

Consolidated Financial Statements of

**BRITISH COLUMBIA FERRY SERVICES INC.**

Three months ended June 30, 2004

# BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Balance Sheets  
(expressed in thousands)

	June 30, 2004 (unaudited)	March 31, 2004
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 20,617	\$ 17,939
Debt service reserve (note 3c)	9,816	-
Accounts receivable	14,784	5,857
Prepaid expenses	12,093	5,717
Inventories	20,333	23,570
	<u>77,643</u>	<u>53,083</u>
Capital assets (note 2)	568,351	551,474
Deferred financing costs	3,677	1,190
Long-term land lease	23,964	24,040
	<u>\$ 673,635</u>	<u>\$ 629,787</u>

## Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable and accrued liabilities	\$ 34,619	\$ 37,262
Interest payable on long-term debt	1,376	61
Accrued employee costs	37,146	36,276
Deferred revenue	23,640	13,003
Current portion of deferred employee obligations	2,415	2,415
	<u>99,196</u>	<u>89,017</u>
Deferred employee obligations	15,656	15,644
Long-term debt (note 3)	449,062	427,701
	<u>563,914</u>	<u>532,362</u>
Shareholders' equity:		
Share capital	75,478	75,478
Retained earnings	34,243	21,947
	<u>109,721</u>	<u>97,425</u>
Contingent liabilities (note 5)		
	<u>\$ 673,635</u>	<u>\$ 629,787</u>

See accompanying notes to consolidated financial statements.

On behalf of the Board:

(Signed) "Elizabeth J. Harrison, Q.C." Director

(Signed) "Doug Allen" Director

# BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Statements of Earnings and Retained Earnings (unaudited)  
(expressed in thousands)

	For the three months ended	
	June 30, 2004	June 30, 2003
<b>Revenue:</b>		
Tolls	\$ 86,588	\$ 81,426
Ferry service fees	26,649	26,396
Federal-Provincial Subsidy Agreement	6,086	5,994
Retail	16,650	15,468
Other income	4,442	4,368
	<u>140,415</u>	<u>133,652</u>
<b>Expenses:</b>		
Operations	67,512	64,619
Maintenance	21,235	18,144
Administration	16,959	16,334
Cost of retail goods sold	6,544	5,740
Amortization	10,858	10,876
	<u>123,108</u>	<u>115,713</u>
<b>Earnings from operations</b>	17,307	17,939
Gain on foreign exchange	88	79
Interest expense	(5,099)	(5,698)
Gain on disposal of capital assets	-	9
<b>Net earnings</b>	<u>12,296</u>	<u>12,329</u>
Retained earnings (deficit), beginning of period	21,947	(40,630)
Transfer from contributed surplus	-	40,630
<b>Retained earnings, end of period</b>	<u>\$ 34,243</u>	<u>\$ 12,329</u>

See accompanying notes to consolidated financial statements.

# BRITISH COLUMBIA FERRY SERVICES INC.

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

	For the three months ended	
	June 30, 2004	June 30, 2003
Cash provided by (used in):		
<b>Operations:</b>		
Net earnings	\$ 12,296	\$ 12,329
Items not involving cash:		
Amortization	10,858	10,876
Other non-cash charges	(764)	131
Change in non-cash operating working capital	(1,887)	13,136
	20,503	36,472
<b>Financing:</b>		
Proceeds from issuance of bonds	249,868	-
Proceeds from issuance of bridge financing	198,703	-
(Repayment of) proceeds from long-term debenture	(427,701)	427,701
Establishment of debt service reserve	(9,816)	-
Deferred financing costs incurred	(2,511)	-
Proceeds from issuance of share	-	1
Redemption of shares	-	(427,701)
Payment to the Province of British Columbia	-	(17,213)
	8,543	(17,212)
<b>Investing:</b>		
Proceeds from disposal of capital assets	-	13
Purchase of capital assets	(26,368)	(10,302)
	(26,368)	(10,289)
Increase in cash and cash equivalents	2,678	8,971
Cash and cash equivalents, beginning of period	17,939	14,557
Cash and cash equivalents, end of period	\$ 20,617	\$ 23,528

Supplemental cash flow information (note 4)

See accompanying notes to consolidated financial statements.

# BRITISH COLUMBIA FERRY SERVICES INC.

Notes to Consolidated Financial Statements (unaudited)  
(columnar dollars expressed in thousands)

For the three months ended June 30, 2004

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

The interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the fiscal year ended March 31, 2004. The disclosures provided below are incremental to those included with the annual consolidated financial statements. The interim consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto for the year ended March 31, 2004.

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

## 1. Significant accounting policies:

### (a) 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 90 days.

### (b) Hedging relationships:

Effective April 1, 2004, the Company adopted Canadian Institute of Chartered Accountants ("CICA") Accounting Guideline 13 ("AcG 13") "Hedging Relationships." AcG 13 addresses the identification, designation, documentation, and effectiveness of hedging transactions for the purpose of applying hedge accounting. It also establishes conditions for applying, and the discontinuance of, hedge accounting and hedge effectiveness testing requirements. Under the new guideline, the Company is required to document its hedging transactions and explicitly demonstrate that hedges are effective in order to continue hedge accounting for positions hedged with derivatives.

### (c) Asset retirement obligations:

Effective April 1, 2004, the Company adopted the CICA Handbook Section 3110, "Asset Retirement Obligations." The new standard requires recognition of a liability at its fair value for any legal obligation 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.

# BRITISH COLUMBIA FERRY SERVICES INC.

Notes to Consolidated Financial Statements (unaudited)  
(columnar dollars expressed in thousands)

For the three months ended June 30, 2004

## 2. Capital assets:

June 30, 2004	Cost	Accumulated amortization	Net book value
Ships owned	\$ 739,520	\$ 445,751	\$ 293,769
Ships under capital lease	50,377	31,655	18,722
Berths, buildings and equipment	73,183	49,793	23,390
Berths, buildings and equipment under capital lease	405,171	204,895	200,276
Land	1,107	-	1,107
Construction-in-progress	31,087	-	31,087
	<u>\$ 1,300,445</u>	<u>\$ 732,094</u>	<u>\$ 568,351</u>

March 31, 2004	Cost	Accumulated amortization	Net book value
Ships owned	\$ 708,087	\$ 440,203	\$ 267,884
Ships under capital lease	50,377	30,892	19,485
Berths, buildings and equipment	73,152	48,066	25,086
Berths, buildings and equipment under capital lease	404,397	202,104	202,293
Land	1,107	-	1,107
Construction-in-progress	35,619	-	35,619
	<u>\$ 1,272,739</u>	<u>\$ 721,265</u>	<u>\$ 551,474</u>

Included in ships under capital lease are the Queen of Surrey and the Queen of Oak Bay. It is anticipated that the title will pass, without additional payments, for the Queen of Surrey and the Queen of Oak Bay on January 1, 2006 and January 1, 2007 respectively.

In addition to the construction-in-progress referenced above, contractual commitments for capital assets under construction at June 30, 2004 totaled \$17.5 million (March 31, 2004 - \$28.4 million).

# BRITISH COLUMBIA FERRY SERVICES INC.

Notes to Consolidated Financial Statements (unaudited)  
(columnar dollars expressed in thousands)

For the three months ended June 30, 2004

### 3. Long-term debt:

	June 30 2004	March 31 2004
5.74% Senior Secured Bonds, Series 04-1, due May 2014 (a)	\$ 250,000	\$ -
Unamortized discount	(131)	-
	249,869	-
Non-revolving bridge term facility, due May 2006 (b)	200,000	-
Unamortized discount	(807)	-
	199,193	-
Debenture held by the Province of British Columbia	-	427,701
	\$ 449,062	\$ 427,701

During the period, the Company entered into a master trust indenture which establishes common security and a set of common covenants by the Company for the benefit of all of its 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 bonds 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 Series 04-1 bonds are redeemable in whole or in part at the option of the Company.

#### (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, currently undrawn; a three year revolving extendible facility in an amount up to \$77.5 million, currently undrawn; and a \$200 million two year non-revolving bridge term facility, fully drawn.

Amounts drawn under the credit facility are in the form of bankers' acceptances discounted at market discount rates plus specified stamping fees. In regard to the bridge term facility, the amount was drawn as a three month bankers' acceptance bearing a discount rate and stamping fee equivalent to an interest rate of 2.64%.

# BRITISH COLUMBIA FERRY SERVICES INC.

Notes to Consolidated Financial Statements (unaudited)  
(columnar dollars expressed in thousands)

For the three months ended June 30, 2004

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### 3. Long-term debt (continued):

(c) *Debt service reserve:*

The company is required to maintain a debt service reserve fund for the Series 04-1 bonds and all amounts drawn under the credit facility equal to not less than six months forecasted debt service, to be increased under certain conditions. The debt service reserve fund is currently invested in short-term investments.

### 4. Supplemental cash flow information:

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For the three months ended	June 30 2004	June 30 2003
Cash paid during the period for interest	\$ 3,495	\$ -
Non-cash transactions:		
Issuance of preferred shares	-	75,477
Disposal of terminals, net book value	-	230,232
Terminal structures capital lease, net prepaid	-	205,888
Terminal land operating lease, net prepaid	-	24,344

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### 5. Collective Agreements:

The collective agreement between the Company and the BC Ferry and Marine Workers' Union ("BCFMWU") expired on October 31, 2003.

On December 12, 2003, the Company and BCFMWU agreed to binding arbitration in regard to the British Columbia Ferry Services Inc. union employees. Binding arbitration is a dispute resolution process that determines the terms and conditions of the collective agreement. The decision of the Arbitrator is final and binding. It is unlikely there will be a new collective agreement prior to late August 2004.

Until the new collective agreement is reached, the Company is operating under the prior collective agreement. Additional liabilities, if any, arising from the new collective agreement cannot be reasonably estimated at this time.

During the three months ended June 30, 2004 the Company's subsidiary, Deas Pacific Marine Inc. has entered into a new four year collective agreement with BCFMWU.