Management's Discussion and Analysis
of Financial Condition and Results of Operations
For the six months ended September 30, 2005
Dated November 2, 2005

The following is our discussion and analysis of the financial condition and results of operations for British Columbia Ferry Services Inc. as of November 2, 2005. This should be read in conjunction with our unaudited interim consolidated financial statements and related notes for the three and six-month periods ended September 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 a wide range of ferry and ancillary 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 B.C.

During the three months ended September 30, 2005, we provided over 49,000 sailings, carrying 7.5 million passengers and 2.7 million vehicles. Vehicle traffic was 0.4% higher, while passenger traffic was 0.5% lower than the three months ended September 30, 2004. These traffic levels are lower than expected, which we believe is primarily due to reduced levels of tourism.

Significant events during or subsequent to the three months ended September 30, 2005, include the following:

- 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. On September 20, 2005, we signed a letter of intent with Vancouver Shipyards of the Washington Marine Group regarding construction of a new 125-car ferry. A final agreement with Vancouver Shipyards is subject to the successful conclusion of contract negotiations and satisfaction of a number of conditions, including full federal government support under the Structured Financing Facility Program. Delivery of a new vessel is expected by December 2007.
- We maintain deferred fuel cost accounts, as ordered by the British Columbia Ferries Commissioner in September, 2004, to mitigate the effect on our earnings of unpredictable and uncontrollable price volatility in world fuel oil markets. Differences between the set unit prices established in this order and actual unit prices of fuel oil (net of hedge gains and losses) are charged to these deferred fuel cost accounts. On July 24, 2005, the Commissioner approved price cap increases of 4% for major routes and 6% for most others. These increases allowed for fuel surcharges that took effect July 25, 2005. The fuel costs recovered through the surcharge collections are applied against the deferred fuel

cost accounts. As part of his Order, the Commissioner also increased the set prices for fuel to be charged to operations by 5% effective July 24. As a result of continuing high fuel costs, we are considering applying to the Commissioner for additional price cap increases to allow for further fuel surcharges. See "Financial Overview—Expenses" for more details.

- On August 30, 2005, we acquired a 26-car ferry, the *MV John Atlantic Burr*, from the State of Utah. Although this vessel will need substantial investment to meet both our internal and Transport Canada's requirements, it will be available for relief service on minor routes next summer. See "Investing in Our Capital Assets" for more details.
- On September 17, 2005, the *Queen of Nanaimo* was transferred to dry dock for a planned $15.0 million refurbishment expected to be completed by the end of the year. See "Investing in Our Capital Assets" for more detail.
- By September 30, 2005, we received two expressions of interest in response to a request we issued to identify parties interested in providing ferry service on our northern routes. On October 21, 2005 we also issued a request for expressions of interest for the operation of our Brentwood Bay to Mill Bay route on Vancouver Island. While we will maintain responsibility for the long-term delivery of 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.
- On October 13, 2005, we entered into loan agreements for up to $180 million with the German Export Bank, KfW to finance the purchase of two "Super C-class" vessels. The funds will be released upon the conditional acceptance of the vessels. See "Investing in Our Capital Assets" for more detail.
- On November 1, 2005, (October 1, 2005 on the Northern routes) our fares increased an average of 2.8% on the three major routes connecting Vancouver Island to the Lower Mainland and 4.4% on the remaining routes. This annual increase is permitted in the *Coastal Ferry Act.*

Financial Overview

This section provides an overview of our financial performance for the three months ended September 30, 2005 compared to the three months ended September 30, 2004 as well as the six months ended September 30, 2005 (year-to-date) compared to the six months ended September 30, 2004.

Our consolidated net earnings for the three months ended September 30, 2005 were $1.8 million or 2.9% lower than the net earnings for the three months ended September 30, 2004 ($0.3 million higher or 0.4% year-to-date).

	Three Months Ended September 30				Six Months Ended September 30			
($ millions)	2005	2004	Variance	%	2005	2004	Variance	%
Total revenue	198.3	194.4	3.9	2.0%	343.4	334.8	8.6	2.6%
Expenses	(131.0)	(126.5)	(4.5)	3.6%	(255.0)	(249.6)	(5.4)	2.2%
Earnings from operations	67.3	67.9	(0.6)	-0.9%	88.4	85.2	3.2	3.8%
Interest and other	(6.1)	(4.9)	(1.2)	24.5%	(12.8)	(9.9)	(2.9)	29.3%
Net earnings	61.2	63.0	(1.8)	-2.9%	75.6	75.3	0.3	0.4%

Revenue

Our total revenues for the three months ended September 30, 2005 have increased over the three months ended September 30, 2004 as well as year-to-date, as shown in the table below.

	Three Months Ended September 30				Six Months Ended September 30			
			Increase(Decrease)				Increase	
($ millions)	2005	2004		%	2005	2004		%
Tariff - vehicles	78.0	76.5	1.5	2.0%	134.9	130.9	4.0	3.1%
Tariff - passengers	50.5	49.5	1.0	2.0%	83.3	81.7	1.6	2.0%
Ferry service fees	31.2	30.7	0.5	1.6%	58.2	57.4	0.8	1.4%
Federal-provincial subsidy	6.2	6.1	0.1	1.6%	12.4	12.2	0.2	1.6%
Retail	24.5	24.6	(0.1)	-0.4%	41.8	41.2	0.6	1.5%
Other income	7.9	7.0	0.9	12.9%	12.8	11.4	1.4	12.3%
Total revenue	198.3	194.4	3.9	2.0%	343.4	334.8	8.6	2.6%

Comparison of Revenue

The improvement in vehicle tariff revenue in the three months ended September 30, 2005, compared to the three months ended September 30, 2004, is a result of overall increased vehicle traffic volumes and higher tariff rates. 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*.

Vehicle Traffic Volume	Three Months Ended September 30			
			Increase (Decrease)	
	2005	2004		%
Major routes	1,270,931	1,275,822	(4,891)	-0.4%
Other routes	1,471,302	1,455,750	15,552	1.1%
Total	2,742,233	2,731,572	10,661	0.4%
	Six Months Ended September 30			
			Increase (Decrease)	
	2005	2004		%
Major routes	2,237,929	2,232,605	5,324	0.2%
Other routes	2,698,004	2,673,332	24,672	0.9%
Total	4,935,933	4,905,937	29,996	0.6%

Vehicle traffic volumes increased 0.4% for the three months ended September 30, 2005 compared to the three months ended September 30, 2004 (0.6% year-to-date). The largest increase of 4,297 (10,020 year-to-date) was experienced on our Horseshoe Bay-Langdale route. Vehicle traffic on our major routes declined 0.4% in the three months ended September 30, 2005 compared to the same period in the prior year. We believe reduced levels of tourism have contributed to this decline. There was also a change in the mix of type of vehicles carried which further contributed to a decline in expected revenue.

Passenger Traffic Volume	Three Months Ended September 30			
			Increase (Decrease)	
	2005	2004		%
Major routes	3,983,218	4,036,049	(52,831)	-1.3%
Other routes	3,537,091	3,523,522	13,569	0.4%
Total	7,520,309	7,559,571	(39,262)	-0.5%
	Six Months Ended September 30			
			Increase (Decrease)	
	2005	2004		%
Major routes	6,776,067	6,856,418	(80,351)	-1.2%
Other routes	6,262,013	6,288,997	(26,984)	-0.4%
Total	13,038,080	13,145,415	(107,335)	-0.8%

Total passenger traffic volume in the three months ended September 30, 2005 decreased by 0.5% from the three months ended September 30, 2004 (0.8% year-to-date). The major routes experienced a 1.3% decline while the other routes increased by 0.4%. As with vehicle traffic volume, we believe that reduced levels of tourism have contributed to the decline on the major routes. Total passenger tariff revenue increased by 2.0% as a result of tariff rate increases described above.

Ferry service fees were higher in the three months ended September 30, 2005, than in the three months ended September 30, 2004, due to an increase of $0.5 million or 13.1% ($0.8 million or 11.6% year-to-date) in social program fees. These programs include discount fares for B.C. seniors, students travelling 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 Consumer Price Index for Vancouver.

Retail revenue includes food and other retail merchandise sales. The decline in passenger traffic in the three months ended September 30, 2005 from the three months ended September 30, 2004 resulted in a reduction in retail revenue that was mostly offset by an increase in average spending per passenger. For the six months ended September 30, 2005 compared to the six months ended September 30, 2004 the increase of $0.6 million is attributable to an increase of 0.9% in food and beverage spending per passenger and an increase of 3.1% in average retail goods spending per passenger. This increase was mainly attributable to positive customer response to our gift shop expansions on the *Queen of Oak Bay* and the *Spirit of British Columbia.*

The increase in other income reflects increased usage of our reservation system and an increase in the price of reservations. Reservation revenues were $0.7 million (16.6%) higher in the three months ended September 30, 2005 compared to the three months ended September 30, 2004, ($1.2 million or 17.8% year-to-date). The major routes provided $0.6 million ($1.1 million year-to-date) more revenue from reservations with the balance of the increase from the Horseshoe Bay–Langdale route.

Expenses

Expenses for the three months ended September 30, 2005 increased $5.7 million or 4.3% over the three months ended September 30, 2004 ($8.3 million or 3.2% year-to-date), as shown in the table below.

	Three Months Ended September 30				Six Months Ended September 30			
			(Increase)Decrease				(Increase)Decrease	
($ millions)	2005	2004		%	2005	2004		%
Operations	84.9	81.0	3.9	4.8%	160.0	154.8	5.2	3.4%
Maintenance	13.1	13.7	(0.6)	-4.4%	31.2	36.3	(5.1)	-14.0%
Administration	10.5	10.4	0.1	1.0%	22.4	19.7	2.7	13.7%
Cost of retail goods sold	9.0	9.4	(0.4)	-4.3%	15.8	15.9	(0.1)	-0.6%
Amortization	13.5	12.0	1.5	12.5%	25.6	22.9	2.7	11.8%
Gain (loss) on foreign exchange	(0.1)	0.2	(0.3)		(0.2)	0.1	(0.3)	
Interest expense	6.2	4.7	1.5		13.0	9.8	3.2	
Total expense	137.1	131.4	5.7	4.3%	267.8	259.5	8.3	3.2%

Comparison of Expenses

The total increase in operations expenses from the three months ended September 30, 2004 to the three months ended September 30, 2005 was $3.9 million ($5.2 million year-to-date). The most significant variances were:

- $0.5 million increase ($1.6 million year-to-date) due to property taxes being recorded at actual paid amounts in the six months ended September 30, 2005 while the prior year-to-date reflected an expectation of a reduction in property taxes related to a dispute in assessed values, which is continuing;
- $0.5 million increase ($1.5 million year-to-date) relating to timing of advertising campaigns;
- $0.4 million increase ($0.6 million year-to-date) in costs of uniforms issued and maintained;
- $1.8 million increase year-to-date for costs arising from the *Queen of Oak Bay* incident.[1]; and
- $2.0 million increase in labour, material and supply costs for vessel and terminal operations in the three months ended September 30, 2005, resulting in year-to-date costs at the same level as incurred in the six months ended September 30, 2004

In consideration of our aging fleet and infrastructure, we conduct a significant maintenance program. Maintenance expenses, which include expenditures for vessel refit and maintenance as well as terminal maintenance activities, were $0.6 million lower in the three months ended September 30, 2005 than in the three months ended September 30, 2004 ($5.1 million year-to-date). This reflects extraordinary maintenance expenses we incurred in the prior year. We will continue our maintenance program to ensure the safety and reliability of our operations.

---

[1] On June 30, 2005, the *Queen of Oak Bay* ran aground resulting from a loss of power caused by a mechanical failure of an engine speed control device. No injuries were sustained. Of the earlier reported 28 damaged boats, two claims, that will be covered by insurance, have yet to be resolved. There also remains one unresolved claim for damage to an adjacent property.

Administration expenses increased $0.1 million in the three months ended September 30, 2005 over the three months ended September 30, 2004 ($2.7 million year-to-date). The more significant items contributing to this increase include:

- A planned increase in corporate information technology support of $0.3 million ($1.4 million year-to-date) resulting from the many new initiatives and upgrades in our computer systems;
- $0.4 million increase ($0.7 million year-to-date) attributable to the implementation of our Internal Control Certification initiative. This initiative arises from changes in securities legislation that require CEO and CFO certification of internal controls over financial reporting; and
- $0.3 million decrease ($0.6 million increase year-to-date) in timing of employee wages and benefits.

The decreased cost of retail goods sold reflects the lower level of retail sales in the three months ended September 30, 2005 compared to the three months ended September 30, 2004 as well as decreased food and beverage costs mainly on the major routes. The gross margin has increased by 1% compared to the prior year.

Amortization increased a total of $1.5 million in the three months ended September 30, 2005 from the three months ended September 30, 2004 ($2.7 million year-to-date). 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 three months ended September 30, 2005 increased a total of $1.5 million over the three months ended September 30, 2004 ($3.2 million year-to-date), 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. In September 2005 we received interest rate support through the Structured Financing Facility Program offered by the Government of Canada for the *Queen of Oak Bay* mid-life upgrade. A total of $4.0 million in support has been granted of which we have received $0.5 million to offset interest costs previously capitalized on the *Queen of Oak Bay* mid-life upgrade. The remaining balance of $3.5 million is held in trust and will be paid to us to offset bond interest costs incurred on our 6.25% Senior Secured Bonds, Series 04-4. $1.0 million will be paid to us on each semi-annual bond interest payment date, commencing October 13, 2005, until the funds are exhausted. Bond interest costs to September 30, 2005 have been reduced by $1.0 million to reflect this interest rate support.

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 their continuation. Differences in fuel costs arising from our actual price paid per litre being higher or lower than the unit set price are charged to 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 have 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 ago, 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 British Columbia Ferries 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 to apply to all fares. Proceeds from the fuel surcharges are credited against balances in the deferred fuel cost accounts.

As part of the Order, the British Columbia Ferries 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 Order can be viewed on the Commissioner's website at www.bcferrycommission.com

As a result of continuing high fuel costs, our annual fuel cost projection is now $76 million this fiscal year. As this would prevent any significant reduction of the deferred fuel cost account balances, we are considering applying to the British Columbia Ferries Commissioner for additional price cap increases to allow for further fuel surcharges.

During the three months ended September 30, 2005, we re-established a fuel hedging program and entered into commodity fixed price swaps that will fix between 69% and 78% of projected monthly consumption over the balance of the fiscal year commencing in October, 2005. We are also taking reasonable fuel-saving measures, including focusing on engineering efficiencies during vessel refits and installing more fuel-efficient diesel engines where appropriate. For the six months ended September 30, 2005, compared to the same period in the previous year, we have been successful in reducing our fuel consumption by 2.9% with a reduction in sailings provided of less than 0.7%.

Quarterly Financial Highlights

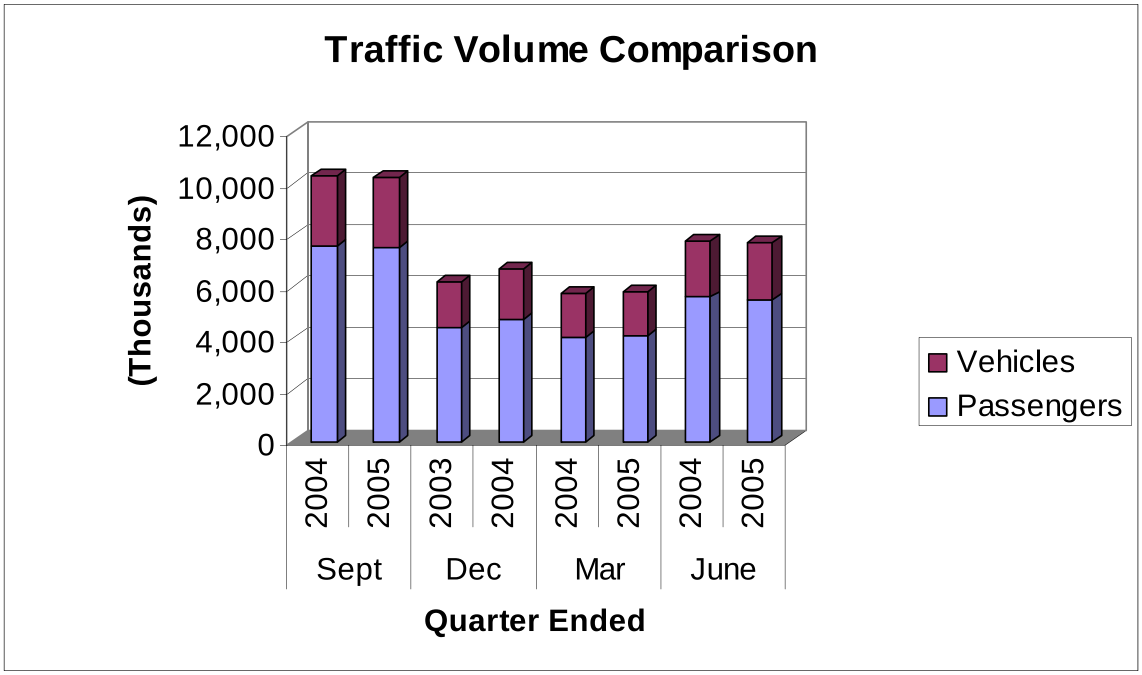
The table below compares earnings by quarter for the most recent eight quarters.

	Quarter Ended							
($ millions)	Sep 05	Jun 05	Mar 05	Dec 04	Sep 04	Jun 04	Mar 04	Dec 03
Total revenue	198.3	145.2	107.0	122.7	194.4	140.4	103.1	110.2
Earnings (loss from operations)	67.3	21.1	(23.8)	3.6	67.9	17.3	(30.3)	(0.8)
Net earnings (loss)	61.2	14.4	(31.3)	(4.2)	63.0	12.3	(36.4)	(8.2)

Net earnings in the quarter ended September 30, 2005 were lower than the same quarter in the previous year by $1.8 million. The prior three quarters were higher than the corresponding quarter in the previous year with increases ranging from $2.1 million to $5.1 million. The average increase for the latest four quarters was $2.4 million.

Total revenue in each of the latest four quarters was 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 vehicle 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 generally take effect in

November of each year as permitted in the Coastal Ferry Act. Vehicle traffic increased over the previous year in every quarter, ranging from 0.4% in the quarter ended September 30, 2005, to 8.7% in the quarter ended December 31, 2004, with an average four-quarter increase of 2.5%. Passenger traffic was higher than the previous year in the quarters ended March and December but lower in the quarters ended June and September. The average four-quarter increase was 1.6%. We are experiencing lower than expected traffic levels. We believe this is primarily due to reduced levels of tourism.



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. Our primary uses of funds are operational expenses, capital asset acquisitions and upgrades, and interest payments on our long-term debt. 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 and Uses of Cash

Changes in cash and cash equivalents for the three and six months ended September 30, 2005, and the three and six months ended September 30, 2004, are summarized in the table below.

	Three Months Ended September 30		Six Months Ended September 30	
($ millions)	2005	2004	2005	2004
Net income for the period	61.2	63.0	75.6	75.3
Items not involving cash:				
Amortization	13.5	12.0	25.6	22.9
Other non-cash charges	0.2	(0.2)	0.2	0.4
Fuel costs deferred	(3.2)	(1.2)	(8.5)	(1.2)
Change in operating working capital	(7.8)	(13.8)	(20.3)	(17.0)
Cash provided by operating activities	63.9	59.8	72.6	80.4
Cash provided by financing activities	0.0	0.3	0.0	8.8
Cash used in investing activities	(13.4)	(11.5)	(47.1)	(37.9)
Total increase in cash	50.5	48.6	25.5	51.3

The June 30, 2005 cash flow statement has been amended to correct a misclassification of non-operating working capital totalling $15.9 million. The effect of this reclassification is to decrease previously reported cash used by changes in operating working capital by $15.9 million and to increase previously reported cash used in the purchase of capital assets by $15.9 million during the three months ended June 30, 2005.

Cash provided by operating activities was $63.9 million for the three months ended September 30, 2005 ($72.6 million year-to-date). Included in these results was an increase in non cash working capital of $7.8 million ($20.3 million year-to-date). This increase for the three months ended September 30, 2005 was primarily due to:

- $5.4 million decrease in deferred revenue mainly due to a $4.8 million reduction in the amount of prepaid reservations reflecting the seasonality of our business;
- $5.1 million increase in accounts receivable mainly due to timing of receipt of ferry service fees from the provincial government
- $4.1 million decrease in trade payables and accrued liabilities reflecting payment of contract holdbacks regarding the *Queen of Oak Bay* mid-life upgrade.

These increases were partially offset by a decrease in working capital resulting from a $7.6 million increase in accrued bond interest payable (semi-annual interest payments to be made in October and November)

The $20.3 million increase in non cash working capital for the six months ended September 30, 2005 was primarily due to:

- $7.9 million reduction in trade payables and accrued liabilities reflecting the increased spending in the last quarter of fiscal 2005, which was settled in fiscal 2006;
- $6.5 million increase in accounts receivable mainly due to timing of receipt of ferry service fees from the provincial government;
- $4.3 million increase in prepaid expenses, comprising of:
  - $2.5 million increase due to property taxes for the period October through December 2005;
  - $0.9 million increase in prepaid fuel;
  - $0.7 million increase in prepaid insurance; and
  - $0.2 million increase in other prepaid expenses.

There were no financing activities during the six months ended September 30, 2005.

Cash used in investing activities was $13.4 million in the three months ended September 30, 2005 ($47.1 million year-to-date). This was due to capital expenditures, on a cash basis, of $13.1 million ($46.0 million year-to-date) and an increase in lands under long-term lease of $0.3 million ($1.1 million year-to-date). The significant capital transactions this year are described below in “Investing in Our Capital Assets”.

Investing in Our Capital Assets

Capital expenditures totalled $14.1 million for the three months ended September 30, 2005. The more significant expenditures included:

- $2.9 million life saving and fire protection upgrade on the *Queen of Nanaimo*;
- $0.8 million in terminal and building upgrades at the Tsawwassen terminal;
- $7.6 million in marine structures, including $3.8 million at the Swartz Bay terminal, $1.5 million at the Tsawwassen terminal and $1.0 million upgrade at the facility of our subsidiary, Deas Pacific Marine; and
- $1.8 million in software development, mainly for improvements in retail and food services and operational efficiencies such as crew scheduling.

Capital expenditures totalled $39.0 million for the six months ended September 30, 2005. This level of expenditure reflects significant investments in our fleet, terminals and information systems to improve customer service and operating efficiency. Expenditures included the following:

- Vessel upgrades and modifications including $11.9 million of a $35.1-million mid-life upgrade on the *Queen of Oak Bay;* $3.0 million life saving and fire protection upgrade on the *Queen of Nanaimo;* and $1.8 million on the “Super C–class” vessel project;
- $4.4 million in terminal and building upgrades, including a $1.9-million upgrade of passenger facilities at the Horseshoe Bay terminal and $2.1 million towards retail redevelopment at the Tsawwassen terminal;

- $11.3 million in marine structures, including $4.2 million at the Tsawwassen terminal, $3.9 million at the Swartz Bay terminal and $1.0 million at the facility of our subsidiary, Deas Pacific Marine; and
- $5.3 million in software development, which will enhance customer service improvements in areas such as reservations and retail and food services, as well as improve 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 in June 2005, following an extensive mid-life upgrade. The total project cost was $35.1 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.

The *Queen of Nanaimo*, which provides service on our minor routes, was transferred to dry dock on September 17, 2005 for a planned $15.0 million refurbishment. The vessel, built in 1964, will undergo upgrades to lifesaving equipment and structural fire protection, improvements to passenger accommodations and a new oily water separator. The *Queen of Nanaimo* is expected to return to service later this year.

“Super C-Class” vessel construction

Three Super C-class vessels are being built for us under contracts with Flensburger Schiffbau-Gesellschaft. These new vessels 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 vessels are currently on-time and on-budget with the first to be delivered by December 2007.

MV John Atlantic Burr

In August 2005, we acquired a ferry from the State of Utah for $200,000 (US) through a competitive bid process. This vessel, the *MV John Atlantic Burr*, is similar in design to our three “K-class” vessels, the *MV Kahloke, MV Klitsa* and the *MV Kwuna*. It was designed in Victoria in 1985 and was substantially upgraded with its hull and superstructure lengthened in 1996. This vessel will require an investment of approximately $4.5 million in delivery costs and modifications this winter to upgrade it to our standards and the requirements of Transport Canada. A new vessel of this size would cost approximately $20 million to construct.

Tsawwassen Quay

In June 2005, the new $7 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 4 million passengers each year. The facility is managed by Lonsdale Quay Market Corp. under a 10-year lease agreement. This partnership is an example of the long-term business strategies we seek to develop.

Tsawwassen Terminal Marine Structures
In the six months ended September 30, 2005, we spent $4.3 million ($16.3 million total) upgrading 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 nearing completion with a total forecast cost of $16.8 million.

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, prepaid tickets and other services will 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.

Risk Management

Understanding and managing risk are important parts of our business. A discussion of enterprise-wide risk management can be found in the risk management section of our fiscal 2005 annual Management's Discussion and Analysis. Our risk profile is substantially unchanged during the six months ended September 30, 2005.

The safety of the public, our employees and the protection of the environment are our highest priorities. There is a heightened security concern in the transportation industry. We continue to review and enhance our security planning to ensure that security measures are proactive and responsive. We 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.

Accounting Practices

Critical Accounting Policies and Estimates

This 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.

During the three months ended September 30, 2005, we adopted a new accounting policy, Interest Rate Support. For more information on significant accounting policies, please refer to note 1 of our March 31, 2005, financial statements and note 1 of our September 30, 2005 interim 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.