

Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Nine months ended December 31, 2004

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Balance Sheets
(expressed in thousands)

	December 31, 2004 (unaudited)	March 31, 2004
Assets		
Current assets:		
Cash and cash equivalents	\$ 79,696	\$ 17,939
Debt service reserve (note 5c)	15,054	-
Accounts receivable	9,460	5,857
Prepaid expenses	5,666	5,717
Inventories	23,672	23,570
	<u>133,548</u>	<u>53,083</u>
Capital assets (note 2)	592,468	551,474
Deferred financing costs	8,065	1,190
Deferred fuel costs (note 3)	4,838	-
Long-term land lease (note 4)	27,123	24,040
	<u>\$ 766,042</u>	<u>\$ 629,787</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 26,562	\$ 37,262
Interest payable on long-term debt	4,860	61
Accrued employee costs	37,560	36,276
Deferred revenue	11,329	13,003
Current portion of deferred employee obligations	2,415	2,415
	<u>82,726</u>	<u>89,017</u>
Deferred employee obligations	15,251	15,644
Long-term debt (note 5)	499,575	427,701
	<u>597,552</u>	<u>532,362</u>
Shareholders' equity:		
Share capital	75,478	75,478
Retained earnings	93,012	21,947
	<u>168,490</u>	<u>97,425</u>
Commitments (note 2)		
	<u>\$ 766,042</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		Nine months ended	
	December 31		December 31	
	2004	2003	2004	2003
Revenue:				
Tolls	\$ 72,859	\$ 63,074	\$ 285,479	\$ 264,266
Ferry service fees	24,942	24,749	82,334	81,739
Federal-Provincial Subsidy Agreement	6,085	5,994	18,257	17,982
Retail	14,609	12,775	55,836	51,467
Other income	4,233	3,651	15,610	15,116
	122,728	110,243	457,516	430,570
Expenses:				
Operations	68,371	64,056	223,151	213,178
Maintenance	23,557	21,128	59,860	54,550
Administration	10,231	9,859	29,992	28,356
Cost of retail goods sold	5,802	4,869	21,694	18,849
Amortization	11,185	11,121	34,060	33,267
	119,146	111,033	368,757	348,200
Earnings (loss) from operations	3,582	(790)	88,759	82,370
Gain (loss) on foreign exchange	(194)	22	(269)	88
Interest expense	(7,249)	(5,583)	(17,063)	(17,082)
Loss on disposal of capital assets	(375)	(1,811)	(362)	(902)
Net earnings (loss)	(4,236)	(8,162)	71,065	64,474
Retained earnings (deficit), beginning of period	97,248	72,636	21,947	(40,630)
Transfer from contributed surplus	-	-	-	40,630
Retained earnings, end of period	\$ 93,012	\$ 64,474	\$ 93,012	\$ 64,474

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

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

	Three months ended		Nine months ended	
	December 31		December 31	
	2004	2003	2004	2003
Cash provided by (used in):				
Operations:				
Net earnings (loss)	\$ (4,236)	\$ (8,162)	\$ 71,065	\$ 64,474
Items not involving cash:				
Amortization	11,185	11,121	34,060	33,267
Other non-cash charges	(3,545)	1,488	(4,298)	(1,113)
Change in non-cash operating working capital	6,192	24,363	(10,907)	(3,400)
	9,596	28,810	89,920	93,228
Financing:				
Proceeds from issuance of bonds	249,698	-	499,566	-
Proceeds from issuance of bridge financing	-	-	199,780	-
Repayment of bridge financing	(200,000)	-	(200,000)	-
(Repayment of) proceeds from long-term debenture	-	-	(427,701)	427,701
Establishment of debt service reserve	(5,223)	-	(15,054)	-
Deferred financing costs incurred	(3,684)	-	(6,988)	-
Proceeds from issuance of share	-	-	-	1
Redemption of shares	-	-	-	(427,701)
Payment to the Province of British Columbia	-	-	-	(17,213)
	40,791	-	49,603	(17,212)
Investing:				
Proceeds from disposal of capital assets	17	45	30	17,441
Purchase of capital assets	(38,740)	(12,753)	(74,754)	(31,566)
Increase in lands under long-term lease	(1,169)	-	(3,042)	-
	(39,892)	(12,708)	(77,766)	(14,125)
Increase in cash and cash equivalents	10,495	16,102	61,757	61,891
Cash and cash equivalents, beginning of period	69,201	60,346	17,939	14,557
Cash and cash equivalents, end of period	\$ 79,696	\$ 76,448	\$ 79,696	\$ 76,448

Supplemental cash flow information (note 6)

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 nine months ended December 31, 2004

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

The interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the fiscal year ended March 31, 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 winter months 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 nine months ended December 31, 2004

1. Significant accounting policies (continued):

(c) 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.

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 deferred and recognized in income in the period in which the underlying hedged transaction is recognized.

(d) 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.

(e) Comparative figures:

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

BRITISH COLUMBIA FERRY SERVICES INC.

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

For the nine months ended December 31, 2004

2. Capital assets:

December 31, 2004	Cost	Accumulated amortization	Net book value
Ships owned	\$ 749,620	\$ 458,871	\$ 290,749
Ships under capital lease	50,377	32,374	18,003
Berths, buildings and equipment	78,086	53,245	24,841
Berths, buildings and equipment under capital lease	413,617	207,772	205,845
Land	1,107	-	1,107
Construction-in-progress	51,923	-	51,923
	\$ 1,344,730	\$ 752,262	\$ 592,468

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
	\$ 1,272,739	\$ 721,265	\$ 551,474

For the three months ended December 31, 2004 capitalized financing costs during construction amounted to \$0.3 million (three months ended December 31, 2003 - \$0.1 million). For the nine months ended December 31, 2004 capitalized financing costs during construction amounted to \$1.2 million (nine months ended December 31, 2003 - \$0.6 million).

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 December 31, 2004 for capital assets to be constructed totaled \$365.9 million (March 31, 2004 - \$28.4 million). Included in the contractual commitments as at December 31, 2004 is \$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.

BRITISH COLUMBIA FERRY SERVICES INC.

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

For the nine months ended December 31, 2004

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.

4. 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.

During the current year, 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 December 31, 2004, the Horseshoe Bay improvements were complete and the Swartz Bay improvements were in progress. Long-term land lease has been increased by \$3.0 million and by \$0.3 million in regard to the Horseshoe Bay and Swartz Bay improvements, respectively. The increases to long-term land lease will be amortized over the remaining lease period, commencing the month following completion of improvements.

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For the nine months ended December 31, 2004

5. Long-term debt:

	December 31 2004	March 31 2004
5.74% Senior Secured Bonds, Series 04-1, due May 2014 (a)	\$ 250,000	\$ -
Unamortized discount	(125)	-
	249,875	-
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (a)	\$ 250,000	\$ -
Unamortized discount	(300)	-
	249,700	-
Debenture held by the Province of British Columbia	-	427,701
	\$ 499,575	\$ 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 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, currently undrawn; and a three year revolving extendible facility in an amount up to \$77.5 million, currently undrawn.

During the first quarter, the company fully drew upon a \$200 million two year non-revolving bridge term facility. The amount has been fully repaid during the third quarter, and is no longer available under the credit facility.

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For the nine months ended December 31, 2004

5. Long-term debt (continued):

(c) Debt service reserve:

The company is required to maintain a debt service reserve for the Series 04-1 and 04-4 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.

6. Supplemental cash flow information:

	Three months ended		Nine months ended	
	December 31		December 31	
	2004	2003	2004	2003
Cash paid during the period for interest	\$ 7,176	\$ -	\$ 10,719	\$ 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
