other forms of transportation.

Environmental Risk
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, discharge of storm water and vessel fuel delivery.

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, any of which could have a material adverse effect. Although we believe we maintain adequate environmental insurance, there can be no guarantee that the insurance coverage will be sufficient to cover all such losses.

Labour Disruption Risk
The majority of our employees are members of the B.C. Ferry and Marine Workers’ Union. On October 15, 2004, the collective bargaining agreement was settled through binding arbitration by Arbitrator Vince Ready which set out a seven year term to October 31, 2010. This award is expected to provide us with seven years of labour stability. However, there can be no guarantee that other labour disturbances will not occur and have a material adverse effect on our operations.

Terrorism Risk
Since the September 11, 2001 terrorist attacks, there has been a heightened concern about terrorism in the minds of the travelling public. The occurrence of a major terrorist attack, either domestic or international and whether it was within the transportation industry or not, could have a material adverse effect on demand for ferry services. 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 impact on our business, results from operations and financial condition.

Income Tax Risk
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 is 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 which are now included in a February 27, 2004 release from the Department of Finance of draft amendments to the Income Tax Act. We have received a non-binding opinion from CRA that proposes 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.

Risk of Default under Material Contracts
There is a risk that we will default under the Coastal Ferry Services Contract or the Terminal Leases. The consequences of such default could include, among other things, an adjustment to service fees from the Province or the forced sale of our vessels to the Province for net book value and termination of the Terminal Leases.
Aboriginal Land Claims

Canadian courts have recognized that aboriginal peoples may possess rights at law in respect of land used or occupied by their ancestors where treaties have not been concluded to deal with these rights and where treaties between aboriginal peoples and the Crown set out express rights. These rights may vary from limited rights of use for traditional purposes to a right of aboriginal title and will depend upon, among other things, the nature and extent of the prior aboriginal use and occupation of lands. The courts have encouraged the Canadian federal and provincial governments and aboriginal peoples to resolve rights claims through the negotiation of treaties.

Aboriginal groups have claimed substantial portions of land in British Columbia over which they assert aboriginal title or in which they have a traditional interest.

A process is now in place within British Columbia to deal with aboriginal land claims under the British Columbia treaty process. These negotiations have been and will likely remain ongoing for a number of years, depending on the commitment of the parties involved and the precedents set by the outcomes of the first settlement agreements. Under evolving jurisprudence, Canadian governments have a duty to consult and accommodate aboriginal peoples where Crown approvals or licences are required in respect of existing or new terminal facilities or operations at such facilities and could affect or impact aboriginal interests.

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.

In addition, the Province will reimburse us for damages suffered if there is a final court decision or a treaty settlement that recognizes or confers upon aboriginal peoples a proprietary or other interest in the ferry terminal properties which right or interest interferes 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. The remaining balance at March 31, 2006 of $6.5 million ($6.5 million at March 31, 2005) 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, multiemployer pension plan. In April 2003, we were converted from a Crown corporation into an independent company incorporated under the provincial Company Act. In February 2004, our company and the union representing our employees jointly submitted a formal application for all our employees and our company to remain within the Plan. In March 2004, the Public Service Pension Board of Trustees agreed to the proposal.

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, 2005, indicated an unfunded liability in the Basic Account of $767 million.

Effective April 1, 2006, the Public Service Pension Board of Trustees increased contribution rates for plan members and employers by 1.88% each, effectively eliminating the actuarial liability.

Retirement Bonus Liability

We sponsor a plan that provides a post-retirement benefit for 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 was obtained in March 2005 and the accrued benefit obligation estimated at $10 million. The liability included in accrued employee future benefits in our financial statements at March 31, 2006 was $9.8 million ($9.5 million at March 31, 2005).

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.

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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, 2006, we have three regulatory assets or liabilities:

• Deferred fuel costs: the difference between amounts allowed by the regulator in operating expense and those actually incurred with recovery expected through future tariffs or surcharges;

• Performance term submission costs: costs for incremental contracted services relating to our second performance term submission based on the expectation that our regulator will approve the recovery of these costs over our second performance term that begins April 1, 2008;

• Tariffs in excess of price caps: the amount by which average annual tariffs collected at a specific date exceed established price caps set under the terms of the Coastal Ferry Act. The excess amounts collected will be returned to customers through future tariffs.

If the regulator’s future actions are different from our expectations, the timing and amount of the recovery of deferred costs 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 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

In April 2005 the Canadian Institute of Chartered Accountants (“CICA”) issued Handbook Section 3865, replacing Accounting Guideline 13 which we had adopted on April 1, 2004. The new standard addresses the identification, designation, documentation and effectiveness of hedging transactions for the purpose of applying hedge accounting. It also identifies situations where hedge accounting is to be discontinued. Under this guideline, we are required to prepare formal documentation for each individual derivative at inception in order to apply hedge accounting for positions hedged with derivatives. We have elected to apply hedge accounting on currency derivatives. We have elected not to apply hedge accounting on fuel commodity derivatives, and therefore, we have recorded the $0.9 million fair market value of commodity derivatives in our balance sheet at March 31, 2006 (nil at March 31, 2005).

Rate Regulation

In May 2005, the CICA issued Accounting Guideline 19 to establish financial statement guidelines for entities subject to rate regulation. This guideline requires disclosure of general information regarding the nature and economic effects of rate regulation, as well as additional information on how rate regulation has affected the financial statements. The guideline does not address recognition and measurement issues associated with the accounting for rate-regulated operations.

Asset Retirement Obligations

On April 1, 2004, we adopted the CICA new standard for recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated asset retirement costs. Under the new standard the fair value of a liability for an asset retirement obligation must be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value is added to the carrying amount of the associated asset, which is then expensed over the asset’s estimated useful life. The liability is accreted over the estimated useful life of the asset through charges to expenses.

As we are not aware of any future liabilities associated with the retirement of our assets, the adoption of this policy does not result in the recording of an asset retirement liability and therefore our financial statements have not been impacted by this new standard. In addition, as our operations are regulated, there is a reasonable expectation that any significant asset retirement costs would be recoverable through future tariffs.

Future Accounting Changes

We anticipate that we will be required to adopt, on April 1, 2007, the new accounting rules for comprehensive income as set out in the CICA Handbook Section 1530 “Comprehensive Income” and Section 3251 “Equity”. These sections introduce the concept of Comprehensive Income and Accumulated Other Comprehensive Income. We are currently assessing the impact of adoption of these new requirements.
DISCLOSURE CONTROLS
In 2004, the Canadian Securities Administrators ("CSA") issued an instrument requiring our CEO and CFO ("certifying officers") to certify that they are responsible for:

- establishing and maintaining disclosure controls;
- ensuring the disclosure controls are designed to provide reasonable assurance that material information is made known to them and is properly recorded, disclosed and reported;
- evaluating the effectiveness of the disclosure controls; and
- disclosing their conclusions about the effectiveness at the end of the period covered by the annual filings.

Our certifying officers have evaluated the effectiveness of our disclosure controls as of March 31, 2006, and as a result of that evaluation have concluded that our disclosure controls and procedures were effective for the year ended March 31, 2006.

CORPORATE STRUCTURE AND GOVERNANCE
Our Board of Directors and Management consider good corporate governance to be central to the effective, efficient and prudent operation of the Company. Both Management and the Board have monitored and, where appropriate, responded to regulatory developments aimed at improving corporate governance practices, increasing corporate accountability and enhancing the transparency of public company disclosure.

In 2004, the Canadian Securities Administrators ("CSA") issued an instrument requiring our CEO and CFO ("certifying officers") to certify that they are responsible for:

- establishing and maintaining disclosure controls;
- ensuring the disclosure controls are designed to provide reasonable assurance that material information is made known to them and is properly recorded, disclosed and reported;
- evaluating the effectiveness of the disclosure controls; and
- disclosing their conclusions about the effectiveness at the end of the period covered by the annual filings.

Our certifying officers have evaluated the effectiveness of our disclosure controls as of March 31, 2006, and as a result of that evaluation have concluded that our disclosure controls and procedures were effective for the year ended March 31, 2006.

The following disclosure is in accordance with the Instrument.

DISCLOSURE CONTROLS
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- establishing and maintaining disclosure controls;
- ensuring the disclosure controls are designed to provide reasonable assurance that material information is made known to them and is properly recorded, disclosed and reported;
- evaluating the effectiveness of the disclosure controls; and
- disclosing their conclusions about the effectiveness at the end of the period covered by the annual filings.

Our certifying officers have evaluated the effectiveness of our disclosure controls as of March 31, 2006, and as a result of that evaluation have concluded that our disclosure controls and procedures were effective for the year ended March 31, 2006.

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 and Human Resources 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 and 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 General Counsel, the Corporate Secretary, the Chair of the Board and the Chair of the Governance and Human Resources Committee. 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 eleven 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 another issuer, other than British Columbia Ferry Services Inc. (“BCFS”), which is a reporting issuer (or the equivalent) in Canada or a foreign jurisdiction:

Elizabeth J. Harrison, Q.C.:
Director, Unilens Vision Inc.

Graham M. Wilson:
Director, ITRON Inc.
Trustee and Director, Hardwoods Distribution Trust
Trustee, Sequoia Oil & Gas Ltd.

Peter R. B. Armstrong:
Director, Pacific Insight Electronics Corporation
Director, Versacold Income Fund

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 full day session, held prior to a new director attending his/her first BCFS Board meeting, during which the new director is briefed by members of senior management and receives written information about the business and operations of BCFS and Board governance practices, including the duties and obligations of directors. All new directors receive a copy of the Board Governance Manual. This 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. To facilitate ongoing education, the Board Chair and the Chair of the Governance and Human Resources Committee periodically canvases the directors to determine their training and education needs and interests; arrange ongoing visits by directors to the Company’s facilities and operations; arrange for the attendance of directors at seminars or conferences of interest and relevance to their position as a director of the Company; and encourage and facilitate presentations by outside experts to the Board or Committees on matters of particular import or emerging significance. Directors are also provided with memberships in the Institute of Corporate Directors which provides them with opportunities to attend programs and courses relevant to corporate governance.

Responsibility for ensuring that orientation and ongoing education are provided to directors rests with the Chair of the Board. The Governance and Human Resources 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”) on November 10, 2004. Notice of adoption of the Code as Company policy was communicated to the Company’s personnel by intra-Company information bulletin widely distributed throughout the Company. 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 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 email address, each monitored by the Executive Director of Internal Audit, have been established and this has been communicated to Company employees by intra-Company information bulletin. The contact particulars are also posted with the Code on the Company’s intranet site.

The Board, through the Audit and 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 General Counsel, the Corporate Secretary, the Chair of the Board and the Chair of the Governance and Human Resources Committee.
Nomination of Directors

The Governance and Human Resources Committee has responsibility for the director nomination process. The Committee is composed entirely of independent directors. The responsibilities, powers and operations of the Committee are described in the Board Governance Manual.

The B.C. Ferry Authority (the “BCFA”), through its Board of Directors, selects the Board of Directors of British Columbia Ferry Services Inc. (“BCFS”) by March 31 each year. While not a requirement, it is current practice that the directors of BCFA will also be directors of BCFS. Additional members may be appointed to the Board of BCFS by BCFA.

The appointment process for BCFS directors occurs concurrently with the BCFA Director appointment process because of the overlap of the Boards of BCFA and BCFS. The Articles of Incorporation of BCFS permit a total of 20 directors of BCFS, hence directors may be appointed to the Board of BCFS in addition to those who are also directors of BCFA. It is viewed as desirable to maintain consistency between the two Boards so that the interests of BCFA and BCFS are properly aligned. However, the ability to appoint additional directors to the Board of BCFS gives flexibility in ensuring adequate skill sets and experience are available within the members of the Board of BCFS.

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

The skill sets and experience of the candidates for the BCFA Board that are put forward by the nominating entities and the Province are reviewed by the BCFS Governance and Human Resources Committee to ascertain if there will be any gaps in the skill sets and experience of the Board of BCFS, assuming BCFA directors also become BCFS directors. If gaps are identified, the Chair of the BCFS Board, in consultation with the Chair of the BCFS Governance and Human Resources Committee and the President & CEO, seeks out suitable candidates for nomination as directors of BCFS to fill such gaps.

The BCFS Governance and Human Resources Committee reviews the nominees and makes recommendations to the Board of Directors. These recommendations take into account the talents of the existing BCFS Board, and the talents of all nominees (including BCFA Board nominees and appointees who may become BCFS Board members, if applicable), taking the skills and experience profile established for BCFS directors into account.

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

Compensation

The Governance and Human Resources Committee reviews the compensation of directors and the President & CEO annually. The Committee is composed entirely of independent directors and operates under terms of reference adopted by the Board.

The Committee engages an external compensation advisor to research and provide independent advice to the Committee on the level and types of compensation for directors and the President & CEO. In making its recommendations to the Board, the Committee takes into account the types of compensation and the amounts paid by other comparable companies.

Board Committees

Audit and Finance Committee (at March 31, 2006):
Chair: Graham M. Wilson
Members: Douglas E. Allen, Thomas W. Harris, John R. Henderson, Maureen V. Macarenko

The Audit and Finance Committee (“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 our 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;
- 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. Douglas E. Allen acted as interim Chief Executive Officer of the Company from October 16, 2002 until May 5, 2003.

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 1, 2005, all recommendations of the Committee to nominate or compensate an external auditor have been adopted by the Board.

The aggregate fees billed by our external auditor in each of the last two fiscal years were:

<table>
<thead>
<tr>
<th>Year ended March 31</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit (including involvement in bond prospectus)</td>
<td>121.8</td>
<td>176.8</td>
</tr>
<tr>
<td>Tax services (mainly commodity related)</td>
<td>–</td>
<td>11.8</td>
</tr>
<tr>
<td>All other fees</td>
<td>65.2</td>
<td>1.6</td>
</tr>
<tr>
<td>Advisory services (including internal audit support)</td>
<td>111.4</td>
<td>–</td>
</tr>
<tr>
<td>Enterprise Risk Management project</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>298.4</strong></td>
<td><strong>190.2</strong></td>
</tr>
</tbody>
</table>

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.

In addition to the Audit and Finance Committee, the Board has appointed the following two Committees, both of which are composed entirely of independent directors:

**Governance and Human Resources Committee (at March 31, 2006):**

**Chair:** Douglas E. Allen

**Members:** Peter R.B. Armstrong, John R. Henderson, Robert W. McCaskill, Graham M. Wilson

Effective April 1, 2006, Peter R.B. Armstrong ceased to be a member of the Governance and Human Resources Committee and Doreen J. Hewitt became a member of the Committee.

The Governance and Human Resources 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 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;
- review the human resources strategies of the Company, including management recruitment, development, retention, compensation, and succession planning;
- identify and recommend to the Board suitable candidates for nomination as directors of the Company, and otherwise fulfills the responsibilities of a nominating committee; and
- review and recommend to the Board appropriate compensation for directors, the President & CEO and senior executive, and otherwise fulfill the responsibilities of a compensation committee.
Safety, Health, Environment and Security Committee
(at March 31, 2006):

Chair: G. Raymond Whitehead

Members: Sandy M. Fulton, Doreen J. Hewitt, Maureen Macarenko, Robert W. McCaskill

Effective April 1, 2006, Doreen J. Hewitt ceased to be a member of the Safety, Health, Environment and Security Committee and Peter R. B. Armstrong became a member of the Committee.

The Safety, Health, Environment and 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.

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 and Human Resources Committee annually reviews and makes recommendations to the Board on the method and content for annual evaluations.

The evaluation method varies from year to year. In the previous two years, the board has engaged an independent governance consultant to coordinate the evaluation. The consultant has collected information on individual director’s assessments of the performance of the board against its terms of reference, the Board Chair against the Board Chair’s terms of reference, and each Committee, including the Committee Chair, against its terms of reference. A detailed written questionnaire has been used for this purpose, as well as individual discussions between each director and the independent consultant. The consultant has presented the results of the evaluation to the Governance and Human Resources Committee and the Board and has prepared recommendations for action. Considering the consultant’s report and recommendations, the Governance and Human Resources Committee has prepared and implemented an action plan for the upcoming year. This action plan is reviewed and approved by the Board.

The Board also undertakes an assessment of individual director performance annually. This occurs through in-depth discussions between individual directors and the Board Chair.

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.

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 traffic volume and tariff revenue risk, the impact of competition, asset risk, accident/casualty loss risk, tax risk, environmental risk, regulatory risk, labour disruption risk, 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.
MANAGEMENT’S RESPONSIBILITY

BC Ferries management is responsible for presentation and preparation of the annual consolidated financial statements, management’s discussion and analysis (“MD&A”) and all other information in this annual report.

The accompanying consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements and information in the MD&A necessarily include amounts based on management’s informed judgements and best estimates. The financial information presented elsewhere in this annual report is consistent with that in the consolidated financial statements.

To meet its responsibility for reliable and accurate financial statements, management has established systems of internal control which are designed to provide reasonable assurance that assets are safeguarded from loss and that reliable financial records are maintained. These systems are monitored by management and by internal auditors. In addition, the internal auditors perform appropriate tests and related audit procedures.

The consolidated financial statements have been examined by KPMG LLP, independent chartered accountants. The external auditors’ responsibility is to express a professional opinion on the fairness of management’s consolidated financial statements. The auditors’ report outlines the scope of their examination and sets forth their opinion.

The Board of Directors, through its Audit and Finance Committee, oversees management’s responsibilities for financial reporting and internal control. The Audit and Finance Committee meets with the internal auditors, the independent auditors and management to discuss auditing and financial matters and to review the consolidated financial statements and the independent auditors’ report. The Audit and Finance Committee reports its findings to the Board for consideration in approving the consolidated financial statements for issuance.

David L. Hahn
President & Chief Executive Officer

Rob Clarke
Executive Vice President & Chief Financial Officer

AUDITORS’ REPORT

To the Shareholders of British Columbia Ferry Services Inc.

We have audited the consolidated balance sheets of British Columbia Ferry Services Inc. as at March 31, 2006 and 2005 and the consolidated statements of earnings and retained earnings and cash flows for each of the years then ended. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP
Chartered Accountants

Victoria, Canada
May 17, 2006
### CONSOLIDATED BALANCE SHEETS

(Expressed in thousands)

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$2,291</td>
<td>$41,524</td>
</tr>
<tr>
<td>Short-term investments (note 2)</td>
<td>14,988</td>
<td>15,054</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>21,227</td>
<td>6,147</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>6,702</td>
<td>5,095</td>
</tr>
<tr>
<td>Inventories</td>
<td>21,809</td>
<td>21,699</td>
</tr>
<tr>
<td></td>
<td>67,017</td>
<td>89,519</td>
</tr>
<tr>
<td>Capital assets (note 3)</td>
<td>707,324</td>
<td>630,291</td>
</tr>
<tr>
<td>Deferred financing costs</td>
<td>8,183</td>
<td>7,987</td>
</tr>
<tr>
<td>Regulatory assets (note 4)</td>
<td>22,783</td>
<td>8,000</td>
</tr>
<tr>
<td>Long-term land lease (note 5)</td>
<td>28,370</td>
<td>27,585</td>
</tr>
<tr>
<td></td>
<td>$833,677</td>
<td>$763,382</td>
</tr>
<tr>
<td><strong>LIABILITIES AND SHAREHOLDERS’ EQUITY</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts payable and accrued liabilities</td>
<td>$69,326</td>
<td>$49,552</td>
</tr>
<tr>
<td>Interest payable on long-term debt</td>
<td>12,251</td>
<td>12,251</td>
</tr>
<tr>
<td>Accrued employee costs</td>
<td>44,810</td>
<td>39,371</td>
</tr>
<tr>
<td>Deferred revenue</td>
<td>14,000</td>
<td>13,756</td>
</tr>
<tr>
<td>Regulatory liabilities (note 4)</td>
<td>958</td>
<td>–</td>
</tr>
<tr>
<td>Current portion of accrued employee future benefits</td>
<td>800</td>
<td>631</td>
</tr>
<tr>
<td>Current portion of obligation under capital lease</td>
<td>25</td>
<td>26</td>
</tr>
<tr>
<td></td>
<td>142,170</td>
<td>115,587</td>
</tr>
<tr>
<td>Accrued employee future benefits (note 6)</td>
<td>16,737</td>
<td>16,849</td>
</tr>
<tr>
<td>Long-term debt (note 7)</td>
<td>499,604</td>
<td>499,581</td>
</tr>
<tr>
<td>Obligations under capital lease (note 8)</td>
<td>138</td>
<td>164</td>
</tr>
<tr>
<td></td>
<td>658,649</td>
<td>632,181</td>
</tr>
<tr>
<td>Shareholders’ equity:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share capital (note 9)</td>
<td>75,478</td>
<td>75,478</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>99,550</td>
<td>55,723</td>
</tr>
<tr>
<td></td>
<td>175,028</td>
<td>131,201</td>
</tr>
<tr>
<td><strong>Commitments (notes 3 and 13)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contingent liabilities (note 17)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Subsequent event (note 18)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>$833,677</td>
<td>$763,382</td>
</tr>
</tbody>
</table>

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Graham M. Wilson
Director

Elizabeth J. Harrison, QC
Director
## Consolidated Statements of Earnings and Retained Earnings

(Expressed in thousands)

<table>
<thead>
<tr>
<th>Years ended March 31,</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tariffs</td>
<td>$353,624</td>
<td>$345,851</td>
</tr>
<tr>
<td>Ferry service fees (note 10)</td>
<td>108,223</td>
<td>106,971</td>
</tr>
<tr>
<td>Federal-Provincial Subsidy Agreement (note 11)</td>
<td>24,890</td>
<td>24,343</td>
</tr>
<tr>
<td>Retail</td>
<td>68,749</td>
<td>67,776</td>
</tr>
<tr>
<td>Other income</td>
<td>23,676</td>
<td>19,514</td>
</tr>
<tr>
<td><strong>Total Revenue:</strong></td>
<td>579,162</td>
<td>564,455</td>
</tr>
<tr>
<td><strong>Expenses:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operations</td>
<td>291,771</td>
<td>294,035</td>
</tr>
<tr>
<td>Maintenance</td>
<td>81,081</td>
<td>86,746</td>
</tr>
<tr>
<td>Administration</td>
<td>51,181</td>
<td>44,511</td>
</tr>
<tr>
<td>Cost of retail goods sold</td>
<td>26,977</td>
<td>26,513</td>
</tr>
<tr>
<td>Amortization</td>
<td>53,106</td>
<td>47,666</td>
</tr>
<tr>
<td><strong>Total Expenses:</strong></td>
<td>504,116</td>
<td>499,471</td>
</tr>
<tr>
<td><strong>Earnings from operations</strong></td>
<td>75,046</td>
<td>64,984</td>
</tr>
<tr>
<td>Gain (loss) on foreign exchange</td>
<td>249</td>
<td>(61)</td>
</tr>
<tr>
<td>Interest expense (note 12)</td>
<td>(25,128)</td>
<td>(24,480)</td>
</tr>
<tr>
<td>Loss on disposal and write-down of capital assets</td>
<td>(302)</td>
<td>(629)</td>
</tr>
<tr>
<td><strong>Net earnings</strong></td>
<td>49,865</td>
<td>39,814</td>
</tr>
<tr>
<td>Retained earnings, beginning of year</td>
<td>55,723</td>
<td>21,947</td>
</tr>
<tr>
<td>Preferred share dividend (note 9)</td>
<td>(6,038)</td>
<td>(6,038)</td>
</tr>
<tr>
<td><strong>Retained earnings, end of year</strong></td>
<td><strong>$99,550</strong></td>
<td><strong>$55,723</strong></td>
</tr>
</tbody>
</table>

See accompanying notes to consolidated financial statements.
### CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in thousands)

<table>
<thead>
<tr>
<th>Years ended March 31,</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash provided by (used in):</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Operations:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net earnings</td>
<td>$49,865</td>
<td>$39,814</td>
</tr>
<tr>
<td>Items not involving cash:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amortization</td>
<td>53,106</td>
<td>47,666</td>
</tr>
<tr>
<td>Other non-cash charges</td>
<td>1,191</td>
<td>1,248</td>
</tr>
<tr>
<td>Regulatory costs deferred</td>
<td>(14,783)</td>
<td>(8,000)</td>
</tr>
<tr>
<td>Change in operating working capital</td>
<td>8,970</td>
<td>21,323</td>
</tr>
<tr>
<td><strong>Total from operations</strong></td>
<td><strong>98,349</strong></td>
<td><strong>102,051</strong></td>
</tr>
<tr>
<td><strong>Financing:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends paid on preferred shares</td>
<td>(6,038)</td>
<td>(6,038)</td>
</tr>
<tr>
<td>Deferred financing costs incurred</td>
<td>(692)</td>
<td>(7,152)</td>
</tr>
<tr>
<td>Proceeds from issuance of bonds</td>
<td>–</td>
<td>499,566</td>
</tr>
<tr>
<td>Proceeds from issuance of bridge financing</td>
<td>–</td>
<td>199,780</td>
</tr>
<tr>
<td>Repayment of bridge financing</td>
<td>–</td>
<td>(199,780)</td>
</tr>
<tr>
<td>Repayment of long-term debenture</td>
<td>–</td>
<td>(427,701)</td>
</tr>
<tr>
<td>Establishment of debt service reserve</td>
<td>–</td>
<td>(14,988)</td>
</tr>
<tr>
<td><strong>Total from financing</strong></td>
<td><strong>(6,730)</strong></td>
<td><strong>43,687</strong></td>
</tr>
<tr>
<td><strong>Investing:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proceeds from disposal of assets</td>
<td>7</td>
<td>1,334</td>
</tr>
<tr>
<td>Purchase of capital assets</td>
<td>(129,712)</td>
<td>(119,855)</td>
</tr>
<tr>
<td>Increase in lands under long-term lease</td>
<td>(1,147)</td>
<td>(3,632)</td>
</tr>
<tr>
<td><strong>Total from investing</strong></td>
<td><strong>(130,852)</strong></td>
<td><strong>(122,153)</strong></td>
</tr>
<tr>
<td><strong>(Decrease) increase in cash and cash equivalents</strong></td>
<td><strong>(39,233)</strong></td>
<td><strong>23,585</strong></td>
</tr>
<tr>
<td><strong>Cash and cash equivalents, beginning of year</strong></td>
<td>41,524</td>
<td>17,939</td>
</tr>
<tr>
<td><strong>Cash and cash equivalents, end of year</strong></td>
<td><strong>$2,291</strong></td>
<td><strong>$41,524</strong></td>
</tr>
</tbody>
</table>

**Supplemental cash flow information (note 16)**

See accompanying notes to consolidated financial statements.
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 Company is subject to the Coastal Ferry Act (the “Act”) which came into force on April 1, 2003. Its common share is held by the British Columbia Ferry Authority, a corporation without share capital, and it is regulated by the British Columbia Ferries Commissioner (the “Commissioner”) to ensure that rates are fair and reasonable and to monitor service levels.

1. Significant accounting policies:

(a) Basis of presentation:
The consolidated financial statements of the Company are prepared in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Deas Pacific Marine Inc. (“DPMI”), Catamaran Ferries International Inc. (“CFI”), Pacific Marine Leasing Inc. (“PMLI”), and BCF Captive Insurance Company Ltd. (“BCF Captive”). All inter-company balances and transactions have been eliminated on consolidation. CFI was dissolved on April 1, 2006. To date, PMLI has been inactive. BCF Captive was incorporated in March 2005, and commenced operations April 1, 2005.

(b) Regulation:
The Company is regulated by the Commissioner to ensure that tariffs are fair and reasonable and to monitor service levels. In order to recognize the economic effects of regulation, the timing of recognition of certain revenues and expenses may differ from that otherwise expected under generally accepted accounting principles. These timing differences give rise to regulatory assets and regulatory liabilities in the financial statements.

The Accounting Standards Board issued Accounting Guideline 19 “Disclosures by Entities Subject to Rate Regulation” (AcG-19) of the CICA Handbook (Handbook) to establish guidelines on certain aspects of the disclosure and presentation of information in the financial statements of entities subject to rate regulation. AcG-19 requires the disclosure of general information regarding the nature and economic effects of rate regulation, as well as, additional information on how rate regulation has affected the financial statements. The guideline does not address recognition and measurement issues associated with the accounting for rate-regulated operations.

The Company has adopted AcG-19 for the year ended March 31, 2006 (note 4).

(c) Cash and cash equivalents:
Cash and cash equivalents are comprised of cash and investments that are highly liquid in nature and generally have a maturity date of three months or less.

(d) Short-term investments:
Short-term investments are valued at the lower of cost or market value and consist of treasury bills with original maturity dates greater than three months.

(e) Inventories:
Inventories, which consist of materials and supplies, catering stores and fuel, are valued at the lower of weighted-average cost and current replacement cost.

(f) Capital assets:
The costs of major replacements, additions, extensions and improvements, including direct overhead and financing costs during construction are capitalized. The costs of maintenance, repairs, refit and minor renewals or replacements are expensed as incurred.

Capital assets, including assets under capital leases, are amortized on a straight-line basis over the estimated useful lives of the assets at the following rates:

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Estimated useful life</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ship hulls</td>
<td>40 years</td>
</tr>
<tr>
<td>Ship propulsion and utility systems</td>
<td>20 years</td>
</tr>
<tr>
<td>Marine structures</td>
<td>20 to 40 years</td>
</tr>
<tr>
<td>Buildings</td>
<td>20 to 40 years</td>
</tr>
<tr>
<td>Equipment and other</td>
<td>3 to 20 years</td>
</tr>
</tbody>
</table>

(g) Impairment of long-lived assets:
The Company reviews capital assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparison of their carrying amount to the future undiscounted cash flows the assets are expected to generate. If such capital assets are considered to be impaired, the impairment to be recognized equals the amount by which the carrying amount of the assets exceeds their fair market value. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(h) Revenue recognition:
Tariff revenue is recognized when transportation is provided. The value of pre-sold vouchers is included in the balance sheets as deferred revenue.
(i) Pension and other employee future benefit plans:
Defined contribution plan accounting is applied to the Company's multiemployer defined benefit pension and long-term disability plans. These multiemployer plans are administered by external parties and the Company does not have sufficient information to apply defined benefit plan accounting.

The actuarial determination of the accrued benefit obligations for retirement benefits other than pension uses the projected benefit method prorated on service (which incorporates management's best estimate of future salary levels, other cost escalation, retirement ages of employees and other actuarial factors).

For the purpose of calculating the expected return on plan assets, those assets are valued at fair value.

Actuarial gains (losses) arise from the difference between actual long-term rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period or from changes in actuarial assumptions used to determine the accrued benefit obligation. For the Company's retirement bonus and death benefit plans, the excess of the net accumulated actuarial gain (loss) over 10 percent of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active employees. The average remaining service period of the active employees covered by the other (non-pension) retirement benefits plan is 7.5 years.

Past service costs arising from plan amendments are deferred and amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment.

When the restructuring of a benefit plan gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for prior to the settlement.

(j) Use of estimates:
The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the valuation of assets held for resale, the economic life of capital assets and the corresponding period of amortization, the recoverability of capital assets, the valuation of employee future benefits, and provisions for contingencies. Actual results could differ from these estimates.

(k) Taxes:
The Company is a “Tax Exempt Corporation” as described in the Income Tax Act and as such, is exempt from federal and provincial income taxes.

The provision of vehicle and passenger ferry services is an exempt supply under the Excise Tax Act for GST purposes.

(l) Foreign currency transactions:
The Company's normal operating currency is the Canadian dollar. Monetary assets and liabilities denominated in foreign currency are translated to Canadian dollars at the rate of exchange prevailing at the balance sheet date. Revenues and expenses are translated at rates in effect at the time of the transaction. Foreign exchange gains and losses are recognized in the statement of earnings during the year in which they arise.

(m) Deferred financing costs:
Legal and financing costs incurred are capitalized and amortized on a straight-line basis over the life of the financing.

(n) Hedging relationships:
Derivative financial instruments are utilized by the Company to manage market risk against the volatility in foreign currency, interest rate, and fuel price exposures. The Company does not utilize derivative financial instruments for trading or speculative purposes. At the inception of each hedge the company determines whether it will or will not apply hedge accounting.

When applying hedge accounting, the Company documents all relationships between hedging instruments and hedged items, as well as its 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. The Company also assesses, 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 income in the period in which they have been terminated or cease to be effective.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(columnar dollars expressed in thousands)

(o) Asset retirement obligations:
The Company recognizes a liability at its fair value for any legal obligations associated with the retirement of property, plant and equipment when those obligations result from the acquisition, construction, development or normal operation of the assets. A corresponding asset retirement cost is required to be added to the carrying amount of the related asset and amortized to expense on a systematic and rational basis.

It is possible that the Company’s estimates of its ultimate asset retirement obligations could change as a result of changes in regulations, changes in the extent of environmental remediation required, changes in the means of reclamation or changes in cost estimates. Changes in estimates are accounted for prospectively from the period the estimate is revised.

2. Short-term investments:

<table>
<thead>
<tr>
<th>As at March 31,</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restricted funds:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt service reserve, Series 04-1 bonds</td>
<td>$ 7,175</td>
<td>$ 7,175</td>
</tr>
<tr>
<td>Debt service reserve, Series 04-4 bonds</td>
<td>7,813</td>
<td>7,813</td>
</tr>
<tr>
<td></td>
<td>14,988</td>
<td>14,988</td>
</tr>
<tr>
<td>Unrestricted funds:</td>
<td>–</td>
<td>66</td>
</tr>
<tr>
<td>Short-term investments</td>
<td>$ 14,988</td>
<td>$ 15,054</td>
</tr>
</tbody>
</table>

The company is required to maintain a debt service reserve for the Series 04-1 and 04-4 bonds equal to not less than six months forecasted debt service.

3. Capital assets:

<table>
<thead>
<tr>
<th>March 31, 2006</th>
<th>Cost</th>
<th>Accumulated amortization</th>
<th>Net book value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ships owned</td>
<td>$ 776,422</td>
<td>$ 464,073</td>
<td>$ 312,349</td>
</tr>
<tr>
<td>Ship under capital lease</td>
<td>60,421</td>
<td>19,026</td>
<td>41,395</td>
</tr>
<tr>
<td>Berths, buildings and equipment</td>
<td>95,646</td>
<td>61,080</td>
<td>34,566</td>
</tr>
<tr>
<td>Berths, buildings and equipment under capital lease</td>
<td>446,388</td>
<td>215,276</td>
<td>231,112</td>
</tr>
<tr>
<td>Land</td>
<td>1,107</td>
<td>–</td>
<td>1,107</td>
</tr>
<tr>
<td>Construction-in-progress</td>
<td>86,795</td>
<td>–</td>
<td>86,795</td>
</tr>
<tr>
<td></td>
<td>$ 1,466,779</td>
<td>$ 759,455</td>
<td>$ 707,324</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>March 31, 2005</th>
<th>Cost</th>
<th>Accumulated amortization</th>
<th>Net book value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ships owned</td>
<td>$ 758,130</td>
<td>$ 458,115</td>
<td>$ 300,015</td>
</tr>
<tr>
<td>Ship under capital lease</td>
<td>50,426</td>
<td>32,845</td>
<td>17,581</td>
</tr>
<tr>
<td>Berths, buildings and equipment</td>
<td>86,342</td>
<td>54,286</td>
<td>32,056</td>
</tr>
<tr>
<td>Berths, buildings and equipment under capital lease</td>
<td>417,096</td>
<td>209,503</td>
<td>207,593</td>
</tr>
<tr>
<td>Land</td>
<td>1,107</td>
<td>–</td>
<td>1,107</td>
</tr>
<tr>
<td>Construction-in-progress</td>
<td>71,939</td>
<td>–</td>
<td>71,939</td>
</tr>
<tr>
<td></td>
<td>$ 1,385,040</td>
<td>$ 759,749</td>
<td>$ 630,291</td>
</tr>
</tbody>
</table>

p) Interest rate support:
The Company receives interest rate support from the Government of Canada for eligible new Canadian built vessels or major refurbishment of vessels. Amounts receivable in regard to capitalized interest are recognized as a reduction of capitalized interest upon completion of the project. Amounts receivable in regard to post-completion debt service costs are recognized as a reduction to interest expense.

(q) Comparative figures:
Certain comparative figures have been reclassified to conform to the presentation adopted for the current period.
For the year ended March 31, 2006 capitalized financing costs during construction amounted to $2.7 million (2005: $1.5 million).

It is anticipated that the title of the ship under capital lease, the Queen of Oak Bay, will pass to the company, without additional payments, on January 1, 2007. The Queen of Surrey was included in the ships under capital lease category in the year ended March 31, 2005; title passed to the company on January 1, 2006 and the Queen of Surrey is now included in the ships owned category.

In addition to the construction-in-progress referenced above, contractual commitments at March 31, 2006 for capital assets to be constructed totaled $324.2 million (2005: $339.4 million). Included in the contractual commitments as at March 31, 2006 is $308.2 million (2005: $307.4 million) committed for design and construction of three “Super C” Class vessels. Delivery of the three vessels is scheduled to occur during the period from late 2007 to mid 2008.

**4. Financial statement effect of rate regulation:**

The Company is regulated by the Commissioner to ensure that tariffs are fair and reasonable and to monitor service levels. Under the terms of the Act, the tariffs the Company charges its customers are subject to price caps. Annual increases in price caps have been set for the first five year term through March 31, 2008. The Commissioner may, under certain circumstances, allow increases in price caps over the set levels. The Commissioner will establish the price caps to apply for each subsequent term.

The accounting for regulated operations of the Company may differ from non-regulated businesses following Canadian generally accepted accounting principles (GAAP). As a result, the Company records assets and liabilities that result from the regulated price cap setting process that would not be recorded under GAAP for non-regulated entities. Regulatory assets generally represent incurred costs that have been deferred because they are probable of future recovery in tariffs. Regulatory liabilities represent obligations to customers which will be settled through future tariffs. Management continually assesses whether the regulatory assets are probable of future recovery by considering factors such as applicable regulatory changes and recent rate orders to other regulated entities. Management believes the existing regulatory assets are probable of recovery. This determination reflects the current political and regulatory climate, and is subject to change in the future. If future recovery of costs ceases to be probable, asset write-offs would be required to be recognized in current period earnings.

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

<table>
<thead>
<tr>
<th>As at March 31,</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferred fuel costs (a)</td>
<td>$22,715</td>
<td>$8,000</td>
</tr>
<tr>
<td>Performance term submission costs (b)</td>
<td>$68</td>
<td>–</td>
</tr>
<tr>
<td>Total regulatory assets</td>
<td>$22,783</td>
<td>$8,000</td>
</tr>
<tr>
<td>Regulatory liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tariffs in excess of price cap (c)</td>
<td>$958</td>
<td>–</td>
</tr>
</tbody>
</table>

(a) **Deferred fuel costs:**

As prescribed by regulatory order, the Company defers fuel costs in excess of approved fuel costs which were used to develop the regulated price caps. The difference between the approved fuel costs and the actual fuel costs (including fuel hedge gains and losses) is deferred for recovery from future tariffs. The order also allows interest to be included in the amount to be recovered. Also prescribed by regulatory order, the Company collects fuel surcharges which are applied against deferred fuel costs. It is expected that the recovery period of deferred fuel costs is two to six years. If the Company were not a regulated entity, earnings for the year ended March 31, 2006 would have been $14.7 million lower due to this deferral (2005: $8.0 million lower).

(b) **Performance term submission costs:**

The Commissioner has authorized the Company to defer costs of representation associated with the second performance term. The Commissioner will consider these costs in the determination of the price caps set for the four years beginning April 1, 2008. The Commissioner has not included an allowance for a return on investment for this item. It is expected that the recovery period will be the four year period of the second performance term, commencing April 1, 2008. If the Company were not a regulated entity, earnings for the year ended March 31, 2006 would have been $0.1 million lower due to this deferral (2005: nil).

(c) **Tariffs in excess of price cap:**

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 March 31, 2006, tariffs charged to customers on the major route group exceeded the price cap by $1.0 million (2005: nil). A liability has been recorded to recognize the obligation to return this amount to customers. It is expected that the settlement will occur in the next fiscal quarter. In the absence of rate regulated accounting, GAAP would require these revenues to be recognized as income in the year earned, and earnings for the year ended March 31, 2006 would have been $1.0 million higher (2005: nil).
5. Long-term land lease:

On April 1, 2003, the Company's land and structures comprising its terminals were transferred by the Company to the BC Transportation Financing Authority (“BCTFA”), a British Columbia Crown Corporation and related party at the time of the transaction. In exchange, the Company received recognition of a prepayment for leases of the transferred terminal structures and land. The structures, having lives of less than the lease term, are considered a capital lease and, as such, have been capitalized and included with capital assets and are amortized in accordance with the Company's amortization policy.

The land, having an indefinite useful life, is considered an operating lease. The prepayment of the land lease has been deferred and will be amortized on a straight-line basis over eighty years, being the initial sixty year lease period, plus an additional twenty year bargain renewal option.

The transaction is reflected at the book values of the transferred terminal structures and land.

During the year ended March 31, 2005, the Company entered into an agreement with BCTFA in which the Company would make improvements to the highways approaching Horseshoe Bay and Swartz Bay terminals in exchange for increased lands under the existing land lease. As at March 31, 2006, the improvements were complete. Long-term land lease has been increased in the year ended March 31, 2006 by $1.1 million (2005: $3.9 million) with regard to these highway improvements. The increases to long-term land lease will be amortized over the remaining lease period, commencing the month following completion of improvements.

6. Accrued employee future benefits:

(a) Description of benefit plans:

The Company and its employees contribute to the Public Service Pension Plan (the “Plan”). The Pension Corporation of the Province of British Columbia administers the Plan, including the payment of retirement and post-employment benefits on behalf of employers. The Plan is a multiemployer defined benefit pension plan. Under joint trusteeship, which became effective January 1, 2001, the risk and reward associated with the Plan’s unfunded liability or surplus is shared between the employers and the plan members and will be reflected in their future contributions.

In addition, eligible employees are entitled to other retirement and future benefits as provided for under the collective agreement and terms of employment. A retirement bonus and a death benefit, both unfunded defined benefit plans, and both administered by the Company, are based on years of service and final average salary. A funded long-term disability multiemployer plan provides disability income benefits after employment, but before retirement.

The Company also administers an unfunded accumulated sick leave bank (“Sick Bank obligation”), consisting of unused sick time credits, earned prior to the discontinuation of the sick leave accumulation benefit, in 1979. Accumulated sick leave may be drawn down at 100%, or paid out at 50%. Benefits are paid out at current salary rates. No new credits are accumulated to this bank.

The Company's employees may also receive compensation benefits arising from claims prior to March 31, 2003 administered by the Workers’ Compensation Board (“WCB obligation”). Prior to March 31, 2003, the Company participated in the Workers’ Compensation Board deposit class coverage system. Subsequent to March 31, 2003 the Company has been covered under the Workers’ Compensation Board rate system. The change to the rate system resulted in a residual liability from the deposit class system that has been valued by actuarial assumptions as appropriate for a closed plan. Currently this obligation is unfunded.

(b) Total cash payments:

Total cash payments for employee future benefits for the year ended March 31, 2006, consisting of cash contributed by the Company to its multiemployer defined benefit plans, cash payments directly to beneficiaries for its unfunded other benefit plans, and cash contributed to a third party administrator of an unfunded plan, was $17.6 million (2005: $16.6 million).

(c) Defined benefit plans:

All of the Company’s defined benefit plans, except its multiemployer plans, are currently unfunded. The most recent actuarial valuation of the retirement bonus and death benefit plans is as at March 31, 2005, with the next valuation expected as of March 31, 2008. The most recent actuarial valuations of the WCB obligation and the Sick Bank obligation are as at December 31, 2002 and March 31, 2001, respectively.
<table>
<thead>
<tr>
<th></th>
<th>Accrued benefit obligations</th>
<th>Other benefit plans</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2006</td>
<td>2005</td>
</tr>
<tr>
<td>Balance, beginning of year</td>
<td>$ 18,276</td>
<td>$ 18,059</td>
</tr>
<tr>
<td>Current service cost</td>
<td>493</td>
<td>556</td>
</tr>
<tr>
<td>Interest cost</td>
<td>816</td>
<td>853</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(1,156)</td>
<td>(1,841)</td>
</tr>
<tr>
<td>Actuarial (gains) losses</td>
<td>(51)</td>
<td>649</td>
</tr>
<tr>
<td>Balance, end of year</td>
<td>$ 18,378</td>
<td>$ 18,276</td>
</tr>
</tbody>
</table>

### Reconciliation of funded status of the benefit plans to the amounts recorded in the financial statements

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of plan assets</td>
<td>$ –</td>
<td>$ –</td>
</tr>
<tr>
<td>Accrued benefit obligation</td>
<td>18,378</td>
<td>18,276</td>
</tr>
<tr>
<td>Funded status of plans – deficit</td>
<td>(18,378)</td>
<td>(18,276)</td>
</tr>
<tr>
<td>Unamortized net actuarial loss</td>
<td>841</td>
<td>796</td>
</tr>
<tr>
<td>Accrued benefit liability</td>
<td>(17,537)</td>
<td>(17,480)</td>
</tr>
<tr>
<td>Current portion of accrued employee future benefits</td>
<td>800</td>
<td>631</td>
</tr>
<tr>
<td>Accrued employee future benefits</td>
<td>$ (16,737)</td>
<td>(16,849)</td>
</tr>
</tbody>
</table>

### Elements of defined benefit costs recognized in the year

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current service cost, net of employee contributions</td>
<td>$ 493</td>
<td>$ 556</td>
</tr>
<tr>
<td>Interest cost</td>
<td>771</td>
<td>853</td>
</tr>
<tr>
<td>Actuarial (gains) losses</td>
<td>(51)</td>
<td>649</td>
</tr>
<tr>
<td>Elements of employee future benefits costs before adjustments to recognize the long-term nature of employee future benefit costs</td>
<td>1,213</td>
<td>2,058</td>
</tr>
<tr>
<td>Difference between actuarial (gain) loss recognized for year and actual actuarial (gain) loss on accrued benefit obligation for year</td>
<td>–</td>
<td>(796)</td>
</tr>
<tr>
<td>Defined benefit costs recognized</td>
<td>$ 1,213</td>
<td>$ 1,262</td>
</tr>
</tbody>
</table>

### Significant assumptions

**The significant assumptions used are as follows (weighted average):**

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accrued benefit obligation as of March 31:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discount rate</td>
<td>4.6%</td>
<td>4.6%</td>
</tr>
<tr>
<td>Rate of compensation increase</td>
<td>2.0%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Annual employee retention rate</td>
<td>92.0%</td>
<td>92.0%</td>
</tr>
<tr>
<td>Employees with eligible dependents at pre-retirement death</td>
<td>43.0%</td>
<td>43.0%</td>
</tr>
</tbody>
</table>

| Benefit cost for years ended March 31: |                         |                    |
| Discount rate                        | 4.5%                      | 5.0%               |
| Rate of compensation increase        | 2.0%                      | 2.0%               |
| Annual employee retention rate       | 92.0%                     | 95.0%              |
| Employees with eligible dependents at pre-retirement death | 43.0%                      | 43.0%              |
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(columnar dollars expressed in thousands)

(d) Multiemployer plans:
The total cost recognized for the Company’s multiemployer plans is as follows:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Service Pension Plan contributions (i)</td>
<td>$14,237</td>
<td>$12,682</td>
</tr>
<tr>
<td>Long-term disability plan contributions</td>
<td>$2,183</td>
<td>$2,086</td>
</tr>
<tr>
<td>Long-term disability plan amortization of surplus (ii)</td>
<td>$64</td>
<td>$64</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$16,484</strong></td>
<td><strong>$14,832</strong></td>
</tr>
</tbody>
</table>

i) The March 31, 2005 actuarial valuation report for the Public Service Pension Plan was received by the Public Service Pension Board of Trustees on December 14, 2005. This report indicated that the pension fund has an unfunded liability of $767 million. Under the terms of the plan’s joint trust agreement, plan members and employers share in any increase or decrease in contribution rates. In order to address the unfunded liability, the plan trustees have increased the member and employer contribution rates by 1.88%, effective April 1, 2006.

ii) Contribution rates are actuarially determined every three years as a percentage of covered payroll. The most recent valuation, as at March 31, 2002, determined a fund surplus, which is being amortized over a period of ten years, via a reduction in the employer contribution rate. The next valuation will be as at March 31, 2005 and is expected June, 2006.

7. Long-term debt:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.74% Senior Secured Bonds, Series 04-1, due May 2014 (a)</td>
<td>$250,000</td>
<td>$250,000</td>
</tr>
<tr>
<td>Unamortized discount</td>
<td>(108)</td>
<td>(121)</td>
</tr>
<tr>
<td>Total</td>
<td>249,892</td>
<td>249,879</td>
</tr>
<tr>
<td>6.25% Senior Secured Bonds, Series 04-4, due October 2034 (a)</td>
<td>$250,000</td>
<td>$250,000</td>
</tr>
<tr>
<td>Unamortized discount</td>
<td>(288)</td>
<td>(298)</td>
</tr>
<tr>
<td>Total</td>
<td>249,712</td>
<td>249,702</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$499,604</strong></td>
<td><strong>$499,581</strong></td>
</tr>
</tbody>
</table>

In May 2004, the Company entered into a master trust indenture which established common security and a set of common covenants for the benefit of all lenders under the Company’s financing plan. The financing plan encompasses an ongoing program capable of accommodating a variety of corporate debt instruments and borrowings ranking pari passu. Currently, the Company has issued two bonds series and entered into a credit facility. The master trust indenture requires the Company to maintain a debt service reserve.

(a) Bonds:

Bonds are issued under supplemental indentures either as obligation bonds or as pledged bonds. The bonds are secured by a registered first mortgage and charge over vessels, an unregistered first mortgage and charge over ferry terminal leases, and by a general security agreement on property and contracts. The bonds are redeemable in whole or in part at the option of the Company. Interest on the Series 04-1 bonds is payable semi-annually on May 27 and November 27 of each year until maturity. Interest on the Series 04-4 bonds is payable semi-annually on April 13 and October 13 of each year until maturity.
(b) Credit facility:
The Company entered into a credit facility with a syndicate of Canadian banks, secured by pledged bonds. The credit facility makes available to the Company a 364 day revolving operating facility with a one year term-out in an amount up to $77.5 million, and a three year revolving extendible facility in an amount up to $77.5 million. Both facilities are undrawn as at March 31, 2006.

(c) Debt service reserve:
The Company is required to maintain a debt service reserve for the Series 04-1 and 04-4 bonds equal to not less than six months forecasted debt service, to be increased under certain conditions. A debt service reserve of $7.2 million and $7.8 million on the Series’ 04-1 and 04-4 bonds, respectively, is currently invested in short-term investments.

In addition, the Company has entered into loan agreements which make up to $180 million available to finance the Company’s purchase of two “Super C” Class vessels. These funds will be released to coincide with the conditional acceptance dates of the vessels, expected in 2008.

8. Obligations under capital lease:
During the prior year, the Company entered into a lease agreement for a training facility. The initial lease period is for a term of ten years, expiring April, 2015. The Company may, at its option, extend the lease term for up to two periods of five years each. Use of the facility by other organizations is controlled by the Company during the lease period. A discount rate of 6.25% has been used to determine the present value of the obligation under capital lease.

Future minimum lease payments:

<table>
<thead>
<tr>
<th>Year ended</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>$66</td>
</tr>
<tr>
<td>2008</td>
<td>66</td>
</tr>
<tr>
<td>2009</td>
<td>66</td>
</tr>
<tr>
<td>2010</td>
<td>66</td>
</tr>
<tr>
<td>2011</td>
<td>66</td>
</tr>
<tr>
<td>Thereafter</td>
<td>151</td>
</tr>
<tr>
<td>Executory costs and imputed interest included in payments</td>
<td>(318)</td>
</tr>
<tr>
<td>Current portion of capital lease liability</td>
<td>(25)</td>
</tr>
<tr>
<td></td>
<td>$138</td>
</tr>
</tbody>
</table>

9. Share capital:
(a) Authorized:
1,000,000 Class A voting common shares, without par value
1 Class B voting common share, without par value
80,000 Class C non-voting, 8% cumulative preferred shares, with a par value of $1,000 per share, convertible to Class A shares upon the sale of the outstanding Class B share by the initial shareholder. Special rights attached to the Class C shares restrict the Company’s ability to issue shares and to declare dividends.
(b) Issued and outstanding:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number of shares</td>
<td>Amount $</td>
</tr>
<tr>
<td>Class B, common</td>
<td>1</td>
<td>$1</td>
</tr>
<tr>
<td>Class C, preferred</td>
<td>75,477</td>
<td>75,477</td>
</tr>
<tr>
<td></td>
<td>$75,478</td>
<td>$75,478</td>
</tr>
</tbody>
</table>

(c) Dividends:
Dividends on the Class C cumulative preferred shares, if declared, are payable annually on March 31 of each year. All dividend entitlements to date have been paid.

10. Ferry service fees:
The Company entered into an agreement with the Province of British Columbia commencing April 1, 2003 to provide ferry services that would not be commercially viable under the current regulated tariff structure. In exchange for fees, the Company provides agreed ferry service levels on specified routes and administers certain social policy initiatives on behalf of the Province. The agreement is for a period of sixty years, the details of which are renegotiated after a first term of five years and each four-year term thereafter. The initial term provides for annual fees of approximately $107 million.

11. Federal-Provincial Subsidy Agreement:
The Company receives revenue provided to the Province of British Columbia from the Government of Canada pursuant to a contract between the federal and provincial governments for the provision of ferry, coastal freight and passenger services in the waters of British Columbia. The annual payment increases with the Vancouver Consumer Price Index.

12. Interest rate support:
The Government of Canada has agreed to provide $5.6 million in the form of interest rate support to the Company for major refurbishments on two vessels. Of this, $0.6 million has been recorded during the year as a reduction of capitalized interest, and $2.0 million has been recorded as a reduction of interest expense (year ended March 31, 2005: nil). The remaining $3.0 million will be recognized over the next eighteen months as a reduction of interest expense.

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.

13. Strategic relationship agreement:
In April 2003, the Company formed a five-year strategic relationship agreement with IBM Canada Ltd. to lease computer hardware and software, as well as to implement business and technology solutions for the Company.

Commitments made by the Company under this agreement are estimated as follows:

<table>
<thead>
<tr>
<th>Year ended</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$6,748</td>
<td>$6,524</td>
</tr>
<tr>
<td></td>
<td>$13,272</td>
<td></td>
</tr>
</tbody>
</table>

14. Risk management:
(a) Fuel management:
The Company may manage its exposure to vessel fuel price volatility by entering into swap agreements with certain financial intermediaries in order to add a fixed component to the inherent floating nature of fuel prices. When fuel hedging instruments are used, it is solely for the purpose of reducing fuel price risk, not for generating trading profits. Gains and losses resulting from the contracts are recognized as a component of fuel costs (also see note 4).

(b) Credit and interest rate risk:
Management does not believe that the Company is subject to any significant concentration of credit risk. Most of the Company's receivables result from tickets sold to passengers through the use of major credit cards. These receivables are short-term, generally being settled shortly after sale. The Company manages the credit exposure related to financial instruments by selecting credit-worthy counter-parties and by limiting its exposure to a single counter-party.

The Company may enter into interest rate agreements to manage its exposure on debt instruments. As at March 31, 2006, the Company has no interest rate agreements.
(c) Foreign exchange risk:
The Company may enter into foreign exchange forward contracts to manage its exposure on future purchase commitments. As at March 31, 2006, the Company has entered into foreign exchange forward contracts valued at Cdn $449.9 million, for the committed cost, including customs and duty, of three new “Super C” Class vessels that are payable in Euros (2005: $449.9 million).

(d) Fair value of financial instruments:
The fair value of financial instruments not currently carried at market value is summarized in the following table. Judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates determined as of March 31, 2006 and 2005, are not necessarily indicative of the amounts the Company could have realized in current markets.

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term debt</td>
<td>$499,604</td>
<td>$552,968</td>
</tr>
<tr>
<td>Foreign currency forward contracts</td>
<td>-</td>
<td>45,300</td>
</tr>
<tr>
<td>Obligations under capital lease</td>
<td>163</td>
<td>163</td>
</tr>
</tbody>
</table>

Fair market values have been estimated by reference to quoted market prices for the actual or similar instruments where available. The fair values of cash and cash equivalents, short term investments, accounts receivable, accounts payable and accrued liabilities, accrued employee costs, and interest payable on long-term debt approximate their carrying amounts due to their short term to maturity.

As at March 31, 2006, the Company had outstanding fuel hedges with a notional amount of $19.3 million which are marked to market and recognized in the consolidated financial statements at a value of $0.9 million (2005: nil).

The carrying values and approximate fair market values of the Company’s longer term financial instruments are:

15. Related party transactions:
In accordance with the Act, the Company is responsible for paying any expenses that are incurred by its parent, British Columbia Ferry Authority (“BCFA”), without charge. During the year ended March 31, 2006, the Company paid $99,702 (2005: $31,796) of such expenses.

The Province of British Columbia owns the Company’s 75,477 non voting preferred shares, but has no voting interest in either the Company or its parent, BCFA.

16. Supplemental cash flow information:

<table>
<thead>
<tr>
<th>Years ended March 31,</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash paid during the year for interest</td>
<td>$30,175</td>
<td>$12,828</td>
</tr>
</tbody>
</table>

17. Contingent liabilities:
The Company, in conducting its usual business activities, is involved in various legal proceedings and litigation, the outcome of which is indeterminable. It is the Company’s policy to carry adequate insurance to minimize the financial risk associated with such matters. Management is of the opinion that the aggregate net liability, if any, of these proceedings and litigation would not be significant to the Company. Any additional future costs or recoveries, which differ from the accrued amounts, will be recorded as expenses or revenues as determined.

18. Subsequent event:
On March 22, 2006 the vessel Queen of the North ran aground and subsequently sank. Subsequent to March 31, 2006, the Company has settled with its Hull and Machinery insurance providers. The Company has received insurance proceeds, net of deductible, of $67.9 million in settlement of the claim under the Hull and Machinery policy. At March 31, 2006, $6.6 million of the proceeds from this claim have been recognized to offset insurable loses (including $4.3 million net book value of capital assets) incurred as a result of this event.
CORPORATE DIRECTORY
(as of June 2006)

Board of Directors
Elizabeth J. Harrison, QC
Chair

Thomas W. Harris 1
Vice Chair

Douglas E. Allen 1, 2

Peter R.B. Armstrong 3

Sandy M. Fulton 3

David L. Hahn

John R. Henderson, FCA 1, 2

Doreen J. Hewitt 2

Maureen V. Macarenko 1, 3

Robert W. McCaskill 2, 3

G. Raymond Whitehead 3

Graham M. Wilson 1, 2

1. Audit & Finance Committee
2. Governance & Human Resources Committee
3. Safety, Health, Environment & Security Committee

Senior Officers of the Company
David L. Hahn
President & CEO

Robert P. Clarke
Executive Vice President & Chief Financial Officer

Michael J. Corrigan
Executive Vice President & Chief Operating Officer

William R. Cottick
Executive Vice President, Corporate Affairs & General Counsel

Glen N. Schwartz
Executive Vice President, Human Resources & Corporate Development

Captain Trafford M. Taylor
Executive Vice President, New Vessel Construction & Industry Affairs

Officers of the Company
Manuel A. Achadinha
Vice President, Terminal Operations

Captain George A. Capacci
Vice President, Fleet Operations

Mark F. Collins
Vice President, Engineering

Geoffrey H. Dickson
Vice President, Food & Retail Operations

L. Blaine Ellis
Vice President, Employee Relations

M. Alana Gallagher
Treasurer

Cynthia M. Lukaitis
Vice President & Corporate Secretary

Daniel Wong
Vice President, Corporate Relations
## CONTENTS

**B.C. FERRY AUTHORITY**
- A2  A Message from the Chair
- A3  Corporate Profile
- A4  Summary of Meetings
- A6  Financial Statements
- A10 Corporate Directory
The B.C. Ferry Authority is an independent, no-share corporation that holds the single issued voting share of the new British Columbia Ferry Services Inc.

As the shareholder of British Columbia Ferry Services Inc., the Authority appoints the Board of Directors of British Columbia Ferry Services Inc. The members of the B.C. Ferry Authority Board are also directors of British Columbia Ferry Services Inc.

The B.C. Ferry Authority is governed by the Coastal Ferry Act, which establishes a process for the appointment of directors to ensure broad regional representation. In accordance with the act, the Authority has a nine-member Board of Directors. The Board is composed of individuals with a wide range of experience.

Four directors are appointed from nominations received from four appointment areas comprised of 13 coastal regional districts. In addition, one director is appointed from nominations from the union representing the employees of British Columbia Ferry Services Inc., two directors are appointed from the community-at-large and two additional directors are appointed by the provincial government.

The board is dedicated to ensuring that the highest corporate governance standards are adhered to in its deliberations.

Elizabeth J. Harrison, QC
Chair
August 1, 2006
B.C. Ferry Authority (the “Authority”) is a no-share-capital corporation created under the *Coastal Ferry Act* (British Columbia). It holds the single issued voting share of British Columbia Ferry Services Inc. (BCFS), a company incorporated in British Columbia which is subject to the *Business Corporations Act* (British Columbia) and the successor organization to what was the Crown corporation operating as British Columbia Ferry Corporation. The Province of British Columbia is the holder of all of the preferred shares of BCFS. The Authority appoints the Board of Directors of BCFS.

**Appointment of Directors**

The appointment process and composition of the Board of Directors of the Authority is set out in the *Coastal Ferry Act*. The Board includes four appointees nominated from appointment areas comprised of coastal regional districts, one appointee nominated by the BC Ferry and Marine Workers’ Union, two appointees of the Province of British Columbia, and two appointees of members from the community-at-large. Directors are appointed to the Board of the Authority for terms of three years and may serve for up to two consecutive terms (or three consecutive terms in the case of current Directors who served on the first Board of the Authority). At present, as a matter of Board policy, the Directors of the Authority are also Directors of the operating company, BCFS.

The terms of three Directors expired March 31, 2006. During the year, the Board sought and received nominations of qualified individuals to serve as directors from the Central Vancouver Island & Northern Georgia Strait and the Northern Coastal & North Island appointment areas and also considered qualified candidates for appointment from the community-at-large. Two nominees from the appointment areas, both of whom were the incumbent directors, together with the incumbent Director from the community-at-large, were selected and re-appointed to the Board effective April 1, 2006.

In selecting individuals to serve as Directors of the Authority, the Board had two primary objectives. Firstly, it was to ensure that the composition of the Board would meet the requirements of the *Coastal Ferry Act*. Secondly, it was to ensure that, collectively, the Board would contain the skills and experience necessary to ensure the sound performance of the Authority and the effective interaction and operation of the Board. The Skills and Experience Profile adopted by the Authority contains the specific criteria that guided the Board in its appointment process during the year.

**Bylaws of the Authority**

There were no amendments made to the General Bylaws of the Authority during the year. As part of the Director appointment process, the Board identified certain amendments to the Skills and Experience Profile in the areas of “Statutory Qualifications,” “Personal Attributes” and “Key Skills” that it wishes to make. The Skills and Experience Profile is included as Schedule “A” to the General Bylaws of the Authority and, in accordance with the *Coastal Ferry Act*, the amendments have been posted for public view on the Authority’s website and will take effect on September 1, 2006.
The Board meets regularly to conduct its business. During the year, the Board and its Committees met on 18 occasions. These included the Annual General Meeting of the Authority held in accordance with Section 18 of the *Coastal Ferry Act*. Following is a summary of the meetings of the Board and its Committees.

<table>
<thead>
<tr>
<th>DATE</th>
<th>TYPE</th>
<th>OUTCOMES</th>
</tr>
</thead>
</table>
| JUN 7, 05| Audit & Finance Committee     | • Financial statements of the Authority for the year ended March 31, 2005 recommended for approval to the Board  
|          |                               | • Independence letter and findings report on the audit process received from the External Auditor |
| JUN 8, 05| Governance Committee          | • Code of Business Conduct and Ethics for the Authority recommended for approval to the Board  
|          |                               | • Report from the Chair of the Governance Committee on the review of conflict-of-interest forms completed by Directors and Officers of the Authority  
|          |                               | • Approach to revising the Board Governance Manual recommended for approval to the Board |
| JUN 9, 05| Board of Directors            | • Financial statements of the Authority for the year ended March 31, 2005 approved  
|          |                               | • Code of Business Conduct and Ethics for the Authority approved  
|          |                               | • Approach to revising the Board Governance Manual approved  
|          |                               | • Corporate Secretary authorized to execute, on behalf of the Authority, the shareholders’ unanimous consent resolutions pertaining to all of the business required to be transacted at the Annual General Meeting of British Columbia Ferry Services Inc. |
| AUG 29, 05| Audit & Finance Committee     | • Financial statements of the Authority for the three months ended June 30, 2005 recommended for approval to the Board |
| AUG 29, 05| Board of Directors            | • Financial statements of the Authority for the three months ended June 30, 2005 approved  
|          |                               | • 2004/05 Annual Report of the Authority approved  
|          |                               | • 2005 Annual General Meeting of the Authority discussed; date, time and location confirmed |
| SEP 19, 05| Audit & Finance Committee     | • Discussion with the External Auditor |
| SEP 19, 05| Governance Committee          | • Process for appointment of Directors effective April 1, 2006 discussed  
|          |                               | • Skills and experience requirements of the Board reviewed  
| SEP 20, 05| Board of Directors            | • Process for appointment of Directors effective April 1, 2006 discussed |
| SEP 20, 05| Annual General Meeting        | • Annual General Meeting held pursuant to the *Coastal Ferry Act* (Section 18) |
| NOV 16, 05| Audit & Finance Committee     | • Financial statements of the Authority for the six months ended September 30, 2005 recommended for approval to the Board  
|          |                               | • 2005/06 terms of engagement for the External Auditor approved  
|          |                               | • Committee meeting dates for 2006/07 and 2007/08 approved |
| NOV 16, 05| Governance Committee          | • Status and next steps in the consideration of the nominees received from the appointment areas for appointment to the Board effective April 1, 2006 discussed  
|          |                               | • Status and next steps in the appointment of a Director from the community-at-large effective April 1, 2006 discussed  
|          |                               | • Process for Board of Directors self-assessment evaluation discussed  
|          |                               | • Extension of the appointment of the Chair of the Governance Committee through March 31, 2006 recommended to the Board for approval  
|          |                               | • Appointment of Corporate Secretary effective November 15, 2006 recommended to the Board for approval  
<p>|          |                               | • Committee meeting dates for 2006/07 and 2007/08 approved |</p>
<table>
<thead>
<tr>
<th>DATE</th>
<th>TYPE</th>
<th>OUTCOMES</th>
</tr>
</thead>
<tbody>
<tr>
<td>NOV 17, 05</td>
<td>Board of Directors</td>
<td>• Financial statements of the Authority for the six months ended September 30, 2005 approved</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Extension of the appointment of the Chair of the Governance Committee through to March 31, 2006 approved</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Appointment of Corporate Secretary effective November 15, 2006 approved</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Shareholder resolutions of the Authority authorizing the filing of a transition application by British Columbia Ferry Services Inc. pursuant to the British Columbia Business Corporations Act ratified and approved</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Date, time and location of the 2006 Annual General Meeting confirmed</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Board meeting dates for 2006/07 and 2007/08 approved</td>
</tr>
<tr>
<td>NOV 25, 05</td>
<td>Board of Directors</td>
<td>• Recommendations of the Governance Committee with respect to the appointment of Directors nominated by the Central Vancouver Island &amp; Northern Georgia Strait and the Northern Coastal &amp; North Island appointment areas considered; Directors appointed for three-year terms effective April 1, 2006</td>
</tr>
<tr>
<td>FEB 21, 06</td>
<td>Audit &amp; Finance Committee</td>
<td>• 2006/07 operating budget for the Authority recommended for approval to the Board</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Financial statements of the Authority for the nine months ended December 31, 2005 recommended for approval to the Board</td>
</tr>
<tr>
<td>FEB 22, 06</td>
<td>Governance Committee</td>
<td>• Appointment of Director from the community-at-large for three-year term commencing April 1, 2006 recommended for approval to the Board</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Amendments to the Articles of British Columbia Ferry Services Inc. recommended for approval to the Board</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Amendments to the Board’s definition of Director independence recommended for approval to the Board</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Results of Board of Directors’ self-assessment evaluation reviewed and discussed</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Director compensation reviewed and discussed</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Committee composition reviewed and discussed</td>
</tr>
<tr>
<td>FEB 28, 06</td>
<td>Board of Directors</td>
<td>• 2006/07 operating budget for the Authority approved</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Financial statements of the Authority for the nine months ended December 31, 2005 approved</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Director from the community-at-large appointed for a three year term commencing April 1, 2006</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Location of the Authority’s Annual General Meetings in 2007, 2008 and 2009 confirmed</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Amendments to the Board’s definition of Director independence approved</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Changes in Director compensation effective April 1, 2006 approved</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Results of Board of Directors’ self-assessment evaluation reviewed and discussed</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Amendments to the Articles of British Columbia Ferry Services Inc. approved</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Directors of British Columbia Ferry Services Inc. effective April 1, 2006 appointed</td>
</tr>
<tr>
<td>MAR 29, 06</td>
<td>Governance Committee</td>
<td>• Amendments to the Skills and Experience Profile of the Authority recommended for approval to the Board</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Questionnaire to assist the Board in making a determination as to the independence of its Directors recommended for approval to the Board</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Amendments to the Terms of Reference for the Governance Committee recommended for approval to the Board</td>
</tr>
<tr>
<td>MAR 30, 06</td>
<td>Board of Directors</td>
<td>• Amendments to the Skills and Experience Profile of the Authority approved, with such amendments to be made public for four months prior to coming into effect</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Questionnaire to assist the Board in making a determination as to the independence of its Directors approved</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Amendments to the Terms of Reference for the Governance Committee approved</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Chair and Vice Chair effective April 1, 2006 appointed</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Committee Chairs and members effective April 1, 2006 appointed</td>
</tr>
</tbody>
</table>
AUDITORS’ REPORT

To the Board of Directors, B.C. Ferry Authority

We have audited the statement of financial position of B.C. Ferry Authority as at March 31, 2006 and the statements of operations and changes in net assets for the year then ended. These financial statements are the responsibility of the Authority’s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Authority as at March 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

Victoria, Canada
May 17, 2006
STATEMENT OF FINANCIAL POSITION  
(expresssed in thousands)

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment in British Columbia Ferry Services Inc.</td>
<td>$99,551</td>
<td>$55,724</td>
</tr>
<tr>
<td>NET ASSETS</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Invested in common share of British Columbia Ferry Services Inc.</td>
<td>$1</td>
<td>$1</td>
</tr>
<tr>
<td>Accumulated undistributed earnings of British Columbia Ferry Services Inc.</td>
<td>99,550</td>
<td>55,723</td>
</tr>
<tr>
<td></td>
<td>$99,551</td>
<td>$55,724</td>
</tr>
</tbody>
</table>

See accompanying notes to financial statements.

On behalf of the Board:

Graham M. Wilson  
Director

Elizabeth J. Harrison, QC  
Director

STATEMENT OF OPERATIONS  
(expresssed in thousands)

<table>
<thead>
<tr>
<th>Years ended March 31,</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Distributable earnings of British Columbia Ferry Services Inc. (note 2)</td>
<td>$43,827</td>
<td>$33,776</td>
</tr>
<tr>
<td>Expenses:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Administration</td>
<td>100</td>
<td>32</td>
</tr>
<tr>
<td>Recovery from British Columbia Ferry Services Inc. (note 3)</td>
<td>(100)</td>
<td>(32)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excess of revenue over expenses</td>
<td>$43,827</td>
<td>$33,776</td>
</tr>
</tbody>
</table>

See accompanying notes to financial statements.

STATEMENT OF CHANGES IN NET ASSETS  
(expresssed in thousands)

<table>
<thead>
<tr>
<th>Invested in BCFSI</th>
<th>Undistributed Earnings of BCFSI</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance, March 31, 2005</td>
<td>$1</td>
<td>$55,723</td>
</tr>
<tr>
<td>Excess of revenue over expenses</td>
<td>–</td>
<td>$43,827</td>
</tr>
<tr>
<td>Balance, March 31, 2006</td>
<td>$1</td>
<td>$99,550</td>
</tr>
</tbody>
</table>

See accompanying notes to financial statements.
NOTES TO FINANCIAL STATEMENTS
(expressed in thousands)

B.C. Ferry Authority (the “Authority”) was established by the Coastal Ferry Act (British Columbia) (the “Act”) on April 1, 2003 as a corporation without share capital. The Authority is governed by a board of nine directors. The board of directors appoints replacements for outgoing directors for seven of the positions as follows:

• four appointed from nominees provided to the board by each of the four appointment areas consisting of those coastal regional districts that the Lieutenant Governor in Council for British Columbia may prescribe, with one director appointed from each area;

• one appointed from nominees provided by the trade union representing the employees of the British Columbia Ferry Services Inc. (“BCFSI”);

• two appointed from qualified individuals as defined in the Act.

The Lieutenant Governor in Council for British Columbia appoints the other two director positions from qualified individuals as terms expire.

The Authority’s primary purpose is to hold the shares of BCFSI, a company incorporated under the Business Corporations Act (British Columbia), which provides coastal ferry services in British Columbia. The Province of British Columbia (the “Province”) contributed the initial capital to the Authority to fund the purchase of the BCFSI common share. The Act provides that upon a sale of the common share of BCFSI held by the Authority, the Province is to be repaid its initial contribution and the Authority is dissolved. The Act also provides that upon dissolution of the Authority, all remaining assets of the Authority, if any, vest in the Province.

1. Significant accounting policies:

(a) Basis of presentation:
The financial statements are prepared in accordance with Canadian generally accepted accounting principles for not-for-profit entities. The Authority’s investment in its wholly owned subsidiary, BCFSI is accounted for by the equity method. Under the equity method the original cost of the investment is adjusted for the Authority’s share of post-acquisition earnings or losses less dividends.

(b) Revenue recognition:
The Authority follows the deferral method of accounting for contributions. The Authority does not expect to receive endowment contributions.

(c) Taxes:
The Authority and BCFSI are exempt from federal and provincial income taxes.

(d) Statement of Cash Flows:
A statement of cash flows has not been included with these statements as it does not provide additional information.

2. Distributable earnings of British Columbia Ferry Services Inc.:
The distributable earnings of BCFSI consist of the current period net earnings, less any dividends paid in the current period and less a reserve for undeclared preferred share dividend, if any.

<table>
<thead>
<tr>
<th>Years ended March 31,</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net earnings of BCFSI</td>
<td>$ 49,865</td>
<td>$ 39,814</td>
</tr>
<tr>
<td>Dividends paid on 8% cumulative preferred shares</td>
<td>$(6,038)</td>
<td>$(6,038)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$ 43,827</strong></td>
<td><strong>$ 33,776</strong></td>
</tr>
</tbody>
</table>

3. Recovery from British Columbia Ferry Services Inc.:
The Act provides that BCFSI is responsible for paying any expenses that are incurred by the Authority.
4. Subsidiary supplemental information:

The consolidated financial position and operating results for BCFSI and its wholly-owned subsidiaries are summarized below:

<table>
<thead>
<tr>
<th>As at March 31,</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
<td>$ 67,017</td>
<td>$ 89,519</td>
</tr>
<tr>
<td>Capital and other assets</td>
<td>766,660</td>
<td>673,863</td>
</tr>
<tr>
<td></td>
<td>$ 833,677</td>
<td>$ 763,382</td>
</tr>
<tr>
<td>Current liabilities</td>
<td>$ 142,170</td>
<td>$ 115,587</td>
</tr>
<tr>
<td>Accrued employee future benefits</td>
<td>16,737</td>
<td>16,849</td>
</tr>
<tr>
<td>Long-term debt and capital lease obligations</td>
<td>499,742</td>
<td>499,745</td>
</tr>
<tr>
<td></td>
<td>$ 658,649</td>
<td>$ 632,181</td>
</tr>
<tr>
<td>Shareholders' equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common share held by the Authority</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Preferred shares (a)</td>
<td>75,477</td>
<td>75,477</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>99,550</td>
<td>55,723</td>
</tr>
<tr>
<td></td>
<td>175,028</td>
<td>131,201</td>
</tr>
<tr>
<td></td>
<td>$ 833,677</td>
<td>$ 763,382</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Years ended March 31,</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue (including gains)</td>
<td>$ 579,411</td>
<td>$ 564,455</td>
</tr>
<tr>
<td>Expenses (including losses)</td>
<td>529,546</td>
<td>524,641</td>
</tr>
<tr>
<td>Net earnings</td>
<td>49,865</td>
<td>39,814</td>
</tr>
<tr>
<td>Cash flows from operating</td>
<td>98,349</td>
<td>102,051</td>
</tr>
<tr>
<td>Cash flows from financing</td>
<td>(6,730)</td>
<td>43,687</td>
</tr>
<tr>
<td>Cash flows from investing</td>
<td>(130,852)</td>
<td>(122,153)</td>
</tr>
</tbody>
</table>

(a) The outstanding non-voting, 8% cumulative preferred shares are held by the Province and are convertible to common shares upon a sale of the outstanding common share. Special rights attached to the preferred shares restrict BCFSI’s ability to issue share capital and to declare dividends.
B.C. Ferry Authority

Board of Directors (April 1, 2005 – March 31, 2006)

Elizabeth J. Harrison, QC
Chair
(Community-at-large appointment)

Thomas W. Harris¹
Vice Chair
(Central Vancouver Island & Northern Georgia Strait appointment area)

Douglas E. Allen¹,²
(Community-at-large appointment)

Sandy M. Fulton
(Province of B.C. appointment)

John R. Henderson, FCA¹,²
(Southern Mainland appointment area)

Doreen J. Hewitt
(Southern Vancouver Island appointment area)

Maureen V. Macarenko¹
(Northern Coastal & North Island appointment area)

G. Raymond Whitehead
(Organized labour appointment)

Graham M. Wilson¹,²
(Province of B.C. appointment)

1. Audit & Finance Committee
2. Governance Committee

Officers

Elizabeth J. Harrison, QC
Chair

Thomas W. Harris
Vice Chair

William R. Cottick
Executive Vice President, Corporate Affairs & General Counsel

Cynthia M. Lukaitis
Vice President & Corporate Secretary
This report contains historical information and may contain certain forward-looking statements which relate to future events or future performance. These forward-looking statements are based upon management’s current expectations and assumptions as to a number of factors, including, the risks, uncertainties and other factors as described in BC Ferries’ Management’s Discussion and Analysis herein and certain of the other BC Ferries documents available at www.sedar.com. These forward-looking statements are made as of today’s date and are based upon information currently available to management, and BC Ferries assumes no obligation to update or revise them to reflect new events or circumstances. If management’s expectations and assumptions prove to be incorrect or factors change, then actual results could differ materially from the forward-looking information contained in this report.