Management's Discussion & Analysis
of Financial Condition and Results of Operations
For the three months ended June 30, 2005
Dated August 4, 2005

The following is our discussion and analysis of the financial condition and results of operations for British Columbia Ferry Services Inc. as of August 4, 2005. This should be read in conjunction with our unaudited interim consolidated financial statements and related notes for the three month periods ended June 30, 2005 and 2004, and our annual audited consolidated financial statements and related notes together with our fiscal 2005 Management's Discussion and Analysis. These documents are available on the SEDAR web site 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 35 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 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. During the three months ended June 30, 2005 (the first quarter of fiscal 2006), we provided over 42,000 sailings, carrying 5.5 million passengers and 2.2 million vehicles. Vehicle traffic was 0.9% higher than the three months ended June 30, 2004 (the first quarter of fiscal 2005) while passenger traffic was 1.2% lower than the first quarter of the fiscal 2005.

Significant events during or subsequent to our first quarter of fiscal 2006:

- The *Queen of Oak Bay* returned to service on June 13, 2005, following a mid life upgrade and passenger improvement project. This extensive, six-month upgrade has prepared the vessel for another 20 years of service. See "Investing in our Capital Assets" below for more detail.
- The new Tsawwassen Quay retail facility opened at our largest terminal on June 21, 2005. The 16,000 square foot building is designed to enhance the experience of our customers with an expanded selection of food and retail services. See "Investing in our Capital Assets" below for more detail.
- On June 21, 2005, we launched our new stored value card on our major routes, replacing paper assured loading tickets. See "Investing in our Capital Assets" below for more detail.
- On June 30, 2005, the *Queen of Oak Bay*, which sails between Departure Bay and Horseshoe Bay, lost power and ran aground while coming into Horseshoe Bay. The vessel drifted into an adjacent marina, damaging a number of boats. No injuries were sustained. See "Financial Overview – Expenses" for a complete description of this incident.

- As a result of continuing high fuel costs, on June 13, 2005, we filed an application with our regulator, the BC Ferry Commissioner, for extraordinary price cap increases. On July 24, 2005, the Commissioner approved price cap increases of 4 percent for major routes and 6 percent for most others. These increases allowed for fuel surcharges which took effect July 25, 2005. As part of the Order, the Commissioner also increased the set prices for fuel to be charged to operations by 5% effective July 24th. The set prices were originally established in a previous ruling. See "Financial Overview – Expenses" for more details.
- On July 20, 2005, the Commissioner issued a declaration that a new intermediate class ferry to replace the 45 year-old *Queen of Tsawwassen* is reasonably required. We anticipate that a contract will be negotiated in the summer of 2005, enabling the delivery of a new vessel by December, 2007.
- On August 2, 2005, we issued a Request for Expression of Interest (RFEOI) to identify parties interested in providing ferry service on our northern routes. While we will maintain responsibility for the long-term delivery of northern ferry services, under the *Coastal Ferry Act* we are required to test the market to determine if another operator, under contract to us, can provide a more cost effective service offering. The RFEOI is the first stage of a formal process which is expected to take 18 months and will be overseen by an independent fairness auditor.

Financial Overview

This section provides an overview of our financial performance for the first quarter of fiscal 2006.

Our consolidated net earnings grew $2.1 million or 17.5% from the first quarter of the previous fiscal year.

	Three Months Ended June 30			
($millions)	2005	2004	Dollar Variance	% Variance
Total revenue	145.2	140.4	4.8	3.4%
Expenses	(124.1)	(123.1)	(1.0)	-0.8%
Earnings from operations	21.1	17.3	3.8	22.1%
Interest and other	(6.7)	(5.0)	(1.7)	-33.5%
Net Earnings	14.4	12.3	2.1	17.5%

Revenue

Our total revenues for the first quarter of fiscal 2006 have increased over the first quarter of fiscal 2005, as shown in the table below.

	Three Months Ended June 30			
Revenue ($Millions)	2005	2004	Dollar Variance	% Variance
Tariff – vehicles	56.9	54.5	2.4	4.5%
Tariff – passengers	32.8	32.1	0.7	2.1%
Ferry services fees	27.0	26.6	0.4	1.3%
Federal-Provincial subsidy	6.2	6.1	0.1	2.3%
Retail	17.3	16.7	0.6	3.9%
Other income	5.0	4.4	0.6	12.3%
Total Revenue	145.2	140.4	4.8	3.4%
Traffic Volume				
Vehicles	2,193,700	2,174,365	19,335	0.9%
Passengers	5,517,771	5,585,844	(68,073)	-1.2%

The improvement in vehicle tariff revenue in our first quarter of fiscal 2006 compared to the first quarter of fiscal 2005 is a result of increased traffic volumes and higher tariff rates. Vehicle traffic volumes increased 0.9% overall. The largest increase of 4.7% was experienced on our Northern routes which connect Vancouver Island to Prince Rupert and the Queen Charlotte Islands. The annual average tariff rate increase was 2.8% on our three major routes connecting Vancouver Island to the mainland and 4.4% on the remaining routes, as permitted by the *Coastal Ferry Act*.

Total passenger traffic in our first quarter of fiscal 2006 decreased by 1.2% from the first quarter of fiscal 2005. While the Northern routes had additional trips and experienced an increase of 6.8%, our other routes encountered reduced passenger traffic due to the Easter holiday falling in the last quarter of fiscal 2005 rather than the first quarter of fiscal 2006. In addition, it is likely that reduced levels of tourism due to a stronger Canadian dollar and high gasoline prices contributed to this decline. Total passenger tariff revenue increased by 2.1% as a result of tariff rate increases described above.

Ferry service fees were higher in our first quarter of fiscal 2006 than the first quarter of fiscal 2005 due to an increase of $0.4 million (10.0%) 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.

The Federal-Provincial subsidy, which we receive from the Province of British Columbia pursuant to the Coastal Ferry Services Contract, is adjusted each year in accordance with changes in the Vancouver Consumer Price Index.

Retail revenue includes food and other retail merchandise sales. Revenue from food sales grew 2.7% in our first quarter of fiscal 2006 over the first quarter of fiscal 2005, the increase reflecting a March, 2005 price increase of approximately 2.5% and higher spending per passenger. Retail merchandise sales increased 7.4%. This increase was mainly attributable to positive customer response to our gift shop expansions on the *Queen of Cowichan* and the *Spirit of British Columbia.*

The increase in other income reflects increased usage of our reservation system and higher reservation fees. Reservation revenues were $0.5 million higher in our first quarter of fiscal 2006 compared to the first quarter of fiscal 2005, with $0.4 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 market place commissions resulting from new retail facilities at Tsawwassen terminal being under construction and not opening until June 21, 2005. See "Investing in our Capital Assets" below for more detail on the Tsawwassen Quay.

Expenses

Expenses for the first quarter of fiscal 2006 have increased over the first quarter of fiscal 2005, as shown in the table below.

	Three Months Ended June 30			
Expenses ($millions)	2005	2004	Dollar Variance	% Variance
Operations	75.1	73.9	(1.2)	-1.6%
Maintenance	18.1	22.5	4.4	19.4%
Administration	12.0	9.3	(2.7)	-27.9%
Cost of retail goods sold	6.8	6.5	(0.3)	-4.6%
Amortization	12.1	10.9	(1.2)	-11.3%
	124.1	123.1	(1.0)	-0.8%
Gain on foreign exchange	(0.1)	(0.1)	-	-
Interest expense	6.8	5.1	(1.7)	-32.5%
	6.7	5.0	(1.7)	-33.5%
Total Expense	130.8	128.1	(2.7)	-2.0%

Queen of Oak Bay Incident

On June 30, 2005, at approximately 10:10 a.m., the *Queen of Oak Bay*, which sails between Departure Bay and Horseshoe Bay, ran aground while coming into Horseshoe Bay. After losing power, the vessel drifted into an adjacent marina, damaging a number of boats. No injuries were sustained as a result of the incident.

Representatives from Transport Canada, the Transportation Safety Board, Lloyd's Register of Shipping and our engineers have undertaken investigations to determine the factors that contributed to the incident.

Our investigation concluded that a mechanical failure of an engine speed control device (governor) on one engine led to the loss of power.

Damage to the *Queen of Oak Bay* was minimal. Repairs consisted of reinstalling, securing and testing the governor, minor steel work to one fender, paint repair and replacing one propeller blade. The propulsion and control systems of the vessel were undamaged and have been tested. No defects were found in the engine, gearbox, clutch or propeller systems. Transport Canada reissued an operating certificate and the *Queen of Oak Bay* resumed regularly scheduled service on Friday, July 8, 2005.

A total of 28 boats moored at the adjacent marina were damaged or destroyed as a result of the incident. We have been working with boat owners on an individual basis since the incident so that claims would be processed in an expeditious manner. As of August 4, 2005, we have settled or virtually settled (documents awaiting signature) with 24 of these boat owners.

Total costs of this incident are estimated to be approximately $3 million of which a significant portion is expected to be recovered from third parties, including insurers.

Comparison of Expenses
The total increase in operations expenses from the first quarter of fiscal 2005 to the first quarter of fiscal 2006 was $1.2 million. The most significant items were: an increase of $1.1 million due to property taxes being recorded at actual paid amounts in the first quarter of fiscal 2006 while the first quarter of fiscal 2005 reflected an expectation of a reduction in property taxes related to an appeal of assessed values, which is continuing; a provision for net costs arising from the *Queen of Oak Bay* incident of $1.9 million; partially offset by a decrease of $1.0 million in advertising mainly from the timing of contracts and a $0.6 million reduction in vessel operating costs mainly due to the 2005 Easter holiday falling in the last quarter of fiscal 2005 rather than the first quarter of fiscal 2006.

Maintenance expenses which include expenditures for vessel refit and maintenance as well as terminal maintenance activities were $4.4 million lower in our first quarter of fiscal 2006 than the first quarter of fiscal 2005. This was due to a planned reduction in vessel refits of $0.7 million with the balance being changes in scope and scheduling of vessel refits and maintenance.

Administration expenses increased $2.7 million in the first quarter of fiscal 2006 over the first quarter of fiscal 2005. The more significant items contributing to this growth include a planned increase in corporate information technology support of $1.1 million resulting from the many new initiatives and upgrades in our computer systems; $0.9 increase in timing of employee wages and benefits; and $0.3 million for the implementation of the Internal Control Certification initiative. This latter initiative arises from changes in securities legislation which require CEO and CFO certification of internal controls over financial reporting.

The increased cost of retail goods sold in the first quarter of fiscal 2006 over the first quarter of fiscal 2005 reflects the higher level of retail sales and an increase in food and beverage product costs. The expansion of our vessel gift shops with increased lines of merchandise has been very successful.

Amortization increased a total of $1.2 million in the first quarter of fiscal 2006 from the first quarter of fiscal 2005. This reflects the additional assets that came into service during the past 12 months, the most significant being vessel upgrades and modifications.

Interest expenses in the first quarter of fiscal 2006 increased a total of $1.7 million over the first quarter of fiscal 2005, reflecting the overall increase in our level of debt and higher average interest rates due to the longer term nature of our debt in place this quarter.

Fuel Deferral and Related Surcharge
On June 13, 2005, we filed an application with the BC Ferry Commissioner under Section 42 of the *Coastal Ferry Act* for extraordinary price cap increases. We have experienced significantly higher prices for fuel oil than expected. Our annual cost of fuel is projected to be 45% higher than it was two years ago, exceeding $72 million this fiscal year. As a result of the higher costs, the deferral account balances would climb higher 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 percent for major routes connecting Vancouver Island to the mainland and 6 percent on most other routes. The price cap increases allowed for fuel surcharges which took effect on Monday, July 25, 2005 and applies to all fares. Proceeds from the fuel surcharges will be credited against balances in the deferral accounts.

As part of the Order, the Commissioner also increased the set prices established in a previous ruling by 5% effective July 24th. This change will result in a 5% increase in fuel costs charged to expense for the balance of the current fiscal year and for the two succeeding years. This will reduce the projected amount added to the deferral account balances by an equal amount. The Commissioner's Order can be viewed on the Commissioner's website at www.bcferrycommission.com

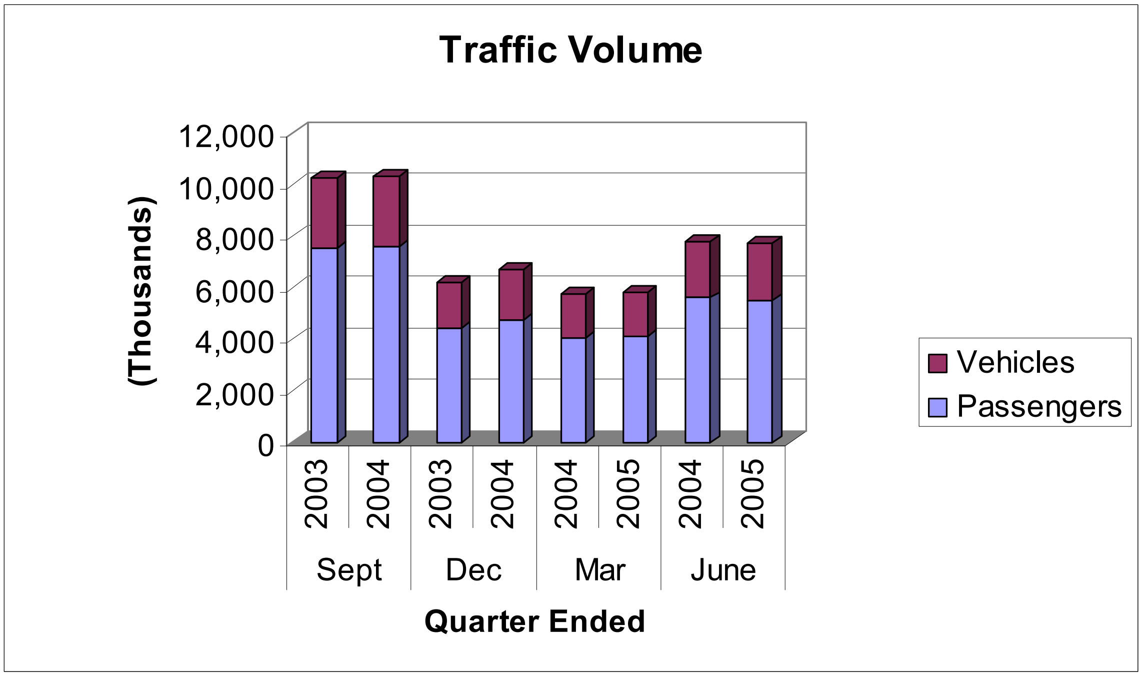
We have established a fuel hedging program and are taking reasonable fuel saving measures, including a focus on engineering efficiencies during vessel refits, and installing more fuel efficient diesel engines where appropriate.

Quarterly Financial Highlights

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

$Millions	Quarter Ended							
	Jun 05	Mar 05	Dec 04	Sep 04	Jun 04	Mar 04	Dec 03	Sep 03
Total revenue	145.2	107.0	122.7	194.4	140.4	103.1	110.2	186.7
Earnings (loss) from operations	21.1	(23.8)	3.6	67.9	17.3	(30.3)	(0.8)	65.2
Net earnings (loss)	14.4	(31.3)	(4.2)	63.0	12.3	(36.4)	(8.2)	60.3

Our net earnings in each of the latest four quarters were higher than the corresponding quarter from the previous fiscal year. The most significant contributing factor to the trend was higher tariff revenue as a result of increases in both traffic and tariff rates. As mentioned above, we increased tariff rates an average of 2.8% on the three major routes and 4.4% on the remaining routes. These increases took effect in November, 2004. In addition, with the exception of the quarter ended June, 2005, traffic increased over the previous year in every quarter, ranging from 0.4% in the quarter ended September, 2004 to 8.6% in the quarter ended December, 2004, with an average four quarter increase of 2.1%.



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.

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. Our liquidity and capacity to access capital markets to maintain operations and fund growth remains substantially unchanged since March 31, 2005.

Sources & Uses of Cash

Changes in cash and cash equivalents for the first quarter of fiscal 2006 and the first quarter of fiscal 2005 are summarized in the table below.

($millions)	Three Months Ended June 30 2005	2004
Cash (used in) provided by operating activities	(7.0)	20.5
Cash provided by financing activities	-	8.6
Cash used in investing activities	(17.9)	(26.4)
Total (decrease) increase in cash	(24.9)	2.7

Our liquidity needs can be 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.

Cash used in operating activities in the first quarter of fiscal 2006 was $7.0 million as summarized below.

($millions)	Three Months Ended June 30 2005	2004
Net income for the period	14.4	12.3
Items not involving cash:		
Amortization	12.1	10.9
Other non-cash charges	-	0.6
Fuel costs deferred	(5.2)	-
Change in operating working capital	(28.3)	(3.3)
Total (decrease) increase in cash	(7.0)	20.5

Working capital requirements increased by $28.3 million in the first quarter of fiscal 2006, primarily due to a reduction in trade payables and accrued liabilities of $19.8 million reflecting the increased spending in the last quarter of fiscal 2005 which was settled in the first quarter of fiscal 2006; a net decrease in interest payable of $7.5 million reflecting semi-annual payments made in April and May, 2005 on bond issuances; an increase in prepaid expenses of $3.5 million mainly due to property taxes for the period July through December, 2005; partially offset by a $4.4 million increase in deferred revenue consisting of unearned reservation and commuter ticket revenue for the upcoming summer months.

There was no cash provided by or used in financing activities during the first quarter of fiscal 2006.

Cash used in investing activities was $17.9 million in the first quarter of fiscal 2006. This was due to capital expenditures of $17.0 million and an increase in lands under long-term lease of $0.9 million. The significant capital transactions this year are described below in “Investing in our Capital Assets”.

Investing in our Capital Assets

Capital expenditures in the first quarter of fiscal 2006 totalled $24.9 million, funded $17.0 million through cash and $7.9 million through non-cash working capital. This level of expenditure reflects significant investments in our fleet, terminals and information systems to increase customer service and operating efficiency. Expenditures included:

- Vessel upgrades and modifications including $12.7 million of a $35.9 million mid-life upgrade on the *Queen of Oak Bay;*
- $3.2 million in terminal and building upgrades, including $1.7 million upgrade of passenger facilities at Horseshoe Bay terminal and $1.3 million towards retail redevelopment at Tsawwassen terminal;
- $3.5 million in marine structures, including $2.8 million at Tsawwassen terminal;
- $3.6 million in software development which will enhance customer service improvements in areas such as reservations and retail and food services, as well as operational efficiencies in crew scheduling

Major Vessel Upgrades

The *Queen of Oak Bay*, which provides service on our Nanaimo-Horseshoe Bay route, returned to full service June 13, 2005, following an extensive mid-life upgrade. The total project cost was over $35 million. The 23 year-old vessel underwent significant upgrades to prepare it for another 20 years of service. The upgrades included improved and expanded passenger amenities, as well as safety, structural and mechanical improvements. The *Queen of Oak Bay* is the third of five "C" Class vessels identified for a mid-life upgrade. The remaining vessels will be completed over the next two years as part of a major program to renew our fleet and terminals.

Tsawwassen Quay

On June 21, 2005, the new 16,000 square foot retail building opened at Tsawwassen, our largest terminal. This new facility offers 18 food, beverage, service and retail outlets. In addition, there are new washroom facilities, bank machines, pay telephones, 7 indoor mobile retail kiosks and 4 outdoor kiosks featuring seasonal crafts and gifts. The Tsawwassen terminal, on average, serves over 4 million passengers each year. The facility is managed by Lonsdale Quay Market Corp. under a ten-year lease agreement. This partnership is an example of the long-term business strategies we seek to develop.

Tsawwassen Terminal Marine Structures

In the first quarter of fiscal year 2006, we completed $2.8 million of a total budget of $17.4 million for betterments at our Tsawwassen Terminal. This project includes replacing marine and vehicle ramp structures, constructing a new foot passenger waiting lounge, tower and access walkway as well as upgrading the electrical service. The project is expected to be completed in September 2005.

Information Technology

On June 21, 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. Our Coast Card introduces on-line internet 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. Assured loading tickets are the first product to be offered on the card. In the future, pre-paid tickets and other services will be available on the cards.

Risk Management

Understanding and managing risk are important parts of our business. A discussion of enterprise wide risk management can be found on pages 13 through 17 of our fiscal 2005 annual Management's Discussion and Analysis. Our risk profile is substantially unchanged during the first three months of fiscal 2006. The following contains a brief update.

Safety and Security

The safety of the public, our employees and the protection of the environment are our highest priorities. We treat all security issues seriously and continue to meet or exceed all legislative requirements respecting the security of our vessels and terminals. We are working closely with Transport Canada under the auspices of the Canadian Ferry Operators Association in the development of marine security policies related to domestic ferry operations. 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.

There is a heightened security concern in the transportation industry resulting from the recent bombings in England. We continue to review and enhance our security planning to ensure that security measures are proactive and responsive.

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.

There have been no changes to the accounting policies as set forth in our fiscal 2005 annual Management's Discussion and Analysis. For more information on significant accounting policies please refer to note 1 of our March 31, 2005 financial statements.

Certain of our 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.

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 BC Ferries' 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, seismic 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.