

Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Nine months ended December 31, 2005

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Balance Sheets
(expressed in thousands)

	December 31, 2005 (unaudited)	March 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	\$ 34,769	\$ 41,524
Short-term investments (note 2)	25,100	15,054
Accounts receivable	9,818	6,147
Prepaid expenses	6,478	5,095
Inventories	23,417	21,699
	<u>99,582</u>	<u>89,519</u>
Capital assets (note 3)	666,539	630,291
Deferred financing costs	8,226	7,987
Deferred fuel costs (note 4)	20,634	8,000
Long-term land lease	28,462	27,585
	<u>\$ 823,443</u>	<u>\$ 763,382</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 42,994	\$ 49,552
Interest payable on long-term debt	4,860	12,251
Accrued employee costs	39,175	39,371
Deferred revenue	12,773	13,756
Current portion of accrued employee future benefits	631	631
Current portion of obligation under capital lease	26	26
	<u>100,459</u>	<u>115,587</u>
Accrued employee future benefits (note 5)	17,360	16,849
Long-term debt (note 6)	499,598	499,581
Obligations under capital lease	143	164
	<u>617,560</u>	<u>632,181</u>
Shareholders' equity:		
Share capital	75,478	75,478
Retained earnings	130,405	55,723
	<u>205,883</u>	<u>131,201</u>
Commitments (note 3)		
Interest rate support (note 7)		
Subsequent event (note 9)		
	<u>\$ 823,443</u>	<u>\$ 763,382</u>

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Original Signed by Elizabeth J. Harrison Director

Original Signed by Graham M. Wilson 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	
	2005	2004	2005	2004
Revenue:				
Tolls	\$ 74,598	\$ 72,859	\$ 292,820	\$ 285,479
Ferry service fees	25,416	24,942	83,599	82,334
Federal-Provincial Subsidy Agreement	6,222	6,085	18,667	18,257
Retail	14,719	14,609	56,486	55,836
Other income	5,078	4,233	17,909	15,610
	126,033	122,728	469,481	457,516
Expenses:				
Operations	69,423	68,371	229,373	223,151
Maintenance	21,780	23,557	52,969	59,860
Administration	10,105	10,231	32,530	29,992
Cost of retail goods sold	6,080	5,802	21,907	21,694
Amortization	13,296	11,185	38,918	34,060
	120,684	119,146	375,697	368,757
Earnings from operations	5,349	3,582	93,784	88,759
Gain (loss) on foreign exchange	54	(194)	231	(269)
Interest expense	(6,307)	(7,249)	(19,273)	(17,063)
Loss on disposal of capital assets	(17)	(375)	(60)	(362)
Net earnings (loss)	(921)	(4,236)	74,682	71,065
Retained earnings, beginning of period	131,326	97,248	55,723	21,947
Retained earnings, end of period	\$ 130,405	\$ 93,012	\$ 130,405	\$ 93,012

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

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

	Three months ended December 31		Nine months ended December 31	
	2005	2004	2005	2004
Cash provided by (used in):				
Operations:				
Net earnings (loss)	\$ (921)	\$ (4,236)	\$ 74,682	\$ 71,065
Items not involving cash:				
Amortization	13,296	11,185	38,918	34,060
Other non-cash charges	386	501	585	867
Net fuel costs deferred	(4,139)	(3,640)	(12,634)	(4,838)
Change in operating working capital	(3,108)	5,720	(23,373)	(11,300)
	5,514	9,530	78,178	89,854
Financing:				
Deferred financing costs incurred	(610)	(3,684)	(613)	(6,988)
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 long-term debenture	-	-	-	(427,701)
Establishment of debt service reserve	-	(5,157)	-	(14,988)
	(610)	40,857	(613)	49,669
Investing:				
Proceeds from (cost of) disposal of capital assets	1	17	(3)	30
Purchase of capital assets	(27,272)	(38,740)	(73,266)	(74,754)
Increase in lands under long-term lease	-	(1,169)	(1,147)	(3,042)
Purchase of short-term notes	(9,904)	-	(9,904)	-
	(37,175)	(39,892)	(84,320)	(77,766)
Increase (decrease) in cash and cash equivalents	(32,271)	10,495	(6,755)	61,757
Cash and cash equivalents, beginning of period	67,040	69,201	41,524	17,939
Cash and cash equivalents, end of period	\$ 34,769	\$ 79,696	\$ 34,769	\$ 79,696

Supplemental cash flow information (note 8)

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, 2005

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, 2005. 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, 2005.

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) Comparative figures:

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

(b) Interest rate support:

The Company receives interest rate support from the Government of Canada for eligible new Canadian built vessels or major refurbishment of vessels. Amounts receivable in regard to capitalized interest are recognized as a reduction of capitalized interest upon completion of the project. Amounts receivable in regard to post-completion debt service costs are recognized as a reduction to interest expense.

BRITISH COLUMBIA FERRY SERVICES INC.

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

For the nine months ended December 31, 2005

2. Short-term investments:

	December 31 2005	March 31 2005
Restricted funds:		
Debt service reserve, Series 04-1 bonds	\$ 7,175	\$ 7,175
Debt service reserve, Series 04-4 bonds	7,813	7,813
	14,988	14,988
Unrestricted funds:	10,112	66
Short-term investments	\$ 25,100	\$ 15,054

The company is required to maintain a debt service reserve for the Series 04-1 and 04-4 bonds equal to not less than six months forecasted debt service.

3. Capital assets:

December 31, 2005	Cost	Accumulated amortization	Net book value
Ships owned	\$ 762,299	\$ 478,434	\$ 283,865
Ships under capital lease	85,556	35,220	50,336
Berths, buildings and equipment	94,464	61,069	33,395
Berths, buildings and equipment under capital lease	444,232	216,184	228,048
Land	1,107	-	1,107
Construction-in-progress	69,788	-	69,788
	\$ 1,457,446	\$ 790,907	\$ 666,539

March 31, 2005	Cost	Accumulated amortization	Net book value
Ships owned	\$ 758,130	\$ 458,115	\$ 300,015
Ships under capital lease	50,426	32,845	17,581
Berths, buildings and equipment	86,342	54,286	32,056
Berths, buildings and equipment under capital lease	417,096	209,503	207,593
Land	1,107	-	1,107
Construction-in-progress	71,939	-	71,939
	\$ 1,385,040	\$ 754,749	\$ 630,291

BRITISH COLUMBIA FERRY SERVICES INC.

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

For the nine months ended December 31, 2005

For the nine months ended December 31, 2005 capitalized financing costs during construction, net of recoveries, amounted to \$1.8 million (nine months ended December 31, 2004 - \$1.2 million; twelve months ended March 31, 2005 - \$1.5 million).

BRITISH COLUMBIA FERRY SERVICES INC.

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

For the nine months ended December 31, 2005

3. Capital assets (continued):

In addition to the construction-in-progress included above, contractual commitments at December 31, 2005 for capital assets to be constructed totalled \$376.9 million (March 31, 2005 - \$339.4 million). Included in the contractual commitments as at December 31, 2005 is \$308.6 million (March 31, 2005 - \$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.

4. Deferred fuel costs:

Deferred fuel cost balances consist of differences between the set unit prices established by the British Columbia Ferries Commissioner (the "Commissioner") and actual unit prices of fuel oil (net of hedge gains and losses), less fuel costs recovered through surcharge collections. The Company maintains the deferral accounts to mitigate the effect on its earnings of unpredictable and uncontrollable price volatility in world fuel oil markets.

During the quarter ended June 30, 2005, the Company applied to the Commissioner for extraordinary price cap increases to enable fuel surcharges to be levied on passenger and vehicle tolls. The Commissioner authorized the price cap increases and the Company implemented fuel surcharges effective July 25, 2005.

In addition, the Commissioner increased by 5%, effective July 24, 2005, the set prices to be used in fuel cost deferral calculations which had been established in a previous order. In his Order, the Commissioner also authorized interest to be calculated on and added to the deferred fuel cost balances, effective July 25, 2005.

	December 31 2005	March 31 2005
Balance, beginning of period	\$ 8,000	\$ -
Current period fuel costs deferred	19,090	8,000
Fuel surcharges collected	(6,945)	-
	20,145	8,000
6% interest accrued	489	-
Balance, end of period	\$ 20,634	\$ 8,000

During the quarter ended December 31, 2005, the Company applied to the Commissioner for additional extraordinary price cap increases that will allow for additional fuel surcharges to be levied on passenger and vehicle tolls. The Commissioner authorized the price cap increases and the Company implemented additional fuel surcharges effective February 1, 2006.

BRITISH COLUMBIA FERRY SERVICES INC.

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(columnar dollars expressed in thousands)

For the nine months ended December 31, 2005

5. Accrued employee future benefits:

During the quarter ended December 31, 2005, the Company recognized total defined benefit costs of \$0.3 million (December 31, 2004 - \$0.3 million).

For the nine months ended December 31, 2005 the Company recognized total defined benefit costs of \$0.9 million (December 31, 2004 - \$0.9 million).

6. Long-term debt:

	December 31 2005	March 31 2005
5.74% Senior Secured Bonds, Series 04-1, due May 2014	\$ 250,000	\$ 250,000
Unamortized discount	(112)	(121)
	249,888	249,879
6.25% Senior Secured Bonds, Series 04-4, due October 2034	250,000	250,000
Unamortized discount	(290)	(298)
	249,710	249,702
	\$ 499,598	\$ 499,581

In addition, the Company has entered into loan agreements which make up to \$180 million available to finance the Company's purchase of two "Super C" Class vessels. These funds will be released to coincide with the conditional acceptance dates of the vessels, expected in 2008.

7. Interest rate support:

The Government of Canada has agreed to provide \$4.0 million in the form of interest rate support to the Company. Of this, \$0.5 million was recorded during the second quarter as a reduction of capitalized interest. During the nine months ended December 31, 2005, \$1.5 million has been recorded as a reduction of interest expense (three months ended December 31, 2005 - \$0.5 million). The remaining \$2.0 million will be recognized over the next twelve months as a reduction of interest expense.

The Company has no requirement to repay these funds, other than as a result of an event of default under the agreement with the Government of Canada.

BRITISH COLUMBIA FERRY SERVICES INC.

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(columnar dollars expressed in thousands)

For the nine months ended December 31, 2005

8. Supplemental cash flow information:

	Three months ended		Nine months ended	
	December 31		December 31	
	2005	2004	2005	2004
Cash paid during the period for interest	\$ 15,063	\$ 7,176	\$ 30,147	\$ 10,719

9. Subsequent event:

On January 19, 2006, the Property Assessment Appeal Board accepted an agreement reached between the Company and BC Assessment Authority to settle the Company's 2004 and 2005 terminal property assessments appeals.

Based on the settlement, the Company expects to recover a total of \$8.2 million in overpaid 2004 and 2005 property taxes, and is working with the various municipalities to develop repayment schedules.