

Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Three months ended June 30, 2006

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Balance Sheets
(expressed in thousands)

	June 30, 2006 (unaudited)	March 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	\$ 27,762	\$ 2,291
Restricted short-term investments	14,988	14,988
Accounts receivable	14,872	21,227
Prepaid expenses	11,882	6,702
Inventories	23,511	21,809
	<u>93,015</u>	<u>67,017</u>
Capital assets (note 2)	717,872	707,324
Deferred financing costs	8,139	8,183
Regulatory assets	23,994	22,783
Long-term land lease	28,278	28,370
	<u>\$ 871,298</u>	<u>\$ 833,677</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 34,615	\$ 69,326
Interest payable on long-term debt	4,737	12,251
Accrued employee costs	45,505	44,810
Deferred revenue	17,911	14,000
Regulatory liabilities	-	958
Current portion of accrued employee future benefits	800	800
Current portion of obligation under capital lease	25	25
	<u>103,593</u>	<u>142,170</u>
Accrued employee future benefits (note 3)	16,727	16,737
Long-term debt (note 4)	499,610	499,604
Obligations under capital lease	132	138
	<u>620,062</u>	<u>658,649</u>
Shareholders' equity:		
Share capital	75,478	75,478
Retained earnings	175,758	99,550
	<u>251,236</u>	<u>175,028</u>
Interest rate support (note 7)	<u>\$ 871,298</u>	<u>\$ 833,677</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)

	For the three months ended	
	June 30, 2006	June 30, 2005
Revenue:		
Tolls	\$ 89,585	\$ 89,694
Ferry service fees	27,106	26,997
Federal-Provincial Subsidy Agreement	6,327	6,222
Retail	17,569	17,289
Other income	5,680	4,987
	<u>146,267</u>	<u>145,189</u>
Expenses:		
Operations	75,701	75,030
Maintenance	17,878	18,137
Administration	12,637	11,953
Cost of retail goods sold	6,841	6,845
Amortization	12,991	12,088
	<u>126,048</u>	<u>124,053</u>
Earnings from operations	20,219	21,136
Gain on foreign exchange	60	75
Interest expense	(5,353)	(6,758)
Gain (loss) on disposal of capital assets	10	(9)
Net earnings before extraordinary gain	<u>14,936</u>	<u>14,444</u>
Extraordinary gain (note 5)	61,272	-
Net earnings	<u>76,208</u>	<u>14,444</u>
Retained earnings, beginning of period	99,550	55,723
Retained earnings, end of period	<u>\$ 175,758</u>	<u>\$ 70,167</u>

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

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

	For the three months ended	
	June 30, 2006	June 30, 2005
Cash provided by (used in):		
Operations:		
Net earnings before extraordinary gain	\$ 14,936	\$ 14,444
Extraordinary gain (note 5)	61,272	-
Net earnings	76,208	14,444
Items not involving cash:		
Amortization	12,991	12,088
Other non-cash charges	215	36
Regulatory costs deferred	(1,211)	(5,255)
Change in operating working capital	(30,834)	(12,445)
	57,369	8,868
Financing:		
Deferred financing costs incurred	(80)	(2)
Investing:		
Proceeds from (cost of) disposal of capital assets	10	(9)
Purchase of capital assets	(31,828)	(32,888)
Increase in lands under long-term lease	-	(911)
	(31,818)	(33,808)
Increase (decrease) in cash and cash equivalents	25,471	(24,942)
Cash and cash equivalents, beginning of period	2,291	41,524
Cash and cash equivalents, end of period	\$ 27,762	\$ 16,582

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 three months ended June 30, 2006

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, 2006. 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, 2006.

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) Asset retirement obligations:

In the period when it can be reasonably determined, the Company recognizes a liability at its fair value for any legal obligations associated with the retirement of long-lived assets when those obligations result from the acquisition, construction, development or normal operation of the assets. A corresponding asset retirement cost is 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.

The Company's long-lived assets include certain vessels which contain undetermined amounts of asbestos. Under certain circumstances the Company may be required to handle and dispose of the asbestos in a manner required by regulations. It is the Company's intention to sell decommissioned vessels into world markets for continued use in providing commercial ferry service. Under these circumstances asbestos remediation would become the responsibility of the new owner.

No amount has been recorded for asset retirement obligations relating to these assets as it is not possible to make a reasonable estimate of the fair value of any such liability due to the indeterminate magnitude, likelihood or financial impact, if any, of this issue.

BRITISH COLUMBIA FERRY SERVICES INC.

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

For the three months ended June 30, 2006

1. Significant accounting policies (continued):

(b) Comparative figures:

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

2. Capital assets:

June 30, 2006	Cost	Accumulated amortization	Net book value
Ships owned	\$ 812,716	\$ 469,715	\$ 343,001
Ship under capital lease	60,421	19,745	40,676
Berths, buildings and equipment	95,949	63,315	32,634
Berths, buildings and equipment under capital lease	449,527	218,157	231,370
Land	1,107	-	1,107
Construction-in-progress	69,084	-	69,084
	\$ 1,488,804	\$ 770,932	\$ 717,872

March 31, 2006	Cost	Accumulated amortization	Net book value
Ships owned	\$ 776,422	\$ 464,073	\$ 312,349
Ship under capital lease	60,421	19,026	41,395
Berths, buildings and equipment	95,646	61,080	34,566
Berths, buildings and equipment under capital lease	446,388	215,276	231,112
Land	1,107	-	1,107
Construction-in-progress	86,795	-	86,795
	\$ 1,466,779	\$ 759,455	\$ 707,324

For the quarter ended June 30, 2006 capitalized financing costs during construction amounted to \$1.3 million (June 30, 2005 - \$1.0 million).

In addition to the construction-in-progress referenced above, contractual commitments at June 30, 2006 for capital assets to be constructed totaled \$380.0 million (March 31, 2006 - \$324.2 million). Included in the contractual commitments as at June 30, 2006 is \$308.1 million (March 31, 2006 - \$308.2 million) committed for design and construction of three "Super C" Class vessels and \$48.2 million (March 31, 2006 - nil) committed to procure an intermediate class vessel. Delivery of the three "Super C" 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 three months ended June 30, 2006

3. Accrued employee future benefits:

During the quarter ended June 30, 2006, the Company recognized total defined benefit costs of \$0.3 million (June 30, 2005 - \$0.3 million).

4. Long-term debt:

	June 30 2006	March 31 2006
5.74% Senior Secured Bonds, Series 04-1, due May 2014	\$ 250,000	\$ 250,000
Unamortized discount	(105)	(108)
	249,895	249,892
6.25% Senior Secured Bonds, Series 04-4, due October 2034	250,000	250,000
Unamortized discount	(285)	(288)
	249,715	249,712
	\$ 499,610	\$ 499,604

5. Extraordinary gain:

On March 22, 2006 the vessel *Queen of the North* ran aground and subsequently sank. During the period ended June 30, 2006, the Company settled with its hull and machinery insurance providers. The Company has received insurance proceeds, net of deductible, of \$67.9 million in settlement of the claim under the hull and machinery policy. At March 31, 2006, \$6.6 million of the proceeds from this claim had been recognized to offset insurable losses (including \$4.3 million net book value of capital assets) incurred as a result of this event.

6. Supplemental cash flow information:

For the three months ended	June 30 2006	June 30 2005
Cash paid during the period for interest	\$ 15,236	\$ 15,036
Cash received from <i>Queen of the North</i> hull and machinery insurance policy	67,875	-

BRITISH COLUMBIA FERRY SERVICES INC.

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

For the three months ended June 30, 2006

7. Interest rate support:

The Government of Canada has agreed to provide \$5.6 million in the form of interest rate support to the Company for major refurbishments on two vessels. During the period ended June 30, 2006, \$0.7 million has been recorded as a reduction of interest expense (year ended March 31, 2006: \$0.6 reduction of capitalized interest, and \$2.0 million reduction of interest expense). The remaining \$2.3 million will be recognized over the next fifteen months as a reduction of interest expense.

Major refurbishments on a third vessel have been approved to receive interest rate support from the Government of Canada, the amount of which is yet to be determined.

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.