Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Nine months ended December 31, 2006

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Balance Sheets
(expressed in thousands)

	December 31, 2006 (unaudited)	March 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 22,008	$ 2,291
Restricted short-term investments	14,988	14,988
Accounts receivable	12,510	21,227
Prepaid expenses	6,501	6,702
Inventories	23,575	21,809
	79,582	67,017
Capital assets (note 2)	834,282	707,324
Deferred financing costs	8,048	8,183
Regulatory assets (note 3)	28,662	22,783
Long-term land lease	28,153	28,370
	$ 978,727	$ 833,677
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 37,850	$ 69,326
Short-term debt (note 4)	41,631	-
Interest payable on long-term debt	4,860	12,251
Accrued employee costs	44,240	44,810
Deferred revenue	12,374	14,000
Regulatory liabilities (note 3)	90	958
Current portion of accrued employee future benefits	800	800
Current portion of obligation under capital lease	25	25
	141,870	142,170
Accrued employee future benefits (note 5)	15,989	16,737
Unrealized losses on derivative instruments (note 6)	2,831	-
Long-term debt (note 4)	499,622	499,604
Obligations under capital lease	120	138
	660,432	658,649
Shareholders' equity:		
Share capital	75,478	75,478
Retained earnings	242,817	99,550
	318,295	175,028
Commitments (note 2)		
Interest rate support (note 9)		
	$ 978,727	$ 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 December 31		Nine months ended December 31	
	2006	2005	2006	2005
Revenue:				
Tariffs	$ 75,233	$ 74,598	$ 295,860	$ 292,820
Ferry service fees	25,703	25,416	84,276	83,599
Federal-Provincial Subsidy Agreement	6,327	6,222	18,982	18,667
Retail	15,919	14,719	58,592	56,486
Other income	5,198	5,078	19,660	17,909
	128,380	126,033	477,370	469,481
Expenses:				
Operations	72,558	69,423	231,530	229,373
Maintenance	21,853	21,780	53,104	52,969
Administration	11,459	10,105	33,889	32,530
Cost of retail goods sold	6,349	6,080	22,865	21,907
Amortization	13,748	13,296	40,371	38,918
	125,967	120,684	381,759	375,697
Earnings from operations	2,413	5,349	95,611	93,784
Gain on foreign exchange	29	54	266	231
Interest expense (note 9)	(4,295)	(6,307)	(13,875)	(19,273)
Gain (loss) on disposal of capital assets	13	(17)	(7)	(60)
Net (loss) earnings before extraordinary gain	(1,840)	(921)	81,995	74,682
Extraordinary gain (note 7)	-	-	61,272	-
Net (loss) earnings	(1,840)	(921)	143,267	74,682
Retained earnings, beginning of period	244,657	131,326	99,550	55,723
Retained earnings, end of period	$ 242,817	$ 130,405	$ 242,817	$ 130,405

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	
	2006	2005	2006	2005
Cash provided by (used in):				
Operations:				
Net (loss) earnings before extraordinary gain	$ (1,840)	$ (921)	$ 81,995	$ 74,682
Extraordinary gain (note 7)	-	-	61,272	-
Net (loss) earnings	(1,840)	(921)	143,267	74,682
Items not involving cash:				
Amortization	13,748	13,296	40,371	38,918
Other non-cash charges	213	386	683	585
Regulatory costs deferred	(616)	(4,139)	(3,048)	(12,634)
Change in operating working capital	14,443	(3,108)	(26,767)	(23,373)
	25,948	5,514	154,506	78,178
Financing:				
Deferred financing costs incurred	(79)	(610)	(239)	(613)
Amounts drawn from credit facility (note 4)	41,515	-	41,515	-
	41,436	(610)	41,276	(613)
Investing:				
Proceeds from (cost of) disposal of capital assets	12	1	28	(3)
Purchase of capital assets	(101,879)	(27,272)	(176,033)	(73,266)
Increase in lands under long-term lease	-	-	(60)	(1,147)
Purchase of short-term notes	-	(9,904)	-	(9,904)
	(101,867)	(37,175)	(176,065)	(84,320)
(Decrease) increase in cash and cash equivalents	(34,483)	(32,271)	19,717	(6,755)
Cash and cash equivalents, beginning of period	56,491	67,040	2,291	41,524
Cash and cash equivalents, end of period	$ 22,008	$ 34,769	$ 22,008	$ 34,769

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:

December 31, 2006	Cost	Accumulated amortization	Net book value
Ships owned	$ 815,430	$ 485,199	$ 330,231
Ship under capital lease	60,421	21,184	39,237
Berths, buildings and equipment	97,882	67,690	30,192
Berths, buildings and equipment under capital lease	478,574	224,171	254,403
Land	1,406	-	1,406
Construction-in-progress	178,813	-	178,813
	$ 1,632,526	$ 798,244	$ 834,282

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 nine months ended December 31, 2006 capitalized financing costs during construction amounted to $4.1 million (December 31, 2005 - $2.3 million).

The title of the ship under capital lease, the Queen of Oak Bay, was passed to the Company, without additional payments, on January 2, 2007.

In addition to the construction-in-progress referenced above, contractual commitments at December 31, 2006 for capital assets to be constructed totaled $521.0 million (March 31, 2006 - $324.2 million). Included in the contractual commitments as at December 31, 2006 is $302.4 million (March 31, 2006 - $308.2 million) committed for design and construction of three "Super C" Class vessels, $126.5 million (March 31, 2006 – nil) for design and construction of a new vessel for use on the north coast, $1.8 million (March 31, 2006 – nil) to procure and modify a northern vessel and $36.4 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 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	December 31 2006	March 31 2006
Deferred fuel costs (a)	$ 26,021	$ 22,715
Performance term submission costs (b)	271	68
Hedge losses – vessel construction contracts (c)	2,370	-
Total regulatory assets	$ 28,662	$ 22,783
Regulatory liabilities		
Tariffs in excess of price cap (d)	$ 90	$ 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 up to five years. If the Company was not a regulated entity, earnings for the quarter ended December 31, 2006 would have been $0.5 million lower (December 31, 2005 - $4.1 million), and earnings for the nine months ended December 31, 2006 would have been $3.3 million lower (December 31, 2005: $12.6 million), except for this deferral.

(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 quarter ended December 31, 2006 would have been $0.1 million lower (December 31, 2005 – nil), and earnings for the nine months ended December 31, 2006 would have been $0.2 million lower (December 31, 2005 – nil), except for this deferral.

(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 quarter ended December 31, 2006 would have been $0.9 million higher (December 31, 2005 – nil), and earnings for the nine months ended December 31, 2006 would have been $2.4 million lower (December 31, 2005 – nil), except for this deferral.

(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 the fiscal quarter ending June 30, 2006. At December 31, 2006 the tariffs charged to customers on the Bear Cove – Mid Coast route group exceed the price cap by $0.1 million (December 31, 2005: nil). These excess amounts are expected to be returned to customers in 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 period collected, and earnings for the quarter ended December 31, 2006 would have been $0.2 million lower (December 31, 2005 - nil), and earnings for the nine months ended December 31, 2006 would have been $0.9 million lower (December 31, 2005 - nil), except for this deferral.

4. Loans:

(a) Bonds:

	December 31 2006	March 31 2006
5.74% Senior Secured Bonds, Series 04-1, due May 2014	$ 250,000	$ 250,000
Unamortized discount	(98)	(108)
	249,902	249,892
6.25% Senior Secured Bonds, Series 04-4, due October 2034	250,000	250,000
Unamortized discount	(280)	(288)
	249,720	249,712
	$ 499,622	$ 499,604

(b) Credit facility:

In May 2006 the Company renegotiated the credit facility with a syndicate of Canadian banks, secured by pledged bonds. The facility makes available to the Company a five year revolving facility in the amount of $155 million. Draws on this facility via 90-day Bankers' Acceptances total $42.0 million at December 31, 2006 and are shown as short-term debt at their discounted value of $41.6 million. The effective interest rate of these borrowings was 4.74%.

(columnar dollars expressed in thousands)

5. Accrued employee future benefits:

During the quarter ended December 31, 2006 the Company recognized total defined benefit costs of $0.3 million (December 31, 2005 - $0.3 million).

During the nine months ended December 31, 2006 the Company recognized total defined benefit costs of $0.9 million (December 31, 2005 - $0.9 million).

6. Unrealized losses on derivative instruments:

The carrying value as at December 31, 2006 of financial derivative instruments not initially designated as foreign currency hedges is $2.8 million (March 31, 2006 – nil).

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 December 31 2006	Three months ended December 31 2005	Nine months ended December 31 2006	Nine months ended December 31 2005
Significant transactions involving cash:				
Cash paid during the period for interest	$ 15,167	$ 15,063	$ 30,429	$ 30,147
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 unrealized losses on derivative instruments	$ (956)	$ -	$ 2,831	$ -

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 quarter ended December 31, 2006, $1.2 million has been recorded as a reduction of interest expense (December 31, 2005 - $0.5 million). For the nine months ended December 31, 2006, $0.5 million has been recorded as a reduction of capitalized interest (December 31, 2005 - $0.5 million) and $3.8 million has been recorded as a reduction of interest expense (December 31, 2005 - $1.5 million).. The remaining $3.0 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.