

Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Six months ended September 30, 2004

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Balance Sheets
(expressed in thousands)

| | September 30, 2004 (unaudited) | March 31, 2004 |
|--------------------------------|-----------------------------------|-------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 69,201 | \$ 17,939 |
| Debt service reserve (note 4c) | 9,831 | - |
| Accounts receivable | 7,359 | 5,857 |
| Prepaid expenses | 9,117 | 5,717 |
| Inventories | 23,274 | 23,570 |
| | <u>118,782</u> | <u>53,083</u> |
| Capital assets (note 2) | 570,097 | 551,474 |
| Deferred financing costs | 4,381 | 1,190 |
| Deferred fuel costs (note 3) | 1,198 | - |
| Long-term land lease | 23,888 | 24,040 |
| | <u>\$ 718,346</u> | <u>\$ 629,787</u> |

Liabilities and Shareholders' Equity

| | | |
|--|-------------------|-------------------|
| Current liabilities: | | |
| Accounts payable and accrued liabilities | \$ 22,284 | \$ 37,262 |
| Interest payable on long-term debt | 4,993 | 61 |
| Accrued employee costs | 35,406 | 36,276 |
| Deferred revenue | 15,037 | 13,003 |
| Current portion of deferred employee obligations | 2,415 | 2,415 |
| | <u>80,135</u> | <u>89,017</u> |
| Deferred employee obligations | 15,723 | 15,644 |
| Long-term debt (note 4) | 449,762 | 427,701 |
| | <u>545,620</u> | <u>532,362</u> |
| Shareholders' equity: | | |
| Share capital | 75,478 | 75,478 |
| Retained earnings | 97,248 | 21,947 |
| | <u>172,726</u> | <u>97,425</u> |
| Subsequent events (note 6) | | |
| | <u>\$ 718,346</u> | <u>\$ 629,787</u> |

See accompanying notes to consolidated financial statements.

On behalf of the Board:

_____ Director

_____ Director

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Statements of Earnings and Retained Earnings (unaudited)

(expressed in thousands)

| | Three months ended | | Six months ended | |
|--|--------------------|------------|------------------|------------|
| | September 30 | | September 30 | |
| | 2004 | 2003 | 2004 | 2003 |
| Revenue: | | | | |
| Tolls | \$ 126,032 | \$ 119,766 | \$ 212,620 | \$ 201,192 |
| Ferry service fees | 30,743 | 30,593 | 57,392 | 56,990 |
| Federal-Provincial Subsidy Agreement | 6,086 | 5,994 | 12,172 | 11,988 |
| Retail | 24,577 | 23,224 | 41,227 | 38,692 |
| Other income | 6,935 | 7,098 | 11,377 | 11,465 |
| | 194,373 | 186,675 | 334,788 | 320,327 |
| Expenses: | | | | |
| Operations | 81,040 | 78,626 | 154,780 | 149,122 |
| Maintenance | 13,676 | 14,293 | 36,303 | 33,421 |
| Administration | 10,422 | 9,025 | 19,761 | 18,498 |
| Cost of retail goods sold | 9,348 | 8,240 | 15,892 | 13,980 |
| Amortization | 12,017 | 11,270 | 22,875 | 22,146 |
| | 126,503 | 121,454 | 249,611 | 237,167 |
| Earnings from operations | 67,870 | 65,221 | 85,177 | 83,160 |
| Gain (loss) on foreign exchange | (163) | (13) | (75) | 66 |
| Interest expense | (4,715) | (5,801) | (9,814) | (11,499) |
| Gain on disposal of capital assets | 13 | 900 | 13 | 909 |
| Net earnings | 63,005 | 60,307 | 75,301 | 72,636 |
| Retained earnings (deficit), beginning of period | 34,243 | 12,329 | 21,947 | (40,630) |
| Transfer from contributed surplus | - | - | - | 40,630 |
| Retained earnings, end of period | \$ 97,248 | \$ 72,636 | \$ 97,248 | \$ 72,636 |

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

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

| | Three months ended September 30 | | Six months ended September 30 | |
|---|------------------------------------|-----------|----------------------------------|-----------|
| | 2004 | 2003 | 2004 | 2003 |
| Cash provided by (used in): | | | | |
| Operations: | | | | |
| Net earnings | \$ 63,005 | \$ 60,307 | \$ 75,301 | \$ 72,636 |
| Items not involving cash: | | | | |
| Amortization | 12,017 | 11,270 | 22,875 | 22,146 |
| Other non-cash charges | (1,356) | (2,732) | (753) | (2,601) |
| Change in non-cash operating working capital | (13,845) | (23,947) | (17,099) | (10,811) |
| | 59,821 | 44,898 | 80,324 | 81,370 |
| Financing: | | | | |
| Proceeds from issuance of bonds | - | - | 249,868 | - |
| Proceeds from issuance of bridge financing | 1,077 | - | 199,780 | - |
| (Repayment of) proceeds from long-term debenture | - | - | (427,701) | 427,701 |
| Establishment of debt service reserve | (15) | - | (9,831) | - |
| Deferred financing costs incurred | (793) | - | (3,304) | - |
| Proceeds from issuance of share | - | - | - | 1 |
| Redemption of shares | - | - | - | (427,701) |
| Payment to the Province of British Columbia | - | - | - | (17,213) |
| | 269 | - | 8,812 | (17,212) |
| Investing: | | | | |
| Proceeds from disposal of capital assets | 13 | 431 | 13 | 444 |
| Purchase of capital assets | (11,519) | (8,511) | (37,887) | (18,813) |
| | (11,506) | (8,080) | (37,874) | (18,369) |
| Increase in cash and cash equivalents | 48,584 | 36,818 | 51,262 | 45,789 |
| Cash and cash equivalents, beginning of period | 20,617 | 23,528 | 17,939 | 14,557 |
| Cash and cash equivalents, end of period | 69,201 | \$ 60,346 | \$ 69,201 | \$ 60,346 |

Supplemental cash flow information (note 5)

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 six months ended September 30, 2004

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) Regulation:

The Company is regulated by the British Columbia Ferry Commissioner (the "Commissioner") to ensure that tolls are fair and reasonable and to monitor service levels. Under the terms of the *Coastal Ferry Act* (the "Act"), the tolls 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 will establish the price caps to apply for each subsequent term.

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.

(b) 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. The debt service reserve is currently invested in short-term investments.

BRITISH COLUMBIA FERRY SERVICES INC.

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

For the six months ended September 30, 2004

1. Significant accounting policies (continued):

(c) 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 discontinuing, 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.

(d) 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 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.

(e) Comparative figures:

Certain comparative figures have been reclassified to conform to the presentation adopted for the current period.

2. Capital assets:

| September 30, 2004 | Cost | Accumulated amortization | Net book value |
|--|--------------|-----------------------------|-------------------|
| Ships owned | \$ 749,853 | \$ 452,525 | \$ 297,328 |
| Ships under capital lease | 50,377 | 32,018 | 18,359 |
| Berths, buildings and equipment | 77,784 | 51,738 | 26,046 |
| Berths, buildings and equipment under capital lease | 413,585 | 205,159 | 208,426 |
| Land | 1,107 | - | 1,107 |
| Construction-in-progress | 18,831 | - | 18,831 |
| | \$ 1,311,537 | \$ 741,440 | \$ 570,097 |

BRITISH COLUMBIA FERRY SERVICES INC.

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

For the six months ended September 30, 2004

2. Capital assets (continued):

| 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 at September 30, 2004 for capital assets to be constructed totaled \$359.1 million (March 31, 2004 - \$28.4 million). Included in the contractual commitments as at September 30, 2004 is \$327.0 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.

3. Deferred fuel costs:

The Commissioner has authorized the Company to maintain deferral accounts to mitigate the effect on its earnings of unpredictable and uncontrollable price volatility in world fuel oil markets. The Commissioner has established set prices for each of the years until March 31, 2008. Differences between the set prices and the actual prices of fuel oil are recorded in the deferral accounts. These deferral accounts will be maintained until March 31, 2008, at which time the Commissioner will decide on their continuation.

Any balance in the deferral accounts will be taken into account by the Commissioner in setting future price cap increases. It is expected that all deferred fuel costs will be recovered through tolls as approved by the Commissioner.

BRITISH COLUMBIA FERRY SERVICES INC.

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

For the six months ended September 30, 2004

4. Long-term debt:

| | September 30 2004 | March 31 2004 |
|---|----------------------|------------------|
| 5.74% Senior Secured Bonds, Series 04-1, due May 2014 (a) | \$ 250,000 | \$ - |
| Unamortized discount | (128) | - |
| | 249,872 | - |
| Non-revolving bridge term facility, due May 2006 (b) | 200,000 | - |
| Unamortized discount | (110) | - |
| | 199,890 | - |
| Debenture held by the Province of British Columbia | - | 427,701 |
| | \$ 449,762 | \$ 427,701 |

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 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. Interest on the Series 04-1 bonds is payable semi-annually on May 27 and November 27.

(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 two week bankers' acceptance bearing a discount rate and stamping fee equivalent to an interest rate of 2.87%.

BRITISH COLUMBIA FERRY SERVICES INC.

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

For the six months ended September 30, 2004

4. Long-term debt (continued):

(c) Debt service reserve:

The company is required to maintain a debt service reserve 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.

5. Supplemental cash flow information:

| | Three months ended September 30 | | Six months ended September 30 | |
|--|------------------------------------|-----------|----------------------------------|-----------|
| | 2004 | 2003 | 2004 | 2003 |
| Cash paid during the period for interest | \$ 48 | \$ 11,305 | \$ 3,543 | \$ 11,305 |
| 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 |

6. Subsequent events:

(a) Public Offering:

On October 13, 2004 the Company completed a public offering of \$250 million, 6.25% Senior Secured Bonds, Series 04-4, due October 13, 2034. The net proceeds from the sale of the bonds will be used primarily to repay the bridge term facility and for general corporate purposes. Interest on the Series 04-4 Bonds will be payable semi-annually on April 13 and October 13 of each year until maturity, commencing April 13, 2005.

(b) Collective Agreement:

On October 15, 2004 the arbitrator issued an interim award in regard to the collective agreement negotiations between the Company and the BC Ferry and Marine Workers' Union. There are no significant additional liabilities arising from the interim award.