Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Six months ended September 30, 2006

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Balance Sheets
(expressed in thousands)

	September 30, 2006 (unaudited)	March 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 56,491	$ 2,291
Restricted short-term investments	14,988	14,988
Accounts receivable	21,029	21,227
Prepaid expenses	11,110	6,702
Inventories	24,474	21,809
	128,092	67,017
Capital assets (note 2)	742,694	707,324
Deferred financing costs	8,094	8,183
Regulatory assets (note 3)	29,002	22,783
Long-term land lease	28,246	28,370
	$ 936,128	$ 833,677
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 27,780	$ 69,326
Interest payable on long-term debt	12,292	12,251
Accrued employee costs	42,718	44,810
Deferred revenue	12,413	14,000
Regulatory liabilities (note 3)	253	958
Current portion of accrued employee future benefits	800	800
Current portion of obligation under capital lease	25	25
	96,281	142,170
Accrued employee future benefits (note 4)	16,183	16,737
Unrealized losses on derivative instruments (note 5)	3,787	-
Long-term debt (note 6)	499,616	499,604
Obligations under capital lease	126	138
	615,993	658,649
Shareholders' equity:		
Share capital	75,478	75,478
Retained earnings	244,657	99,550
	320,135	175,028
Commitments (note 2)		
Interest rate support (note 9)		
	$ 936,128	$ 833,677

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 September 30		Six months ended September 30	
	2006	2005	2006	2005
Revenue:				
Tariffs	$ 131,042	$ 128,528	$ 220,627	$ 218,222
Ferry service fees	31,467	31,186	58,573	58,183
Federal-Provincial Subsidy Agreement	6,328	6,223	12,655	12,445
Retail	25,104	24,478	42,673	41,767
Other income	8,782	7,844	14,462	12,831
	202,723	198,259	348,990	343,448
Expenses:				
Operations	83,271	84,918	158,972	159,950
Maintenance	13,373	13,052	31,251	31,189
Administration	9,793	10,474	22,430	22,425
Cost of retail goods sold	9,675	8,982	16,516	15,827
Amortization	13,632	13,534	26,623	25,622
	129,744	130,960	255,792	255,013
Earnings from operations	72,979	67,299	93,198	88,435
Gain on foreign exchange	177	102	237	177
Interest expense (note 9)	(4,227)	(6,208)	(9,580)	(12,966)
Loss on disposal of capital assets	(30)	(34)	(20)	(43)
Net earnings before extraordinary gain	68,899	61,159	83,835	75,603
Extraordinary gain (note 7)	-	-	61,272	-
Net earnings	68,899	61,159	145,107	75,603
Retained earnings, beginning of period	175,758	70,167	99,550	55,723
Retained earnings, end of period	$ 244,657	$ 131,326	$ 244,657	$ 131,326

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

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

	Three months ended September 30		Six months ended September 30	
	2006	2005	2006	2005
Cash provided by (used in):				
Operations:				
Net earnings before extraordinary gain	$ 68,899	$ 61,159	$ 83,835	$ 75,603
Extraordinary gain (note 7)	-	-	61,272	-
Net earnings	68,899	61,159	145,107	75,603
Items not involving cash:				
Amortization	13,632	13,534	26,623	25,622
Other non-cash charges	255	163	470	199
Regulatory costs deferred	(1,221)	(3,240)	(2,432)	(8,495)
Change in operating working capital	(10,376)	(7,820)	(41,210)	(20,265)
	71,189	63,796	128,558	72,664
Financing:				
Deferred financing costs incurred	(80)	(1)	(160)	(3)
	(80)	(1)	(160)	(3)
Investing:				
Proceeds from (cost of) disposal of capital assets	6	5	16	(4)
Purchase of capital assets	(42,326)	(13,106)	(74,154)	(45,994)
Increase in lands under long-term lease	(60)	(236)	(60)	(1,147)
	(42,380)	(13,337)	(74,198)	(47,145)
Increase in cash and cash equivalents	28,729	50,458	54,200	25,516
Cash and cash equivalents, beginning of period	27,762	16,582	2,291	41,524
Cash and cash equivalents, end of period	$ 56,491	$ 67,040	$ 56,491	$ 67,040

Supplemental cash flow information (note 8)

See accompanying notes to consolidated financial statements.

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.

(columnar dollars expressed in thousands)

2. Capital assets:

September 30, 2006	Cost	Accumulated amortization	Net book value
Ships owned	$ 813,107	$ 477,450	$ 335,657
Ship under capital lease	60,421	20,464	39,957
Berths, buildings and equipment	103,000	65,455	37,545
Berths, buildings and equipment under capital lease	448,350	221,127	227,223
Land	1,406	-	1,406
Construction-in-progress	100,906	-	100,906
	$ 1,527,190	$ 784,496	$ 742,694

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 six months ended September 30, 2006 capitalized financing costs during construction amounted to $2.4 million (September 30, 2005 - $1.5 million).

In addition to the construction-in-progress referenced above, contractual commitments at September 30, 2006 for capital assets to be constructed totaled $561.7 million (March 31, 2006 - $324.2 million). Included in the contractual commitments as at September 30, 2006 is $302.5 million (March 31, 2006 - $308.2 million) committed for design and construction of three "Super C" Class vessels, $126.1 million (March 31, 2006 – nil) for design and construction of a new vessel for use on the north coast, $49.1 million (March 31, 2006 – nil) to procure and modify a northern vessel and $42.2 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 while delivery of the intermediate class vessel and the new north coast vessel is scheduled to occur in mid 2008 and mid 2009 respectively.

(columnar dollars expressed in thousands)

3. Financial statement effect of rate regulation:

The Company is regulated by the Commissioner to ensure that tariffs are fair and reasonable and to monitor service levels. Under the terms of the Act, the tariffs 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 may, under certain circumstances, allow increases in price caps over the set levels. The Commissioner will establish the price caps to apply for each subsequent term.

The accounting for regulated operations of the Company may differ from non-regulated businesses following Canadian generally accepted accounting principles (GAAP). As a result, the Company records assets and liabilities that result from the regulated price cap setting process that would not be recorded under GAAP for non-regulated entities. Regulatory assets generally represent incurred costs that have been deferred because they are probable of future recovery in tariffs. Regulatory liabilities represent obligations to customers which will be settled through future tariffs. Management continually assesses whether the regulatory assets are probable of future recovery by considering factors such as applicable regulatory changes and recent rate orders to other regulated entities. Management believes the existing regulatory assets are probable of recovery. This determination reflects the current regulatory climate, and is subject to change in the future. If future recovery of costs ceases to be probable, asset write-offs would be required to be recognized in the current period earnings at that time.

Accounting for the impacts of rate regulation has resulted in recording the following regulatory assets and liabilities in the consolidated balance sheets:

Regulatory assets	September 30 2006	March 31 2006
Deferred fuel costs (a)	$ 25,528	$ 22,715
Performance term submission costs (b)	148	68
Hedge losses – vessel construction contracts (c)	3,326	-
Total regulatory assets	$ 29,002	$ 22,783
Regulatory liabilities		
Tariffs in excess of price cap (d)	$ 253	$ 958

3. Financial statement effect of rate regulation (continued):

(a) Deferred fuel costs:

As prescribed by regulatory order, the Company defers fuel costs in excess of approved fuel costs which were used to develop the regulated price caps. The difference between the approved fuel costs and the actual fuel costs (including fuel hedge gains and losses) is deferred for recovery from future tariffs. The order also allows interest to be included in the amount to be recovered. Also prescribed by regulatory order, the Company collects fuel surcharges which are applied against deferred fuel costs. It is expected that the recovery period of deferred fuel costs will be two to six years. If the Company was not a regulated entity, earnings for the six months ended September 30, 2006 would have been $2.8 million lower except for this deferral (September 30, 2005: $8.3 million).

(b) Performance term submission costs:

The Commissioner has authorized the Company to defer costs of representation associated with the second performance term. The Commissioner will consider these costs in the determination of the price caps set for the four years beginning April 1, 2008. The Commissioner has not included an allowance for a return on investment for this item. It is expected that the recovery period will be the four year period of the second performance term, commencing April 1, 2008. If the Company was not a regulated entity, earnings for the six months ended September 30, 2006 would have been $0.1 million lower except for this deferral (September 30, 2005 – nil).

(c) Hedge losses –vessel construction contracts

The Company defers hedge gains or losses on financial derivative instruments not designated for hedge accounting purposes and which have been entered into to manage market risk against fluctuations in the Canadian dollar equivalent of vessel construction contracts denominated in foreign currencies. The intent and effect of these transactions is to provide greater certainty of the cost of the related new vessel acquisitions. The total cost of these assets, including hedge gains or losses, has been determined by the Commissioner to be reasonable and will be taken into account in the determination of price caps set for the periods following the entry of these assets into service. It is expected that the settlement or recovery period of hedge gains or losses is five to forty years. If the Company was not a regulated entity, earnings for the six months ended September 30, 2006 would have been $3.3 million lower except for this deferral (September 30, 2005 – nil).

(columnar dollars expressed in thousands)

3. Financial statement effect of rate regulation (continued):

(d) Tariffs in excess of price cap:

The Act contains provisions which ensure that if tariffs charged by the Company exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. At March 31, 2006, tariffs charged to customers on the major route group exceeded the price cap by $1.0 million. This liability was returned to customers through tariffs during fiscal quarter ending June 30, 2006. At September 30, 2006 the tariffs charged to customers exceeded the price cap by $0.3 million (September 30, 2005: nil) Of this, $0.2 million was charged to customers on the major route group and it is expected that settlement will occur in the next fiscal quarter. The remaining $0.1 million was charged to customers on the Bear Cove – Mid Coast route group and is not expected to be settled until the first quarter of the year ended March 31, 2008, the next operating period for this route group. In the absence of rate regulated accounting, GAAP would require these revenues to be recognized as income in the year earned, and earnings for the six months ended September 30, 2006 would have been $0.3 million higher (September 30, 2005: nil).

4. Accrued employee future benefits:

During the six months ended September 30, 2006 the Company recognized total defined benefit costs of $0.6 million (September 30, 2005 - $0.6 million).

5. Unrealized losses on derivative instruments:

The mark-to-market value of financial derivative instruments not designated as foreign currency hedges as at September 30, 2006 is $3.8 million (March 31, 2006 – nil).

6. Long-term debt:

	September 30 2006	March 31 2006
5.74% Senior Secured Bonds, Series 04-1, due May 2014	$ 250,000	$ 250,000
Unamortized discount	(101)	(108)
	249,899	249,892
6.25% Senior Secured Bonds, Series 04-4, due October 2034	250,000	250,000
Unamortized discount	(283)	(288)
	249,717	249,712
	$ 499,616	$ 499,604

(columnar dollars expressed in thousands)

7. Extraordinary gain:

On March 22, 2006 the vessel *Queen of the North* ran aground and subsequently sank. During the fiscal quarter 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.

8. Supplemental cash flow information:

	Three months ended September 30		Six months ended September 30	
	2006	2005	2006	2005
Significant transactions involving cash:				
Cash paid during the period for interest	$ 26	$ 48	$ 15,262	$ 15,083
Cash received from *Queen of the North* hull and machinery insurance policy	$ -	$ -	$ 67,875	$ -
Significant non-cash financing & investing activities:				
Mark-to-market adjustments on derivative instruments	$ 3,787	$ -	$ 3,787	$ -

9. Interest rate support:

The Government of Canada has agreed to provide $9.9 million in the form of interest rate support to the Company for major refurbishments on three vessels (March 31, 2006: $5.6 million). During the period ended September 30, 2006, $0.5 million has been recorded as a reduction of capitalized interest and $2.6 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 $4.2 million will be recognized over the next fifteen 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.