Management's Discussion & Analysis of Financial Condition and Results of Operations

For the fiscal year ended March 31, 2008
Dated May 13, 2008

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The following is our discussion and analysis of the financial condition and results of operations for British Columbia Ferry Services Inc. as of May 13, 2008. This should be read in conjunction with our audited consolidated financial statements and related notes for the years ended March 31, 2008 (fiscal 2008) and March 31, 2007 (fiscal 2007). These documents are available on SEDAR at www.sedar.com and on our Investor webpage at http://www.bcferries.com/about/investors/index.html.

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 ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world, providing frequent year-round transportation service on 25 routes, supported by 37 vessels and 47 terminals. Our service is an integral part of British Columbia's coastal transportation system and has been designated by the Province of British Columbia (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 BC.

We are a versatile company, providing a wide range of ferry services for our customers. In fiscal 2008, we provided more than 187,000 sailings, carrying over 21.7 million passengers and 8.5 million vehicles.

Significant events during or subsequent to fiscal 2008:

New Vessels (See "Investing in our Capital Assets" below for more detail):

- On March 8, 2008, the first of three new Super C-class vessels, the *Coastal Renaissance*, commenced service on the Departure Bay–Horseshoe Bay route following crew training and familiarization in the operation of this brand new state-of-the-art vessel.

  On March 25, 2008, the second Super C-class vessel, the *Coastal Inspiration*, arrived in British Columbia following a 10,000 nautical mile journey from Germany. Crew training and familiarization is currently underway. The vessel is expected to enter service on the Duke Point-Tsawwassen route by the summer of 2008.

  On May 9, 2008, the third and final Super C-class vessel, the *Coastal Celebration*, departed Flensburger Schiffbau-Gesellschaft (FSG) shipyard in Germany for its trans-Atlantic journey to BC. The *Coastal Celebration* is expected to be in service on the Swartz Bay-Tsawwassen route by the fall of 2008.

  These vessels are the largest double-ended ferries in the world, with each vessel measuring 160 metres in length and having a capacity of 1,650 passengers and crew and approximately 370 vehicles. They feature a diesel-electric propulsion system that is one of the largest and most economical of its kind in the world. These new ships will replace aging vessels which currently provide service on our major routes. The total budget for the three vessels is $542 million. The project is currently on schedule and under budget.

- In December 2007, the vessel design for the new *Northern Expedition* was completed. The *Northern Expedition,* which is being built by FSG, is expected to replace the 42-year-old *Queen of Prince Rupert*, operating on our northern routes. This 150-metre vessel, which is expected to be in service in the spring of 2009, will have 55 staterooms and will accommodate 130 vehicles and 600 passengers. The total project budget for this vessel is $200 million. The project is currently on schedule and on budget.

- On January 4, 2008, the hull structure of the *Island Sky*, our new intermediate class ferry, was completed. Steelwork in general is substantially complete and installation and outfitting in preparation for equipment and system testing is underway. The *Island Sky* will allow for the retirement of the 48-year-old *Queen of Tsawwassen*. A $46 million contract with Vancouver Shipyards constitutes the majority of the total project budget of $57 million. The shipyard estimates delivery of the vessel by June 27, 2008.

Major vessel upgrades (See "Investing in our Capital Assets" below for more detail):

- On June 27, 2007, the 31-year-old *Queen of Alberni*, which usually operates on our Duke Point–Tsawwassen route, returned to service following an extensive $39 million upgrade to prepare it for another 20 years of service.

- On October 15, 2007, the *Queen of New Westminster*, which usually operates on our Duke Point–Tsawwassen route, began an upgrade to extend the life of the 44-year-old vessel for a further thirteen years of service. The vessel is expected to return to service in the fall of 2008 and be redeployed on our Tsawwassen–Swartz Bay route.

Other items:

- In fiscal 2008, the British Columbia Ferries Commissioner (the Commissioner) released his final second performance term price cap order establishing price cap increases for the four year term beginning April 1, 2008. The price cap increase on April 1, 2008 (starting from a level which includes fuel surcharges in place at March 31, 2008) was 7.3% on the major routes and 4.0% on all other routes. Each subsequent April 1 of the four-year term, the price cap will increase by 2.7% plus 0.49 times the latest reported annual increase in the Consumer Price Index for British Columbia on the major routes and 5.7% plus 0.73 times the latest reported annual increase in the Consumer Price Index for British Columbia on all other routes.

- On January 11, 2008, we closed a $200 million senior secured bond issue by private placement. The net proceeds were used to repay our credit facility, fund capital expenditures and the debt service reserve related to the bonds and for general corporate purposes. See "Liquidity and Capital Resources" below for more detail.

- In February 2008, coinciding with the conditional acceptance of the *Coastal Inspiration*, we received $90 million in proceeds under a loan agreement with KfW, a German export credit bank. In May 2008, we received a further $90 million in proceeds from KfW, coinciding with the conditional acceptance of the *Coastal Celebration*. The net proceeds from these loans were used to partially finance the purchase of these Super C-class vessels. See "Liquidity and Capital Resources" below for more detail.

CORPORATE STRUCTURE

Coastal Ferry Services Contract

We operate ferry services under a regulatory regime as defined by the *Coastal Ferry Act*, and under the terms set out in the Coastal Ferry Services Contract. This 60-year services contract with the Province, which commenced April 1, 2003, stipulates the number of round trips that must be provided for each regulated ferry service route in exchange for specified fees (ferry service fees). In anticipation of the deployment of new vessels on our northern routes, higher ferry service fees were negotiated with the Province for fiscal 2008, the final year of the first performance term of the contract. See "Northern Service" below for more detail. The Coastal Ferry Services Contract also includes fees for the provision of specific social program services delivered on behalf of the Province.

Under the terms of the Coastal Ferry Services Contract, we also receive an annual amount from the Province based on its agreement with the Government of Canada to fulfill the obligation of providing ferry services to coastal British Columbia. The amount of this payment is adjusted annually based on the Vancouver Consumer Price Index.

Economic Regulatory Environment

The office of the Commissioner was created under the *Coastal Ferry Act*, enacted by the Province on April 1, 2003. The Commissioner regulates price caps for designated ferry route groups which, to the end of the first performance term, were specified in the *Coastal Ferry Act*. The Commissioner is also responsible for regulating the reduction of service, discontinuance of routes and certain other matters. The *Coastal Ferry Act* requires the Commissioner to undertake regulation in accordance with several principles, including placing priority on the financial sustainability of ferry operators, encouraging ferry operators to adopt a commercial approach to ferry service delivery and moving over time to a greater reliance on a user pay system.

The Commissioner regulates our tariffs by establishing price caps commencing with the second performance term. Our first performance term ended March 31, 2008, and our second performance term will end March 31, 2012. The core ferry service fees and service levels for the second term have been set and the Commissioner released a final second performance term price cap order. Under this order, the price cap increase (starting from a level which includes fuel surcharges in place at March 31, 2008) was 7.3% on the major routes and 4.0% on all other routes effective April 1, 2008. On each April 1 for the subsequent three years, the price cap will increase by 2.7% plus 0.49 times the latest reported annual increase in the Consumer Price Index (British Columbia) on the major routes and 5.7% plus 0.73 times the Consumer Price Index (British Columbia) on all other routes.

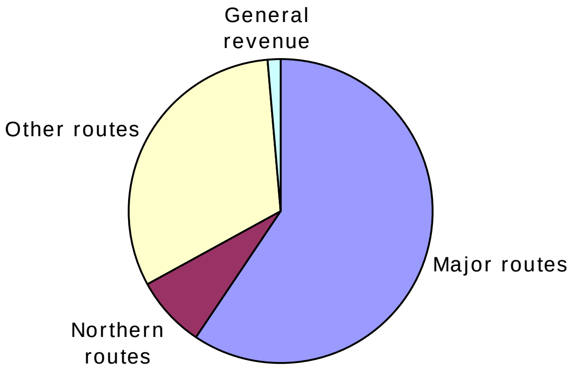
FINANCIAL AND OPERATIONAL OVERVIEW

This section provides an overview of our financial and operational performance over the past three fiscal years.

($ millions)	Year ended March 31 2008	2007	2006
Total revenue	640.7	596.3	579.2
% Growth	7.4%	3.0%	2.6%
Expenses	569.6	528.4	504.1
Earnings from operations	71.1	67.9	75.1
Interest and other	34.0	19.1	25.2
Net earnings before extraordinary gain	37.1	48.8	49.9
Extraordinary gain	-	61.3	-
Net earnings and comprehensive income	37.1	110.1	49.9
	As at March 31		
	2008	2007	2006
Total assets	1,550.5	1,215.8	833.7
Total long-term financial liabilities	1,059.5	766.3	516.5
Cash dividends	6.0	6.0	6.0

Our earnings from operations in fiscal 2008 were $3.2 million higher than in fiscal 2007. However net earnings were $11.7 million lower than net earnings before extraordinary gain in the previous year. Our consolidated net earnings before extraordinary gain in fiscal 2007 were $1.1 million lower than the previous fiscal year. In fiscal 2007, we recorded an extraordinary gain of $61.3 million as a result of insurance proceeds resulting from the loss of the *Queen of the North.* See “Northern Service” below for more detail.

Revenue
Our total revenues have increased steadily over the past three fiscal years as shown in the table below.



In fiscal 2008, the greatest portion of our revenues, 59%, was earned on our three major routes connecting Vancouver Island to Vancouver and the Lower Mainland. The revenue from the northern routes contributed 8% and other routes contributed 32%. General revenue, 1%, consists mainly of marketing rights and interest earned.

Total Revenue

Revenue ($ millions)	Year ended March 31		
	2008	2007	2006
Direct Route Revenue			
Vehicle traffic (volume)	8,578,703	8,521,915	8,543,269
Vehicle tariff	240.6	227.3	221.5
Passenger traffic (volume)	21,788,461	21,664,953	21,729,603
Passenger tariff	141.6	135.9	132.1
Social program fees	17.2	16.0	14.7
Catering & on-board	77.8	71.0	66.9
Other revenue	23.7	23.5	21.0
Total Direct Route Revenue	500.9	473.7	456.2
Indirect Route Revenue			
Ferry service fees	105.5	92.4	93.5
Federal-Provincial subsidy	25.8	25.3	24.9
Total Route Revenue	632.2	591.4	574.6
Other general revenue	8.5	4.9	4.6
Total Revenue	640.7	596.3	579.2

Our largest revenue source is vehicle and passenger tariffs. The annual average tariff rate increase in the first performance term was 2.8% on our three major routes and 4.4% on the remaining routes, as permitted by the *Coastal Ferry Act*. From time to time, we utilize promotional fare incentives designed to stimulate growth in traffic or direct traffic towards our less busy sailings. In calculating the price cap, vehicle and passenger tariffs are combined. The utilization of promotional fare incentives and the effects of being over or under the price cap may cause the average vehicle and passenger tariff rate to be under or over the statutory increase in any one period.

Year to year changes for the past two fiscal years for the major, northern and other routes are discussed separately below.

Year to Year Comparison of Revenues 2008 – 2007

Major Routes

Direct Route Revenue ($ thousands)	Fiscal year ended March 31			
	2008	2007	Increase (Decrease)	
Vehicle traffic (volume)	3,912,269	3,826,459	85,810	2.2%
Vehicle tariff	182,280	171,998	10,282	6.0%
Passenger traffic (volume)	11,304,042	11,146,311	157,731	1.4%
Passenger tariff	104,292	101,300	2,992	3.0%
Social program fees	8,790	8,284	506	6.1%
Catering & on-board	64,154	59,009	5,145	8.7%
Reservation fees	14,035	12,389	1,646	13.3%
Parking	3,110	2,864	246	8.6%
Assured loading	2,662	2,075	587	28.3%
Other revenue	840	4,107	(3,267)	(79.5%)
Total Direct Route Revenue	380,163	362,026	18,137	5.0%
Gross margin - catering & on-board	39,484	35,536	3,948	11.1%

Revenue on the major routes is from customers and related social program fees, and includes no ferry service fees.

Both vehicle traffic and passenger traffic increased over the prior year. The increase in average tariff revenue per vehicle was $1.64 or 3.6% while the increase in average tariff revenue per passenger was $0.14 or 1.5%. The increased traffic and higher average fares resulted in a total increase of $13.3 million in tariff revenue.

Social program fees are reimbursements from the Province of discounts provided on fares for BC seniors, students travelling to and from school, persons with disabilities and persons travelling under the Medical Travel Assistance Program. These fees have increased as a result of higher program usage and higher fares.

All of our vessels that provide service on our major routes have a gift shop and options for food service. The most significant increase in revenues from catering and on-board services was food service, which increased $3.6 million ($3.2 million increase in gross margin) as a result of higher spending per passenger and the higher number of passengers carried. Gift shop sales have also increased with the successful introduction of new apparel, gift products and a 2010 Olympic line.

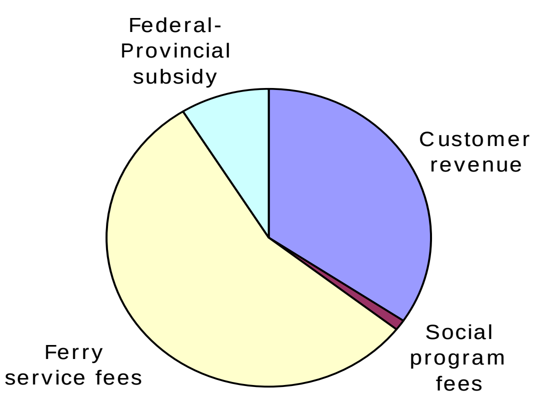
Fees for reservations show a substantial increase as a result of increased usage. Assured loading revenue also shows a marked increase as a result of both increased prices and increased usage.

In May 2005, we ceased sales of paper assured loading tickets and implemented the Coast Card, a plastic card with a magnetic strip, similar to a bank card. A $3.1 million reduction of our deferred revenue liability relating to historical sales of paper tickets was made in fiscal 2007 and is included in other customer revenue in the above table.

Northern Routes

Direct Route Revenue ($ thousands)	Fiscal year ended March 31			
	2008	2007	Increase (Decrease)	
Vehicle traffic (volume)	33,789	25,854	7,935	30.7%
Vehicle tariff	7,053	5,366	1,687	31.4%
Passenger traffic (volume)	101,751	78,159	23,592	30.2%
Passenger tariff	6,282	4,495	1,787	39.8%
Social program fees	581	380	201	52.9%
Catering & on-board	2,324	1,445	879	60.8%
Reservation fees	80	44	36	81.8%
Stateroom rental	964	359	605	168.5%
Hostling	165	155	10	6.5%
Other revenue	45	29	16	55.2%
Total Direct Route Revenue	17,494	12,273	5,221	42.5%
Indirect Revenue				
Ferry service fees	27,350	14,500	12,850	88.6%
Federal-Provincial subsidy	4,389	4,296	93	2.2%
Total Route Revenue	49,233	31,069	18,164	58.5%
Gross margin - catering & on-board	1,246	710	536	75.5%

Our northern routes consist of three regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island. Traffic levels have steadily increased since the resumption of full service, but have not yet reached the levels experienced during fiscal 2006.



Fiscal 2008 revenue from our northern routes consists of 34% from customers, 1% from social program fees, 56% from ferry service fees and 9% from payments under the Federal-Provincial subsidy agreement. The revenue from ferry service fees has increased 88% from fiscal 2007, reflecting resumption of full service with deployment of the new *Northern Adventure* on our northern routes.

The average tariff revenue per vehicle increased $1.19 or 0.6%. The average passenger tariff revenue increase was $4.23 or 7.4%. The increased traffic and higher average tariff resulted in a total tariff revenue increase of $3.5 million.

We receive ferry service fees for these routes under the Coastal Ferry Services Contract. The increase in fees reflects the negotiated increase resulting from the deployment of the *Northern Adventure*, which commenced operations on March 31, 2007.

Reimbursements from the Province for social program fees increased as a result of resumption of regular service and higher fares.

The increase in catering and on-board revenue resulted from the resumption of regular service and from higher food and gift shop sales per passenger. Stateroom revenue, fees for reservations and hostling[1] have increased primarily as a result of the resumption of regular service.

Northern Service

On March 22, 2006, the *Queen of the North*, operating on its regular route from Prince Rupert to Port Hardy, ran aground on Gil Island in Wright Sound and subsequently sank. Our divisional inquiry concluded that human factors were the primary cause of the incident. The Transportation Safety Board (TSB) conclusions, released in March 2008, were consistent with our own.

An emergency environmental plan was implemented in conjunction with external authorities. An extensive monitoring program determined that the spill from the sunken vessel was of short duration and there was minimal effect on the marine ecology of the region. The level of contaminants in edible organisms (i.e. shellfish) was very low and there was no risk for human consumption.

The feasibility and risk of recovering any fuel and lubricants that may remain in the vessel were investigated. The Canadian Coast Guard conclusions were that a significant amount of the fuel and lubricants were released following the incident, a recovery operation would be exploratory at best, and it is probable that there is no recoverable fuel remaining on the vessel. As a result, there is no plan to pursue fuel and lubricant recovery from the incident site.

We purchased oil spill response equipment for the Village of Hartley Bay and have provided oil spill response training to interested Hartley Bay residents. We engaged Hartley Bay residents in the ongoing monitoring of the incident site for leakage and of the adjacent waters for presence and distribution of oil sheen. We equipped them with portable global positioning systems to ensure accuracy of observation and reporting.

Our second stage environmental monitoring program, which started in fall 2007, focuses on testing shellfish. The results of samples collected and tested in September 2007 showed no evidence of contamination from fuel released from the wreck site. This environmental monitoring program will continue with shellfish samples tested before traditional harvesting seasons. We will continue to work with First Nations and other interested parties to ensure appropriate environmental monitoring and response.

[1] Loading and unloading of commercial trailers that are dropped off for transportation on a ferry route.

Northern Routes, cont'd

We maintain commercial insurance coverage for incidents of this nature. Insurance proceeds, net of deductible, of $67.9 million were received in May 2006 in settlement of the claim under the hull and machinery policy. We reported an extraordinary gain of $61.3 million for this event in the first quarter of fiscal 2007. These funds were utilized to partially fund the acquisition of the *Northern Adventure.* We expect that substantially all passenger claims, claims from other parties and costs incurred for environmental containment or cleanup will be paid by our liability insurer.

In March 2007, the *Northern Adventure*, a replacement for the *Queen of the North*, went into service on our northern routes. The two-year-old vessel was purchased in October 2006 and underwent significant modifications to update safety and security equipment, modify the stern to be compatible with our existing berths, upgrade electrical, heating and lighting systems and upgrade customer amenities. This 117-metre vessel has 74 staterooms and accommodates more than 600 passengers and 101 vehicles. With the deployment of this new vessel, the ferry service fees from the Province have increased from the level received prior to the loss of the *Queen of the North* by approximately $11 million annually, beginning April 1, 2007. This level of ferry service fees reflects the cost of the *Northern Adventure* after receipt of import duties remission and related GST totalling $13.9 million.

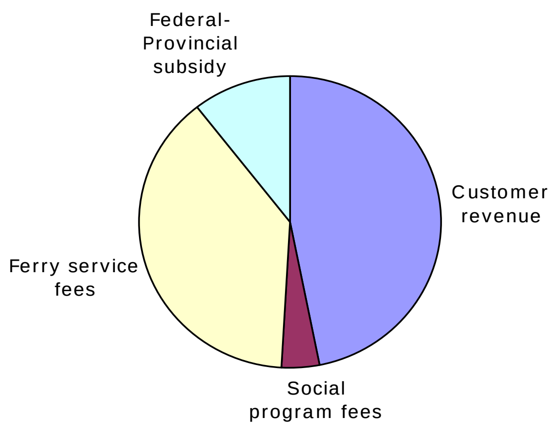
In August 2006, we signed a $133 million contract with FSG to build the *Northern Expedition,* which is expected to replace the 42-year-old *Queen of Prince Rupert* currently operating on our northern routes. This 150-metre vessel, which is planned to be in service in the spring of 2009, will have 55 staterooms and will accommodate 130 vehicles and 600 passengers. See "Investing in our Capital Assets" below for more detail. With the deployment of this new vessel, the ferry service fees from the Province will increase by approximately $22 million annually.

We anticipate a third replacement vessel for the northern service will be acquired and will enter service during our third performance term. Negotiations with the provincial government for increased ferry service fees with respect to this vessel are ongoing.

Other Routes

Direct Route Revenue ($ thousands)	Fiscal year ended March 31 2008	2007	Increase (Decrease)	
Vehicle traffic (volume)	4,632,645	4,669,602	(36,957)	(0.8%)
Vehicle tariff	51,319	49,948	1,371	2.7%
Passenger traffic (volume)	10,382,668	10,440,483	(57,815)	(0.6%)
Passenger tariff	31,004	30,122	882	2.9%
Social program fees	7,877	7,302	575	7.9%
Catering & on-board	11,276	10,552	724	6.9%
Reservation fees	1,388	1,213	175	14.4%
Parking	216	205	11	5.4%
Other revenue	145	147	(2)	(1.4%)
Total Direct Route Revenue	103,225	99,489	3,736	3.8%
Indirect Revenue				
Ferry service fees	78,151	77,929	222	0.3%
Federal-Provincial subsidy	21,467	21,013	454	2.2%
Total Route Revenue	202,843	198,431	4,412	2.2%
Gross margin - catering & on-board	7,087	6,533	554	8.5%

Our other routes consist of 19 regulated routes and eight small unregulated routes primarily serving the northern and southern Gulf Islands and the Sunshine Coast. One of the regulated routes and all of the unregulated routes are operated under contract by alternative service providers. We receive fees from the Province for the provision of service on the unregulated routes, which are included in the ferry service fees in the above table.



Fiscal 2008 revenue from our other routes consists of 47% from customers, 4% from social program fees, 38% from ferry service fees and 11% from payments under the Federal-Provincial subsidy agreement.

Other Routes, cont'd

We experienced a decrease in vehicle and passenger traffic levels on our other routes in fiscal 2008. More than 27% of the vehicle and passenger traffic decrease was as a result of a major refit of the *Mill Bay,* which services our Mill Bay-Brentwood Bay route. Service on this route was suspended for almost two months in the first quarter to allow for the refit. A major refit of the *Mill Bay* is scheduled to occur every four years.

The increase in average tariff revenue per vehicle was $0.38 or 3.6% while the average passenger tariff revenue increase was $0.10 or 3.5%. The increased average fares, partially offset by the reduction in traffic levels, resulted in a total tariff revenue increase of $2.3 million.

Reimbursements from the Province for social program fees increased as a result of higher program usage and higher fares.

During fiscal 2008, the Province agreed to reimburse us a maximum of $1.6 million for the refit of the 23-year-old *Nicola*, which provides service on our unregulated Prince Rupert-Lax Kwala'ams route. At March 31, 2008, we recorded a $0.5 million reduction of maintenance expense, equal to the refits costs incurred to that date.

Increases in catering and on-board revenue resulted from higher food and gift shop sales per passenger and additional sales from an expanded gift shop on the *Queen of Surrey*, which operates between Horseshoe Bay and Langdale.

Fees for reservations have increased as a result of higher usage. The decrease in other income is mainly a result of additional revenue from charters in the first quarter of the prior year.

Year to Year Comparison of Revenues 2007 – 2006

Major Routes

Direct Route Revenue	Fiscal year ended March 31			
($ thousands)	2007	2006	Increase (Decrease)	
Vehicle traffic (volume)	3,826,459	3,790,368	36,091	1.0%
Vehicle tariff	171,998	167,451	4,547	2.7%
Passenger traffic (volume)	11,146,311	11,055,858	90,453	0.8%
Passenger tariff	101,300	97,029	4,271	4.4%
Social program fees	8,284	7,789	495	6.4%
Catering & on-board	59,009	54,516	4,493	8.2%
Reservation fees	12,389	11,581	808	7.0%
Parking	2,864	2,621	243	9.3%
Assured loading	2,075	1,544	531	34.4%
Other revenue	4,107	2,728	1,379	50.5%
Total Direct Route Revenue	362,026	345,259	16,767	4.9%
Gross margin - catering & on-board	35,536	32,415	3,121	9.6%

Vehicle traffic and passenger traffic increased marginally. The increase in average tariff per vehicle was $0.77 or 1.7% while the increase in average tariff per passenger was $0.31 or 3.6%. The increased traffic and higher average fares resulted in a total increase of $8.8 million in tariff revenue.

Social program fees increased as a result of higher program usage and higher fares.

Food sales increased $3.1 million as a result of higher spending per passenger and the higher number of passengers carried. Gift shop sales increased $0.9 million with significant improvements in sales of books, clothing and giftware. We achieved higher sales while increasing margins.

Fees for reservations increased as a result of higher usage while parking commissions and premiums from assured loading sales also increased as a result of both increased prices and increased usage.

Other revenue includes a $3.1 million recognition in fiscal 2007 ($2.0 million in fiscal 2006) for the reduction of our deferred revenue liability relating to historical sales of paper tickets.

Northern Routes

Direct Route Revenue ($ thousands)	Fiscal year ended March 31			
	2007	2006	Increase (Decrease)	
Vehicle traffic (volume)	25,854	37,074	(11,220)	(30.3%)
Vehicle tariff	5,366	7,291	(1,925)	(26.4%)
Passenger traffic (volume)	78,159	117,062	(38,903)	(33.2%)
Passenger tariff	4,495	6,768	(2,273)	(33.6%)
Social program fees	380	548	(168)	(30.7%)
Catering & on-board	1,445	2,728	(1,283)	(47.0%)
Reservation fees	44	120	(76)	(63.3%)
Stateroom rental	359	1,018	(659)	(64.7%)
Hostling	155	135	20	14.8%
Other revenue	29	15	14	93.3%
Total Direct Route Revenue	12,273	18,623	(6,350)	(34.1%)
Indirect Revenue				
Ferry service fees	14,500	15,350	(850)	(5.5%)
Federal-Provincial subsidy	4,296	4,227	69	1.6%
Total Route Revenue	31,069	38,200	(7,131)	(18.7%)
Gross margin - catering & on-board	710	1,597	(887)	(55.5%)

The reduction in vehicle and passenger traffic and related revenue in fiscal 2007 resulted from the loss of regular northern service throughout the summer months.

We receive ferry service fees for these routes under the Coastal Ferry Services Contract. The drop in fees reflects the negotiated reduction resulting from the modified summer service we provided as a result of the loss of the *Queen of the North*.

Fees for hostling increased despite the limited northern service during the summer months. Other revenues increased mainly as a result of rental income at Prince Rupert terminal.

Other Routes

Direct Route Revenue ($ thousands)	Fiscal year ended March 31			
	2007	2006	Increase Decrease)	
Vehicle traffic (volume)	4,669,602	4,715,827	(46,225)	(1.0%)
Vehicle tariff	49,948	46,744	3,204	6.9%
Passenger traffic (volume)	10,440,483	10,556,683	(116,200)	(1.1%)
Passenger tariff	30,122	28,342	1,780	6.3%
Social program fees	7,302	6,337	965	15.2%
Catering & on-board	10,552	9,714	838	8.6%
Reservation fees	1,213	942	271	28.8%
Parking	205	156	49	31.4%
Other revenue	147	150	(3)	(2.0%)
Total Direct Route Revenue	99,489	92,385	7,104	7.7%
Indirect Revenue				
Ferry service fees	77,929	78,199	(270)	(0.3%)
Federal-Provincial subsidy	21,013	20,673	340	1.6%
Total Route Revenue	198,431	191,257	7,174	3.8%
Gross margin - catering & on-board	6,533	5,969	564	9.4%

The increase in average tariff per vehicle was $0.78 or 7.9% and the average tariff revenue per passenger increased $0.20 or 7.4%. The increased average tariff, partially offset by the reduction in traffic levels, resulted in a total tariff revenue increase of $5.0 million.

Reimbursements from the Province for social program fees increased as a result of higher program usage and higher fares.

In fiscal 2007, we experienced higher food sales per passenger and additional sales from an expanded gift shop on the *Queen of Surrey*, which operates between Horseshoe Bay and Langdale.

Fees from reservations increased as a result of higher usage.

Expenses
Expenses for the past three fiscal years are summarized in the table below.

Expenses ($millions)	Year ended March 31 2008	2007	2006
Operations	334.7	309.1	291.7
Maintenance	88.4	84.9	81.1
Administration	49.8	50.6	51.2
Total operations, maintenance & administration	472.9	444.6	424.0
% Increase (decrease)	6.4%	4.9%	(0.3%)
Cost of retail goods sold	29.9	28.3	27.0
Amortization	66.8	55.5	53.1
Total expenses	569.6	528.4	504.1
% Increase	7.8%	4.8%	0.9%
Interest and other			
(Gain) loss on foreign exchange	(0.1)	(0.4)	(0.2)
Interest expense	33.1	19.3	25.1
Loss on disposal of capital assets	1.0	0.2	0.3
Total interest and other	34.0	19.1	25.2

Fuel Deferral and Related Surcharge
In September 2004, the Commissioner issued an order authorizing our use of deferred fuel cost accounts to mitigate the effect of volatility in fuel oil prices on earnings.

Commencing April 1, 2004, the Commissioner established set prices for fuel oil for each of the years until March 31, 2008. At the start of each fiscal year, the set prices increased by the Consumer Price Index (Vancouver). On March 30, 2007, the Commissioner proposed the continued use of inflation-adjusted set prices and deferred fuel cost accounts for the second performance term beginning April 1, 2008.

Differences in fuel costs arising from our actual price paid per litre being higher or lower than the unit set price are charged or credited to the deferred fuel cost accounts.

In order to reduce or eliminate these increasing deferred fuel cost account balances, extraordinary price cap increases were approved by the Commissioner and fuel surcharges were implemented from time to time, beginning in July 2005. On June 1, 2007, adjustments were made to these fuel surcharges on two routes. The deferred fuel cost account balance on the Horseshoe Bay-Langdale route was low enough to allow a reduction in the fuel surcharge. The deferred fuel cost account on the Mill Bay-Brentwood Bay route reflected a surplus position and the fuel surcharge was removed and a rebate was implemented on this route.

Under an agreement reached in March 2007, the Province made a one-time $7.0 million ferry service fee payment for fiscal 2007, which was applied against the deferred fuel cost accounts in accordance with the agreement. Under an agreement reached during fiscal 2008, the Province paid a further $1.3 million, which was also applied against the deferred fuel cost accounts in accordance with this agreement.

The Commissioner has considered $18.5 million of deferred fuel costs in determination of the price caps set for the four years beginning April 1, 2008, and it is expected that recovery will occur over this four year period. The difference between the balance in the deferral accounts at March 31, 2008, and this $18.5 million will form the opening balances of the fuel deferral accounts for the second performance term.

The Commissioner also set an efficiency target requiring us to reduce fuel consumption by 1% in fiscal 2007 and by an additional 1% in fiscal 2008. At the end of fiscal 2008, we exceeded the 2% cumulative efficiency target.

The balances in our deferred fuel cost accounts totalled $11.9 million at March 31, 2008 ($18.8 million at March 31, 2007).

All of the Commissioner's Orders can be viewed at www.bcferrycommission.com.

Year to Year Comparison of Expenses 2008 – 2007

The $25.6 million increase in operations expenses reflects:

- $20.5 million increase in wages and benefits, including:
  - Approximately $8.0 million in wage rate increases averaging about 4%;
  - $4.1 million increase in labour on the northern routes with resumption of full service;
  - $3.5 million increase in benefit costs;
  - $2.5 million in overtime costs; and
  - $2.0 million in additional training costs (an increase in operational training from approximately 11,000 to 14,210 person days);

- $4.6 million increase in fuel expense reflecting the resumption of regular northern service with the addition of the *Northern Adventure*, and an increase in set prices of 1.86% as ordered by the Commissioner; and

- $3.3 million increase in safety and security costs, including $2.0 million for the introduction of our SailSafe program — a joint initiative with the BC Ferry & Marine Workers' Union to identify areas and methods for enhancing current safety practices.

These increases were partially offset by:

- $3.1 million reduction in contracted services relating to the replacement service costs incurred in fiscal 2007 on the northern routes.

The $3.5 million increase in maintenance costs reflects our continued commitment to safety and the age of our fleet. We completed 26 vessel refits in fiscal 2008 with a further two in progress at March 31, 2008. We have also increased maintenance on our terminals.

Administration expenses decreased $0.8 million mainly as a result of a reduction in telecommunication costs.

Amortization increased a total of $11.3 million as a result of additional assets coming into service, including $5.3 million reflecting the *Northern Adventure* entering service in March 2007.

Interest expenses increased $13.8 million primarily due to:

- $12.1 million additional interest relating to our $250 million bond series issued in March 2007;
- $2.4 million additional interest relating to our $200 million bond series issued in January 2008; and
- $2.6 million reduction in funds received from the Structured Financing Facility Program offered by the Government of Canada. We received $2.1 million in remaining support for the *Queen of Nanaimo* and *Queen of Surrey* mid-life upgrades during fiscal 2008.

These increases were partially offset by $3.7 million of additional interest capitalized reflecting our investment in revitalizing our fleet and terminal facilities.

Year to Year Comparison of Expenses 2007 – 2006

The $17.4 million increase in operations expenses reflects:

- $8.5 million increase in wages and benefits, including lump sum payments to employees totalling $3.4 million as a result of the arbitration award; $1.2 million in additional training costs (an increase in operational training from approximately 8,000 to approximately 11,000 person days); and wage rate increases of $6.7 million, partially offset by improved labour scheduling practices and as a result of reduced service on northern routes.
- $3.8 million increase in property tax expense. In fiscal 2006, property tax expense was reduced by $8.2 million in settlement of terminal property tax assessment appeals for 2004 and 2005;
- $2.6 million increase reflecting our renewed uniform program; and
- $1.6 million net increase in marine insurance premiums.

Maintenance expenses, which include expenditures for vessel refit and maintenance as well as terminal maintenance activities, were $3.8 million higher.

Administration expenses decreased $0.6 million mainly as a result of a $2.2 million reduction in severance and restructuring costs, partially offset by a $1.5 million increase in data communications and telecommunication costs.

Amortization increased a total of $2.4 million as a result of additional assets coming into service, including $1.8 million reflecting the *Queen of Surrey* $37.2 million upgrade;

Interest expenses decreased $5.8 million due to:

- $4.0 million of additional interest capitalized reflecting our investment in fleet and terminal revitalization plans;
- $2.7 million increase in interest rate support recorded under the Structured Financing Facility Program. A total of $9.9 million in support for the *Queen of Oak Bay, Queen of Nanaimo* and *Queen of Surrey* mid-life upgrades was granted of which we reflected $4.7 million ($2.0 million in fiscal 2006) as a decrease in bond interest costs and $0.5 million ($0.6 million in fiscal 2006) to offset interest costs previously capitalized on the upgrades. The remaining $2.1 million will be applied against future bond interest costs.

These decreases in interest expense were partially offset by an overall increase in our average level of debt and the effect of interest rates payable on the debt instruments issued and in place as described in the “Liquidity and Capital Resources” section below.

LIQUIDITY AND CAPITAL RESOURCES

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. We expect operating cash flows to fund approximately one half of the capital expenditures over the next five years, with the balance funded by borrowings.

Long-Term Debt

In May 2004 we entered into a master trust indenture. This indenture established common security and a set of common covenants for the benefit of our lenders. Our financing plan encompasses an ongoing program capable of accommodating a variety of corporate debt instruments and borrowings ranking *pari passu*. We do not currently view common share equity as a potential source of capital and have no present intention of offering common shares to the public or other investors.

Under this indenture we completed two $250 million public offerings in fiscal 2005:

- 5.74% senior secured bonds, due May 27, 2014; and
- 6.25% senior secured bonds, due October 13, 2034.

The net proceeds were used primarily to repay a portion of our indebtedness to the Province, to fund reserves required in connection with these bonds and for general corporate purposes. Interest on these bonds is payable semi-annually.

In March 2007, we completed a $250 million, 30-year senior secured bond issue. These private placement bonds bear interest at 5.021%, payable semi-annually. The net proceeds were used primarily to repay our credit facility, fund capital expenditures and the related debt service reserve and for general corporate purposes.

On January 11, 2008, we completed a $200 million 30-year senior secured bond issue. These private placement bonds bear interest at 5.581%, payable semi-annually. The net proceeds were used to fund capital expenditures and the related debt service reserve and for general corporate purposes.

We also are party to a credit agreement with a syndicate of Canadian banks which is secured under the master trust indenture. Under this agreement, we have available a revolving facility in the amount of $155 million. In fiscal 2008 we negotiated an amendment that provides us with an option to request a one-year extension annually. In May 2008, we requested and received a one-year extension to this agreement. The facility, maturing May 12, 2013, is available to fund capital expenditures and other general corporate purposes. Currently there are no draws on this facility.

In fiscal 2006 we executed two loan agreements with KfW, a German export credit bank. These agreements are secured under the master trust indenture. The agreements allow us to borrow up to $90 million per loan, with the net proceeds to be used for partial financing of the purchase of two of the three Super C-class vessels. In February 2008, to coincide with conditional acceptance of the *Coastal Inspiration*, we received $90 million in proceeds under the loan agreements. In May 2008, to coincide with conditional acceptance of the *Coastal Celebration*, we received a further $90 million in proceeds under the loan agreements. These are 12-year amortizing loans, at a fixed interest rate of 4.98%. The agreements defer the principal payments for the first three years to a second tranche on which interest is payable at a floating rate and the principal is due at maturity.

Terminal Leases

We entered into a master agreement with the BC Transportation Financing Authority (BCTFA) effective March 31, 2003, as part of the restructuring of our company. In return for the transfer of ownership interest in all ferry terminals from the former British Columbia Ferry Corporation to the BCTFA at the time of the corporate restructuring, we received recognition of prepayment of rent under terminal leases.

The leases grant us exclusive access and use of ferry terminal properties for a period of 60 years commencing April 1, 2003. The leases are renewable for an additional period of 20 years at a total cost of $20 per lease if the Coastal Ferry Services Contract is renewed. We must manage, maintain and develop the terminals at our own cost.

Since the original transfer, $5.1 million of additional lands at Horseshoe Bay and Swartz Bay were added to the existing terminal leases in exchange for highway improvements. During fiscal 2008 we created land by filling in part of the water lot at Departure Bay terminal at a cost of $1.5 million. It is expected that this land will be added to the land lease once work currently planned for this terminal is completed.

If we fail to meet our obligations under the terminal leases or default under the Coastal Ferry Services Contract, the BCTFA may at its option re-enter and take possession of the ferry terminal properties and at its option terminate the leases. The BCTFA has entered into an acknowledgement agreement with the Bondholders’ Trustee, which sets out certain limitations on the use of this option.

In addition to the above, we have entered into a 40-year lease agreement with the Town of Sidney, B.C., to manage an existing ferry terminal owned by the town. This terminal is the western end of a Washington State Ferries’ route connecting Vancouver Island with Anacortes, WA.

Other Long-Term Liabilities

Other long-term liabilities consist primarily of accrued post-retirement and post-employment benefits and certain regulatory liabilities.

Sources & Uses of Cash

Our liquidity needs are met through a variety of sources, including cash generated from operations and borrowings under our credit facility. Our primary uses of funds are operational expenses, capital asset acquisitions and upgrades and interest payments on our long-term debt.

Sources and uses of cash and cash equivalents for fiscal 2008 and 2007 are summarized in the table below.

	Year ended March 31	
($ millions)	2008	2007
Net income before extraordinary gain	37.1	48.8
Extraordinary gain		61.3
Items not involving cash:		
Amortization	66.8	55.5
Other non-cash charges	1.6	(1.9)
Regulatory costs deferred	11.6	3.9
Change in operating working capital	6.6	(7.1)
Cash provided by operating activities	123.7	160.5
Cash provided by financing activities	256.6	266.7
Cash used in investing activities	(430.0)	(249.4)
Total (decrease) increase in cash	(49.7)	177.8

In fiscal 2008, cash provided by operating activities includes a decrease in non-cash working capital of $6.6 million. This decrease was primarily due to:

- $2.9 million increase in interest payable on the new bond issue and KfW loan;

- $3.1 million increase in deferred revenue as a result of:
    - $1.4 million increase in commuter tickets;
    - $2.7 million increase in assured loading premiums;
    - $0.2 million increase in reservation liabilities and other deferred revenues; and
    - $1.2 million reduction in deferred advertising representing the completion of a prepaid sponsorship agreement with Coca-Cola.

- $3.5 million increase in regulatory liabilities reflecting the increase in tariff revenues collected in excess of the price cap of $3.4 million for the major routes and $0.1 million for the northern routes; These funds will be returned to passengers in future periods through discount fare promotions;

- $5.8 million increase in accrued employee costs;

- $2.8 million decrease in accounts receivable resulting mainly from decreases of:
    - $6.1 million in ferry service fees due to the receipt of fees outstanding at March 31, 2007; and
    - $1.4 million in other receivables.

  These decreases were partially offset by increases of:
    - $1.3 million in social program fees recoverable, reflecting higher program usage and two months of receivable (one month at March 31, 2007); and
    - $3.4 million in commercial travel card receivables as a result of a change in payment terms from net 7 to net 30 days.

The working capital decrease was partially offset by:

- $2.0 million increase in prepaid expenses and inventories;
- $4.7 million decrease in payables and accrued liabilities relating to refit and maintenance and other operating activities; and
- $4.8 million increase in current regulatory assets ($4.6 million of deferred fuel costs and $0.2 million of second performance term submission costs), representing the amounts that will be amortized and recovered in tariffs during fiscal 2009.

Cash provided by financing activities reflects the $200 million Series 08-1 bond issuance and the $90 million loan agreement with KfW, a German export credit bank.

Cash used in investing activities consists mainly of $427.5 million used to purchase capital assets. The significant capital transactions are described below in “Investing in Our Capital Assets”.

INVESTING IN OUR CAPITAL ASSETS

Capital expenditures in fiscal 2008 totalled $452.5 million. This level of expenditure reflects significant investments in our fleet, terminals and information systems to increase customer service and operating efficiency. Total capital expenditures were:

($ millions)	
New vessels, vessel upgrades and modifications	382.8
Terminal marine structures	26.6
Terminal and building upgrades and equipment	27.9
Computer hardware and software development	15.2
Total Capital Expenditures	452.5

New Vessels, Vessel Upgrades and Modifications

Capital expenditures for new vessels, vessel upgrades and vessel modifications in fiscal 2008 included the following:

($ millions)	
New *Coastal Renaissance, Coastal Inspiration* and *Coastal Celebration*	319.8
Life extension of the *Queen of New Westminster*	15.4
Mid-life upgrade to the *Queen of Alberni*	12.9
New intermediate vessel, the *Island Sky*	14.0
New northern vessel, the *Northern Expedition*	8.3
Upgrade and replacement of propulsion and safety equipment on the *Quinsam*, *Quinitsa* and *Queen of Capilano*	6.7
Completion of the *Northern Adventure* with post-acquisition modifications	5.0
Fire suppression system, improvements to crew safety and upgrades to accommodations for the *Howe Sound Queen*	3.0
Two-year project to install Voyage Data Recorders and navigational aids and upgrade vessel connectivity	3.0
Refurbishment of car deck on the *Powell River Queen*	2.3
Sewage treatment upgrade program for 13 vessels	1.9
Passenger accommodation upgrades on the *Queen of Burnaby*	1.4
Other projects	3.0
Import duties remission and related GST on the purchase of the *Northern Adventure*	(13.9)
	382.8

To improve fleet safety, we are installing Voyage Data Recorders (VDRs) on all the vessels in the fleet. A VDR is an electronic data collection system that records and securely stores voyage information from various sources, such as navigation equipment, propulsion control systems, radio communications, voice audio and bridge ambient sounds. They have been installed on 23 vessels to date. Our intention is for the entire fleet to have VDRs fitted by early 2009 and for all new construction vessels to be fitted during construction.

Major Vessel Upgrades

The *Queen of New Westminster*, which usually operates on our Duke Point–Tsawwassen route, is currently undergoing a project to extend the life of the 44-year-old vessel for a further thirteen years of service. This $55 million project will include significant upgrades for structural fire protection; a new marine evacuation system; major electrical upgrades; boiler, auxiliary generator and emergency generator renewal; and propulsion controls upgrade. The *Queen of New Westminster* is expected to return to service in the fall of 2008 and be redeployed on our Tsawwassen–Swartz Bay route.

The *Queen of Alberni*, which usually operates on our Duke Point–Tsawwassen route, returned to service on June 27, 2007, following an extensive $39 million upgrade. The 31-year-old vessel underwent significant upgrades to prepare for another 20 years of service. The upgrades included safety and mechanical improvements as well as improved and expanded passenger amenities. The *Queen of Alberni* is the fifth, and final, C-class vessel to undergo such a major mid-life upgrade. Similar upgrades have been completed on the *Queen of Coquitlam*, *Queen of Cowichan, Queen of Surrey* and *Queen of Oak Bay.*

Coastal Renaissance, Coastal Inspiration and Coastal Celebration

In September 2004 we entered into contracts with FSG to build three new Super C-class vessels that are the largest double-ended vessels in the world. Each vessel measures 160 metres in length and has a capacity of 1,650 passengers and crew and approximately 370 vehicles. These new vessels feature a diesel-electric propulsion system that is one of the largest and most economical of its kind in the world. These Super C-class vessels are replacing aging vessels that have been providing service on our major routes.

The contracts with FSG are design-build and fixed price, totalling $325 million. The contracts provide us with substantial guarantees related to delivery dates, performance criteria, cost certainty and quality of construction. These contracts, together with import duties and taxes of approximately $112 million, form the majority of the total project budget of $542 million. We are currently seeking a remission of the import duties and related GST of approximately $86 million, but are uncertain as to the outcome of this application. Foreign currency based payments in this project have been hedged in Canadian dollars to manage the foreign exchange risk. The project for these three new state-of-the-art vessels is expected to be completed on schedule and within budget.

Construction of the *Coastal Renaissance* started in August 2006 and the vessel was launched in Germany in April 2007. It commenced service on the Departure Bay-Horseshoe Bay route on March 8, 2008, following crew training and familiarization in the operation of this new vessel.

Construction of the *Coastal Inspiration* commenced in November 2006 and the vessel was launched in August 2007. On March 25, 2008, it arrived in British Columbia. Crew training and familiarization is currently underway. The vessel is expected to enter service on the Duke Point-Tsawwassen route by the summer of 2008.

Construction of the *Coastal Celebration* began in April 2007 and the vessel was launched in December 2007. It departed Germany on May 9, 2008, for its trans-Atlantic journey to British Columbia. The vessel is expected to commence service on the Swartz Bay-Tsawwassen route in the fall of 2008.

These three new vessels each feature four unique photographic images promoting the 2010 Olympic and Paralympic Winter Games and the natural beauty of British Columbia. The *Coastal Celebration*'s journey home included a promotional stop in London to raise awareness for the Games and to promote British Columbia as a tourist destination.

Northern Expedition

We signed a $133 million contract with FSG to build a new vessel which is expected to replace the 42-year-old *Queen of Prince Rupert* currently operating on our northern routes. The import duties and taxes on this contract will total approximately $43 million. We will be seeking a remission of the import duties and related GST of approximately $35 million, but are uncertain as to the outcome of our application. This design-build, fixed price contract (the majority of the total project budget of $200 million) provides us with substantial guarantees for delivery dates, performance criteria, cost certainty and quality of construction. Foreign currency based payments in this project have been hedged in Canadian dollars to manage the foreign exchange risk. The vessel design was completed in December 2007 and approximately 60% of the superstructure modules have been assembled. This 150-metre vessel, which is expected to be in service in the spring of 2009, will have 55 staterooms and will accommodate 130 vehicles and 600 passengers.

Northern Adventure

Our application for import duties remission relating to the purchase of the *Northern Adventure* was approved and $13.1 million was received from the federal government in September 2007. The total of $13.9 million, including related GST, has been applied as a reduction of the cost of the vessel. In accordance with the Coastal Ferry Services Contract, the receipt of the import duties remission has resulted in a reduction in provincial northern ferry service fees.

Island Sky

On January 4, 2008, the hull structure of the *Island Sky*, our new intermediate class ferry, was completed. Steelwork in general is substantially complete and erection is underway at Vancouver Shipyards in North Vancouver. The $45.5 million contract with Vancouver Shipyards constitutes the majority of the total project budget of $57 million. The new intermediate vessel will allow for the retirement of the 48-year-old *Queen of Tsawwassen*. The new vessel will measure 102 metres in length and have a capacity of approximately 600 passengers and 125 vehicles. It will feature a new state-of-the-art lifesaving system as well as a variety of amenities, including a lounge and snack bar for passengers. Although the contract provides for delivery of this vessel by April 7, 2008, we have been informed by the shipyard that their revised estimate of the delivery date is June 27, 2008.

Terminal Marine Structures
We continued to reinvest in our terminal infrastructure in fiscal 2008. We made significant upgrades to many of our terminals and made preparations for the arrival of the new Super C-class vessels. Over the next five years, we plan to invest approximately $250 million in our terminals for building and marine structure upgrades.

Capital expenditures on terminal marine structures for fiscal 2008 included the following:

($ millions) Terminal	Description	
Departure Bay	Berth upgrades to accommodate Super C-class vessels	5.0
Horseshoe Bay	Berth upgrades to accommodate Super C-class vessels	4.6
Skidegate	New pontoon, ramp, ramp abutment and two dolphins	4.0
Prince Rupert	New pontoon, ramp, ramp abutment and dolphin	2.1
Bear Cove	New pontoon, ramp and ramp abutment	1.0
Village Bay	Replacement of wingwall structures	1.6
Duke Point	Berth upgrades to accommodate Super C-class vessels	1.5
Otter Bay	Refurbish two floating leads and replace two others	1.4
Departure Bay	Electrical upgrades	1.4
Various	Other projects	4.0
		26.6

To replace aging berths and to accommodate the Super C-class vessels, modifications of marine structures at three berths at Departure Bay terminal and two berths at Horseshoe Bay terminal are complete. The modifications to the berth at Duke Point are currently in progress. These berth refurbishments and upgrades include new trestles, dolphins[2] and catwalks.

Terminal and Building Upgrades and Equipment
Besides upgrades to terminal marine structures, many other terminal upgrades are underway to provide better service to our customers and improve operational efficiencies. The most significant activity this fiscal year has been at two of our major terminals, Departure Bay and Swartz Bay. Capital expenditures on terminal and building upgrades and equipment included the following:

($ millions)	
Departure Bay terminal	17.8
Swartz Bay terminal	6.9
Alert Bay terminal	1.0
Security upgrades	0.9
Other terminal projects	1.3
	27.9

[2] A cluster of pilings firmly fixed to the sea bed and used to assist vessels during docking.

At Departure Bay terminal, the holding compound, pick-up and drop-off area, and the short term parking are being expanded. A new retail building, ticket building, waiting room and washrooms are being built. The foot passenger walkway will be improved and the intersection realigned. In fiscal 2008, we spent $17.8 million of this $40.7 million project.

At Swartz Bay terminal, the holding compound and pre-ticket area are being expanded, new ticket booths built, the radar maintenance building relocated and the exit re-aligned. In fiscal 2008, $6.5 million of the $6.9 million spent on the terminal related to this $9.2 million project.

At Alert Bay terminal, the holding compound was expanded, a pick-up/drop-off lane and passenger sidewalk created, and the waiting shelter replaced. We completed this $2.1 million project in August 2007.

At nine terminals, mainly serving our major and northern routes, we have begun a multi-year project to upgrade our security. This project primarily involves fencing, gating, lighting, access controls and closed circuit television as well as upgrades to foot passenger ticketing areas and baggage screening.

Information Technology

Capital expenditures in information technology include computer hardware and software development to improve operational data capture and reporting, time collection and database security.

We launched a new card-based electronic payment method in March 2008. This electronic swipe card can be redeemed for travel (and eventually, other products and services) instead of using cash, credit cards or prepaid paper tickets. The new card will also offer customers loss protection, which is not available with prepaid paper tickets. The assured loading product which has been available on the Coast Card (first introduced in May 2005) has also been added to this new card.

We implemented a new system to capture and report operational statistics in a more timely and accurate manner. This system utilizes an integrated data management solution to standardize traffic data collection and capture processes.

Other ongoing projects include enhanced reporting initiatives, better external and internal communications, real-time credit card authorization, automated ticketing, and replacement of obsolete technology and security projects. These projects focus on obtaining efficiencies, improving safety and security and providing better service to our customers.

FOURTH QUARTER RESULTS
This section provides an overview of our financial performance for the three months ended March 31, 2008, compared to the three months ended March 31, 2007.

The fourth quarter reflects a seasonal reduction in traffic levels which we utilize to perform upgrades and major maintenance and refit programs as well as to undertake mandatory inspections on the majority of our vessels.

	Three Months Ended March 31			
			Variance	
($ millions)	2008	2007	$	%
Total revenue	124.2	119.0	5.2	4.4%
Expenses	144.2	146.7	2.5	1.7%
Loss from operations	(20.0)	(27.7)	7.7	27.8%
Interest and other	10.5	5.5	(5.0)	(90.9%)
Net loss	(30.5)	(33.2)	2.7	8.1%

Revenue
Our total revenues have increased as shown in the following table.

Revenue ($ millions)	Three months ended March 31		Increase(Decrease)	
	2008	2007	$	%
Direct Route Revenue				
Vehicle traffic (volume)	1,726,422	1,707,063	19,359	1.1%
Vehicle tariff	44.9	43.7	1.2	2.7%
Passenger traffic (volume)	4,133,676	4,034,986	98,690	2.4%
Passenger tariff	24.5	23.7	0.8	3.4%
Social program fees	3.7	3.7	0.0	0.0%
Catering & on-board	14.3	13.0	1.3	10.0%
Other revenue	4.2	6.3	(2.1)	(33.3%)
Total Direct Route Revenue	91.6	90.4	1.2	1.3%
Indirect Route Revenue				
Ferry services fees	24.0	20.2	3.8	18.8%
Federal-Provincial subsidy	6.4	6.3	0.1	1.6%
Total Route Revenue	122.0	116.9	5.1	4.4%
Other general revenue	2.2	2.1	0.1	4.8%
Total Revenue	124.2	119.0	5.2	4.4%

Higher vehicle and passenger traffic volume and higher average tariff rates have resulted in higher tariff revenue of $2.0 million.

The majority of the increase in catering and on-board revenue during the quarter was on our major routes.

Ferry service fees are higher, reflecting resumption of full service with deployment of the new *Northern Adventure* on our northern routes.

Other direct revenue is lower due to the recognition in fiscal 2007 revenue of a $3.1 million write down of the deferred revenue liability relating to historical sales of paper assured loading tickets.

Expenses

Expenses are shown in the following table.

	Three months ended March 31			
			(Increase)Decrease	
($ millions)	2008	2007	$	%
Operations	84.0	77.6	(6.4)	(8.2%)
Maintenance	22.8	31.8	9.0	28.3%
Administration	13.6	16.7	3.1	18.6%
Cost of retail goods sold	5.9	5.4	(0.5)	(9.3%)
Amortization	17.9	15.2	(2.7)	(17.8%)
	144.2	146.7	2.5	1.7%
Interest & other	10.5	5.5	(5.0)	(90.9%)
Total expense	154.7	152.2	(2.5)	(1.6%)

The increase in operations costs reflects our new safety program, additional training costs and wages and benefit increases partially offset by a reduction in uniform costs.

The decrease in maintenance costs reflects the additional refit and maintenance activities that were brought forward from fiscal 2008 into the last quarter of fiscal 2007.

Lower administration costs reflect lower telecommunication costs and the capitalization of computer hardware leases in fiscal 2008.

Amortization increases reflect the vessel, terminal and other projects that came into service during fiscal 2008.

Interest expense increases are primarily a result of our $250 million bond series issued in March 2007, our $200 million bond series issued in January 2008, and the receipt in the last quarter of fiscal 2007 of interest rate support under the Government of Canada's Structured Financing Facility Program.

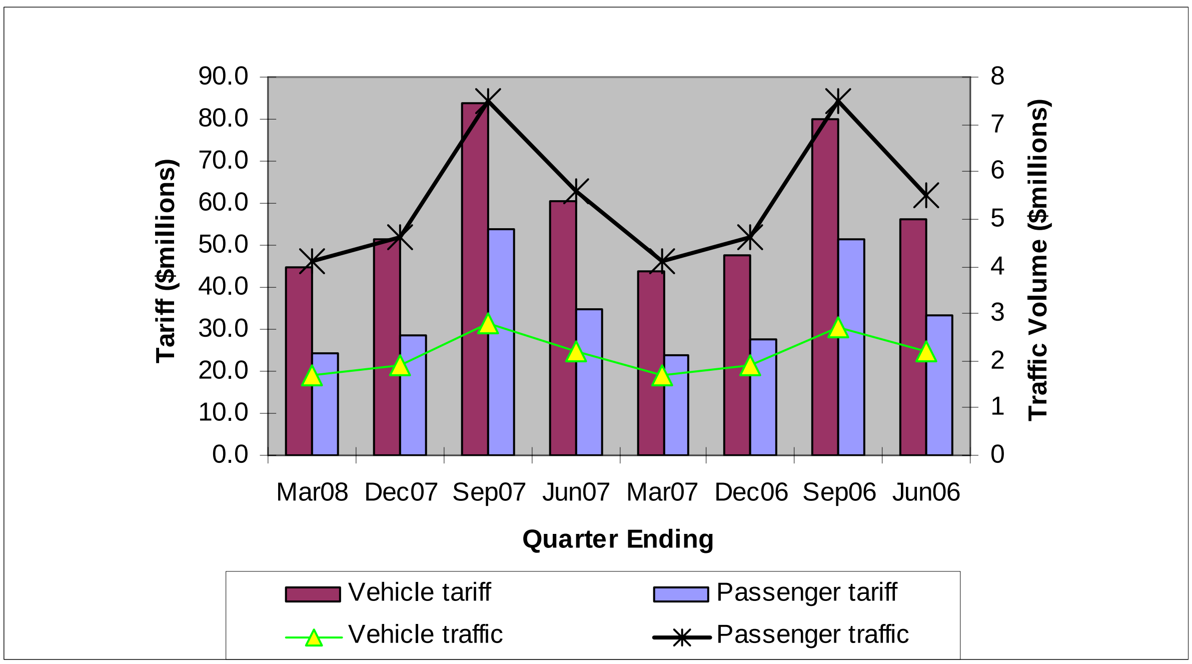
SUMMARY OF QUARTERLY RESULTS

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

	Quarter Ended (unaudited)							
($ millions)	Mar 08	Dec 07	Sep 07	Jun 07	Mar 07	Dec 06	Sep 06	Jun 06
Total revenue	124.2	136.5	220.2	159.8	119.0	128.4	202.7	146.4
(Loss) earnings from operations	(20.0)	(0.4)	69.4	22.1	(27.7)	2.5	73.0	20.3
Net (loss) earnings before extraordinary gain	(30.5)	(7.8)	61.0	14.4	(33.2)	(1.8)	68.9	14.9
Extraordinary gain	0.0	0.0	0.0	0.0	0.0	0.0	0.0	61.3
Net (loss) earnings and comprehensive income	(30.5)	(7.8)	61.0	14.4	(33.2)	(1.8)	68.9	76.2

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.

The following graph demonstrates the seasonality of our revenue and shows the relationship of traffic volume and tariff revenue over the most recent eight quarters.



OUTLOOK

Safety and Environmental Protection

The safety of the public and our employees and the protection of the environment are our highest priorities. Part of our safety plan was to increase, during fiscal 2008, the level of annual operational training we conduct from approximately 11,000 to 14,200 person days. We completed the year having conducted 14,210 days of training.

In October 2007, we officially launched SailSafe — a joint initiative with the BC Ferry & Marine Workers' Union that builds on our current safety practices and reflects our common commitment to safety as an essential part of our business and our daily work. This initiative will involve employees in identifying areas and methods for enhancing current safety practices.

We are proactive in ensuring environmental regulations are met or exceeded and in developing strategies to help us become an industry leader in environmental management. We have programs in place to protect the environment and reduce greenhouse gas emissions and are introducing new initiatives to further mitigate our environmental impact. Besides recycling beverage containers, cardboard and newsprint, we are also:

- using biodegradable hydraulic oils;
- using low sulphur fuel in all vessels;
- replacing chemical products with more environmentally friendly solutions;
- recycling used cooking oil, spent fluorescent tubes and batteries;
- reviewing environmental performance of selected contractors;
- replacing gasoline powered terminal vehicles with electric vehicles; and
- replacing gasoline powered baggage vans with propane powered tugger units.

We have a fuel reduction strategy that is designed to reduce fuel consumption and emissions on our vessels. To date, we have implemented a wide variety of fuel saving measures ranging from operating our vessels more efficiently to installing new, more fuel-efficient engines on some of our vessels and fuel monitoring systems on others and designing and building our new vessels to meet or exceed current environmental standards.

Asset Renewal Program

Although we have one of the largest fleets in the world, the average age of our assets is currently among the oldest of major ferry operators worldwide. To address this, we are continuing with our fleet and asset renewal program. In March 2007, we added the *Northern Adventure* and the *Kuper* to our fleet and in March 2008, the first Super C-class vessel, the *Coastal Renaissance,* commenced service. Over the five-year period ending March 2013, we will bring six new vessels into service with an aggregate cost of $845 million, of which $405 million has been expended to March 31, 2008. These vessels include:

- two additional Super C-class vessels, the *Coastal Inspiration and Coastal Celebration*;
- two northern vessels, the *Northern Expedition* and *Northern Discovery*;
- an intermediate class ferry, the *Island Sky*; and
- a minor vessel to replace the *Tenaka*.

Upgrading and replacing a large share of our fleet through new vessel acquisitions and our revitalization program will also assist in maintaining operational reliability.

We continue to reinvest our retained earnings into our asset renewal program. As the capital projects are completed and come into service, amortization and financing costs will increase. We expect this will cause a decrease in our earnings in the near term.

Traffic

Ferry traffic levels are affected by a number of factors, including transportation costs, the value of the Canadian dollar, weather, global security, levels of tourism, disposable personal income, the local economy, demographics and population growth. We experienced an increase in both total passenger and total vehicle traffic in fiscal 2008, following two years of moderate decreases. Over the past five years they are both trending upwards. In fiscal 2008, we experienced increased traffic levels on our major and northern routes and an overall decrease in traffic levels on our other routes.

During fiscal 2007, traffic levels were negatively affected by the loss of capacity on our northern routes, an unprecedented number of severe wind and snow storms in November and December 2006, and the implementation of fuel surcharges. With the introduction of the *Northern Adventure* into service in March 2007, we anticipated that traffic on our northern routes would return to former levels. Since the resumption of full service, traffic levels have not yet reached the levels experienced in fiscal 2006, but they are steadily increasing. Over the next few years, we anticipate modest traffic volume increases on all our routes.

Vehicle Traffic by fiscal year					
(thousands)	2008	2007	2006	2005	2004
Major routes	3,912.3	3,826.5	3,790.4	3,808.8	3,688.1
Other routes	4,632.6	4,669.6	4,715.8	4,711.5	4,567.1
Northern routes	33.8	25.8	37.1	37.1	37.0
Total	8,578.7	8,521.9	8,543.3	8,557.4	8,292.2
Annual % increase (decrease)	0.7%	(0.3%)	(0.2%)	3.2%	(0.4%)
Five year % increase	3.5%				
Passenger Traffic by fiscal year					
(thousands)	2008	2007	2006	2005	2004
Major routes	11,304.0	11,146.3	11,055.9	11,222.3	10,824.7
Other routes	10,382.7	10,440.5	10,556.7	10,687.0	10,425.7
Northern routes	101.8	78.2	117.0	117.2	117.0
Total	21,788.5	21,665.0	21,729.6	22,026.5	21,367.4
Annual % increase (decrease)	0.6%	(0.3%)	(1.3%)	3.1%	(1.2%)
Five year % increase	2.0%				

Fuel Costs

Fuel is a major cost of our operations. It has increased significantly over the past few years and there is uncertainty of future pricing. We use deferred fuel cost accounts to mitigate the effect of volatility in fuel oil prices on earnings. Differences in fuel costs arising from our actual price paid per litre being higher or lower than the unit set price included in base tariffs are charged or credited to the deferred fuel cost accounts.

In performance term one, to reduce the increasing balances of the deferred fuel cost accounts, the Commissioner approved extraordinary price cap increases to allow for fuel surcharges which were implemented from time to time, beginning in July 2005. In performance term two, there is an automatic mechanism in place to allow price cap increases to provide for implementation of fuel surcharges. Based on the current forecast of fuel pricing, we expect to implement fuel surcharges in the fall of 2008. (See “Fuel Price Risk” below for more detail)

Market Growth
Notwithstanding the pressure on traffic volumes, we see opportunities for growth.

In March 2007, we established Pacific Marine Ventures Inc. (PMV) as a wholly owned subsidiary to pursue strategic business opportunities, including terminal management opportunities outside our routes. In September 2007, PMV assumed management of the Sidney International Ferry terminal. Under a 40-year lease, PMV is managing and developing the towns ferry terminal with a focus on developing new business opportunities. Washington State Ferries continues to be the primary user of the facility with its service to Anacortes, Washington. At the same time, PMV is pursuing other management services opportunities.

To increase our profile in the Lower Mainland, expand our new market reach and further develop travel and tourism partnerships, in February 2008 we signed a lease to develop a 2,700 sq ft travel centre in the new Fairmont Pacific Rim property currently under construction in downtown Vancouver. We anticipate our travel centre will open in late 2009.

During fiscal 2008, we realized a 12.5% increase in commercial traffic revenue compared to the previous year. To increase our capacity in the commercial sector, we have assigned one new Super C-class vessel to each major route between the Lower Mainland and Vancouver Island. As a result, the *Coastal Inspiration* will join the recently upgraded *Queen of Alberni* on our Duke Point–Tsawwassen route – the route most frequently used by commercial truckers. Additionally, our commercial sales team is continuing to actively pursue new business and is implementing new integrated sales solutions and enhanced services for our commercial customers.

Regulation
Transport Canada regulates safety on our vessels by authority of the *Canada Shipping Act*. On July 1, 2007, the *Canada Shipping Act, 2001* came into effect. This is the principal legislation governing the activities of Canadian vessels in all waters and of all vessels in Canadian waters. The impact of the revised regulations on the useful life of some of our vessels and/or the requirement for vessel upgrades is not well defined. There may also be an impact on required crew levels, training and certification which could increase our operating costs. We are addressing the changing regulations through our planning processes and asset renewal initiatives as information becomes available. As always, the safety of our customers and employees remains our highest priority.

In 2001, the federal government enacted the *Marine Transportation Security Act*. Initially the legislation and the associated regulations were limited to international ports and vessels. We have received a copy of the proposed amendments to the existing regulations and the intent is to include domestic ferries and facilities within the *Marine Transportation Security Act* framework. If enacted, we will be required to satisfy a specific level of security on our vessels and at our terminals servicing our major and certain other routes. Considerable security investments will be required in the areas of fencing, cameras, closed circuit TV, better access controls and screening. We have developed a corporate security strategy and completed location-specific security plans on the major routes and northern routes that are required to comply with the regulations. Through the Marine Security Contribution Program, we are eligible for reimbursement of $3.8 million of federal funding under our first application to help offset the costs of perimeter security, access control measures and training. We anticipate making future applications to offset costs of security upgrades to vessels and terminals.

Our tariffs are regulated and our service levels are monitored by the Commissioner. The Commissioner regulates our tariffs by establishing price caps over a performance term. Our first performance term ended March 31, 2008 and our second performance term ends

March 31, 2012. The core ferry service fees and service levels for the second term have been set and the Commissioner released a final second performance term price cap order. Under this order, the price cap increase (starting from a level which includes fuel surcharges in place at March 31, 2008) was 7.3% on the major routes and 4.0% on all other routes effective

April 1, 2008. On each subsequent April 1 of the four-year term, the price cap will increase by 2.7% plus 0.49 times the latest reported annual increase in the Consumer Price Index (British Columbia) on the major routes and 5.7% plus 0.73 times the Consumer Price Index (British Columbia) on all other routes.

Competition

New competitors have emerged in both the passenger-only market and the commercial traffic market in the past few years. To date, passenger-only competitors have not been successful at sustaining operations.

We are witnessing increased competition in the commercial sector, where three companies, including ourselves, are now vying for differing segments of the freight transport business between Vancouver Island and the Lower Mainland. To maintain and potentially increase our market share, we plan on improving operational efficiency and customer service on our three major routes. We will accomplish this by increasing capacity for both commercial and passenger vehicle traffic with the assignment of one Super C-class vessel to each major route and improving traffic efficiency at the Departure Bay and Horseshoe Bay terminals. We are also investigating other new service offerings.

In an effort to reduce costs on our regulated routes and as mandated by the *Coastal Ferry Act*, we are exploring opportunities to have ferry services provided by additional or alternative service providers. While we maintain responsibility for the long-term delivery of ferry services, we are required to test the market to determine if another operator, under contract to BC Ferries, could provide safe, reliable and high quality service that is more cost-effective.

A Request for Proposal (RFP) process is currently under way for the Brentwood Bay-Mill Bay route. We expect to make a decision on whether to proceed with an alternative service provider on this route by the end of June 2008.

During fiscal 2008, we worked with a potential alternative service provider, who approached us on an unsolicited basis, regarding a possible pilot project for the Buckley Bay-Denman Island and Hornby Island-Denman Island routes. The arrangement to consider the viability of the pilot project on an exclusive basis with this company has been terminated.

We are presently preparing to initiate a Request for Expression of Interest (RFEOI) for alternative service delivery of the Campbell River–Quadra Island, Quadra Island–Cortes Island, and Port McNeill–Sointula–Alert Bay routes. We expect to issue the RFEOI in the summer of 2008 and will determine the next steps of the procurement process based on the responses we receive. Additionally, we expect to issue an RFP regarding the operation of our four routes north of Port Hardy; however, the timing of this request is uncertain.

FINANCIAL INSTRUMENTS

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment.

Derivatives

We hedge our exposure to fluctuations in fuel prices and foreign currency exchange rates through the use of derivative instruments. The table below provides details of the carrying value and fair value of the derivative instruments at March 31, 2008 and 2007.

	March 31, 2008				March 31, 2007	
	Number of swaps	Term to maturity (years)	Carrying Value Asset (Liability) ($ millions)	Fair Value Asset (Liability) ($ millions)	Carrying Value Asset (Liability) ($ millions)	Fair Value Asset (Liability) ($ millions)
Commodity Fixed Price Swaps	9	Up to .75	1.8	1.8	0.7	0.7
Foreign Exchange Forward Transactions (Super C-class vessels)	14	Up to .25	0.5	0.5	0.0	(18.7)
Foreign Exchange Forward Transactions (Northern Expedition)	5	Up to 1.0	15.9	15.9	(2.8)	8.6

The commodity derivatives fair value reflects only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel. These fair values reflect the estimated amounts that we would receive or pay should the derivative contracts be terminated at the stated dates. Any gains or losses related to fuel commodity swaps are charged to our deferred fuel cost accounts. At March 31, 2008, we have recorded a receivable of $1.8 million as the estimated gain to terminate the contracts as at this date.

The foreign exchange derivative fair value reflects only the value of the foreign exchange derivatives and not the offsetting change in value of the underlying future purchase of currency. These fair values reflect the estimated amounts we would receive or pay to terminate the derivative contracts at the stated dates. We de-designated all previously designated hedges for hedge accounting on June 30, 2007. With the adoption of the new Canadian Institute of Chartered Accountants (CICA) Handbook sections on financial instruments, all derivatives are recorded at mark to market on our balance sheet. Any gains or losses related to these foreign exchange forward contracts are charged to our regulatory accounts.

We are exposed to credit risk in the event of non-performance by counterparties to derivative instruments. Because we deal with high credit quality institutions in accordance with established credit approval practices, we believe it to be unlikely that any counterparties will fail to meet their obligations.

RISK MANAGEMENT

We continue to employ a variety of commonly accepted methodologies to identify, assess and mitigate risks. We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business. We view the following risks as most important:

Safety

The safety of the public and our employees is our highest priority. In fiscal 2007, we commissioned former BC Auditor General, George L. Morfitt, to conduct an independent review of our safety policies, procedures and practices. We also plan to conduct a similar comprehensive operational safety review at a minimum of every five years as part of our ongoing commitment to ensuring the safety of our passengers and employees.

Some of the recommendations in the Morfitt report were put into practice in fiscal 2007 while others have been incorporated into our new safety program, SailSafe, which was launched in October 2007. SailSafe is a joint initiative with the BC Ferry & Marine Workers' Union that builds on our current safety practices and reflects our common commitment to safety as an essential part of our business and our daily work. This initiative will involve employees in identifying areas and methods for enhancing current safety practices and ensuring that safety is our first priority each and every day.

Asset Risk

We operate in a capital-intensive industry and have an aging infrastructure that requires substantial investment. We plan to spend approximately $900 million in capital expenditures over the next five years, with approximately 50% related to new vessel acquisitions. Our plan includes the replacement of six of our oldest vessels before the end of fiscal 2013. At this time, the *Queen of Vancouver*, *Queen of Saanich*, *Queen of Esquimalt* and the *Queen of Tsawwassen* are available for sale.

At March 31, 2008, we have total long-term debt of $1.03 billion. Future indebtedness is subject to certain limitations. The level of indebtedness could increase our vulnerability to general adverse economic and industry conditions, and limit our flexibility in planning for, or reacting to, changes in business. Also, there can be no guarantee that we will have access to sufficient resources or will be able to maintain our fleet by extending the economic life of existing vessels through major refurbishment.

Regulatory / Performance Risk

Our operations are subject to a wide variety of national and local laws and regulations, all of which may change at any time. There is the potential that the introduction of new safety or other regulations, including new taxes, or the interpretation of existing regulations, may impose a new, unexpected and significant cost burden. (See "OUTLOOK – Regulation" above for a discussion of the potential impacts of the *Canada Shipping Act, 2001* and the *Marine Transportation Security Act*). There can be no guarantee that regulatory changes in the future will not have an adverse effect on us.

We cannot predict how the British Columbia Ferries Commissioner's interpretation, administration and enforcement of the *Coastal Ferry Act* will change over time. Such changes may impact our ability to sustain or increase profitability.

There is a risk that we will default under the Coastal Ferry Services Contract or the Terminal Leases. The consequences of such default could include, among other things, an adjustment to ferry service fees from the Province or the forced sale of our vessels to the Province for net book value and termination of the Terminal Leases.

Traffic Level and Tariff Revenue Risk

Future vehicle and passenger traffic on our vessels will be affected by, among other things, population levels and economic conditions in British Columbia and also by tariff rates. No assurance can be given as to the level of traffic on our system and the tariff revenue that will result.

We believe that demographics are changing on many of the small coastal islands that we serve. Individuals appear to be purchasing properties on these islands as vacation rather than primary residences. These individuals visit their island properties less frequently. This appears to have caused a decrease in the number of commuters on these routes. There is a risk that a continuation of this trend may result in a more significant decline in traffic.

There is a risk that over the long term a general decline in travel (or a reduction in the growth rate) may occur as a result of increasing tariffs, potentially compounded with fuel surcharges. Demand elasticity could change as tariffs increase, thereby resulting in a negative impact on tariff revenue. To date, the tariff increases we have implemented have not caused an obvious decrease in demand.

We believe that a significant number of our customers travel for leisure purposes. Traffic on our vessels may decline, or fail to increase as expected, if world or local events have a negative effect on tourism or other leisure travel.

Fuel Price Risk

Fuel costs have increased significantly over the past few years and have reached unprecedented levels. There is uncertainty of the cost of fuel in the future. We have the ability to pass through increases in fuel costs to our customers with surcharges. Based on current market pricing, we expect to implement fuel surcharges in the fall of 2008.

High levels of fuel pricing could translate into significant fuel surcharges and result in unprecedented total tariff levels. Although our traffic levels have not shown any significant effect from the higher tariff costs, there is uncertainty about the impact on future ferry traffic levels if fuel surcharges and therefore total tariff costs rise significantly. There is a risk of a decline in ferry traffic levels as a result of increasing customer costs resulting from the implementation of fuel surcharges.

The price of motor vehicle fuel has also increased significantly, causing the general cost of travel to increase. Continuing high motor vehicle fuel costs may affect decisions on discretionary travel. There is uncertainty about the impact on ferry traffic levels as a result of the increasing cost of motor vehicle fuel and there is a risk that customers may alter travel plans as a result.

Environmental Risk

Our operations are subject to various environmental laws and regulations dealing with the transportation, storage, presence, use, disposal and handling of hazardous materials and hazardous wastes, discharge of storm water and vessel fuel delivery.

The Kyoto Protocol aims to reduce emissions of greenhouse gases. The provincial government has made a commitment to reduce greenhouse gas emissions by 33% by the year 2020, based on emissions in 2007. While the reduction targets have not yet been set, the transportation industry has been identified as a sector that will have emission limits.
If we were to be involved in an environmental accident or be found in material violation of applicable law and regulations, we could be responsible for material clean-up costs, property damage, and fines or other penalties, any of which could have a material adverse effect. Although we believe we maintain adequate environmental insurance, there can be no guarantee that the insurance coverage will be sufficient to cover all such losses.

Security Risk

Deliberate, malicious acts could cause death, injury or property damage. The occurrence of a major incident could also negatively affect the propensity for the public to travel, reducing our ferry traffic levels. The effect could vary depending on whether it was a domestic or international incident and whether or not it was in the marine transportation industry. It could also lead to a substantial increase in insurance and security costs. Any resulting reduction in tariff revenues and/or increases in costs could have a material adverse impact on our business, results from operations and financial condition.

Accident / Casualty Loss

The occurrence of a major accident or mishap could have a material adverse effect on our business prospects, financial condition or results of operations, and could result in a default under the Coastal Ferry Services Contract unless such accident or mishap qualified as an event of force majeure. We have a sound conventional insurance program designed to mitigate the financial impact of serious incidents. There can be no guarantee, however, that the insurance coverage will be sufficient to cover all such accidents or disasters.

Human Resources

The majority of our employees are members of the BC Ferry & Marine Workers' Union. On March 8, 2007, a final award was released by arbitrator Vince Ready, building on the October 2004 interim award. This is expected to provide us with labour stability until the end of the term on October 31, 2012 and provide a unique and innovative dispute resolution process to facilitate future collective bargaining. However, there can be no guarantee that other labour disturbances will not occur and have a material adverse effect on our operations.

We are also dependent on maintaining our ability to attract, train and retain employees with the requisite skill and capabilities to operate in the marine industry. Shortages of critical skills are emerging in most areas in which we operate.

Income Tax Risk

We received an advance income tax ruling from Canada Revenue Agency (CRA) that, provided the facts and other statements set out therein are accurate, we are a "Tax Exempt Corporation" described in paragraph 149(1)(d.1) of the *Income Tax Act*. This ruling is subject to a proposed amendment to subsection 149(1.3) of the *Income Tax Act* announced by the Department of Finance on December 20, 2002, the essential elements of which are now included in Bill C-10, which received second reading in the Senate on December 4, 2007. We have received a non-binding opinion from CRA that subsection 149(1.3), if amended as proposed on December 20, 2002, will not cause us to cease to be a Tax Exempt Corporation. There can be no assurance that subsection 149(1.3) of the *Income Tax Act* will be amended as proposed, or that we are and will continue to be a Tax Exempt Corporation.

Treaty Negotiations: Aboriginal Rights and Title

Canadian courts have recognized that aboriginal peoples may possess rights at law in respect of land used or occupied by their ancestors where treaties have not been concluded to deal with these rights and where treaties between aboriginal peoples and the Crown set out express rights. These rights may vary from limited rights of use for traditional purposes to a right of aboriginal title. Aboriginal groups have claimed substantial portions of land in British Columbia over which they assert aboriginal title or in which they have a traditional interest.

Under evolving jurisprudence, Canadian governments have a duty to consult and accommodate aboriginal peoples where Crown approvals or licences are required in respect of existing or new terminal facilities or operations at such facilities and could affect or impact aboriginal interests.

Under the master agreement, the Province retains its liability, to the extent any exists, for the acts and omissions of the Province that occurred prior to our possession of the ferry terminal properties leased under the Terminal Leases and will reimburse us for any damages we suffer as a result.

In addition, the Province will reimburse us for damages suffered if there is a final court decision or a treaty settlement that recognizes or confers upon aboriginal peoples a proprietary or other interest in the ferry terminal properties which right or interest interferes with our quiet enjoyment of the ferry terminal properties as set out in the Terminal Leases.

ACCOUNTING PRACTICES

Critical Accounting Policies and Estimates

Our 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.

Our significant accounting policies are contained in note 1 to our consolidated financial statements. Certain of these 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.

We believe the following are the most critical accounting policies and estimates that we have used in the preparation of our financial statements.

Workers' Compensation Claims Liability

Our financial statements include an estimate of residual liability for workers' compensation claims arising from the Workers' Compensation Board (WCB) deposit class coverage system, in which our predecessor entity participated on or prior to March 31, 2003.

The WCB provided our predecessor company with an actuarial valuation of the unfinalized claims remaining to be paid that relate to incidents on or prior to March 31, 2003. This estimate totalled $9.3 million at March 31, 2003 and is drawn down as claims are paid out. In fiscal 2007 we received an actuarial valuation estimating that the unfinalized claims remaining to be paid at March 31, 2006, totalled $4.7 million. As a result we reduced the unfinalized claims liability and decreased expenses by $1.8 million during fiscal 2007. The remaining balance at March 31, 2008, of $2.7 million ($3.6 million at March 31, 2007) is included in accrued employee future benefits in our financial statements.

Public Service Pension Plan

Our employees are members of the Public Service Pension Plan (the Plan), a defined benefit and multiemployer pension plan. In April 2003, we were converted from a Crown corporation into an independent company incorporated under the provincial *Company Act*, and we now validly exist under the *Business Corporations Act* (British Columbia). In February 2004, our company and the union representing our employees jointly submitted a formal application for all our employees and our company to remain within the Plan. In March 2004, the Public Service Pension Board of Trustees agreed to the proposal.

The Plan is exempt from the requirements under the provincial *Pension Benefits Standards Act* to use the “solvency” method in conjunction with the “going concern” method for valuation purposes. As such, the Plan is currently valued solely by the going concern method. The most recent valuation of the total Plan, as at March 31, 2005, indicated an unfunded liability in the Basic Account of $767 million.

Effective April 1, 2006, the Public Service Pension Board of Trustees increased contribution rates for plan members and employers by 1.88% each, effectively eliminating the unfunded actuarial liability.

Retirement Bonus Liability

We sponsor a plan that provides a post-retirement benefit for eligible long service employees. The valuation of this plan is estimated based on complex actuarial calculations using several assumptions. These assumptions are determined by management with significant input from our actuary. The valuation of the obligation depends on such assumptions as discount rate, projected salary increases, retirement age and termination rates. An actuarial valuation of the plan at March 31, 2007, was obtained and the accrued benefit obligation estimated at $13.4 million. The liability included in accrued employee future benefits in our financial statements at March 31, 2008, was $10.5 million ($10.2 million at March 31, 2007).

We have adopted the corridor method of recognizing actuarial gains and losses. Any gains and losses in excess of 10% of the obligation balance will be amortized over the average remaining service period of employees expected to receive benefits under this plan.

Rate Regulation

We follow generally accepted accounting principles which, as we are a regulated entity, may differ from those otherwise expected in non-regulated businesses. These differences occur when the regulator issues orders and generally involve the timing of revenue and expense recognition. The principles we follow ensure that the actions of the regulator, which create assets and liabilities, have been reflected in the financial statements.

The accounting for these items is based on an expectation of the future actions of the regulator. As of March 31, 2008, we have four regulatory assets or liabilities:

- Deferred fuel costs: the difference between amounts allowed by the regulator in operating expense and those actually incurred with recovery expected through future tariffs or surcharges;
- Performance term submission costs: costs for incremental contracted services relating to our second performance term submission which our regulator has approved for recovery over our second performance term that begins April 1, 2008;
- Tariffs in excess of price caps: the amount by which average annual tariffs collected at a specific date exceed established price caps set under the terms of the *Coastal Ferry Act*. The excess amounts collected will be returned to customers through future tariffs;
- Hedge gains – vessel construction contracts: unrealized gains on financial derivative instruments relating to the construction of the *Northern Expedition*, the *Coastal Inspiration* and the *Coastal Celebration*. These gains will ultimately form part of the capital cost of the new vessels.

If the regulator’s future actions are different from our expectations, the timing and amount of the recovery of deferred costs could be substantially different from that reflected in our financial statements.

Amortization Expense
Our capital assets, including assets under capital leases, are amortized on a straight-line basis at varying rates. Amortization rates require the use of estimates of the useful lives of the assets and of salvage to be realized upon asset retirement.

We periodically review asset lives in conjunction with our longer term asset deployment, replacement and upgrade strategies. When we determine that asset lives do not reflect the expected remaining period of benefit, we make prospective changes to the remaining period over which they are amortized. There are a number of uncertainties inherent in estimating our asset lives and changes in these assumptions could result in material adjustments to our financial statements.

As disclosed in note 1 to our financial statements, we review and evaluate our long-lived assets for impairment when events or changes in circumstances indicate that the related amounts may not be recoverable.

Hedging Relationships
In April 2005, the Canadian Institute of Chartered Accountants (CICA) issued Handbook Section 3865, replacing Accounting Guideline 13 which we had adopted on April 1, 2004. This standard addresses the identification, designation, documentation and effectiveness of hedging transactions for the purpose of applying hedge accounting. It also identifies situations where hedge accounting is to be discontinued. Under this guideline, we are required to prepare formal documentation for each individual derivative in order to apply hedge accounting for positions hedged with derivatives.

During fiscal 2005, we elected to apply hedge accounting on the currency derivatives relating to the three new Super C-class vessels. During fiscal 2007 we elected to apply hedge accounting on the currency derivatives for the new *Northern Expedition*. On June 30, 2007, we de-designated all previously designated hedges for hedge accounting. With the adoption effective April 1, 2007, of the new CICA Handbook sections on financial instruments, all currency and fuel commodity derivatives are recorded at mark to market on our balance sheet.

Asset Retirement Obligations
On April 1, 2004, we adopted the CICA new standard for recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated asset retirement costs. Under the new standard the fair value of a liability for an asset retirement obligation must be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value is added to the carrying amount of the associated asset, which is then expensed over the asset’s estimated useful life. The liability is accreted over the estimated useful life of the asset through charges to expenses.

As we are not aware of any future liabilities associated with the retirement of our assets, the adoption of this policy does not result in the recording of an asset retirement liability and therefore our financial statements have not been impacted by this standard. In addition, as our operations are regulated, there is a reasonable expectation that any significant asset retirement costs would be recoverable through future tariffs.

Adoption of New Accounting Standards

Effective April 1, 2007, we adopted the CICA Handbook Section 1530, *Comprehensive Income*, CICA Handbook Section 3251, *Equity*, CICA Handbook Section 3855**,** *Financial Instruments – Recognition and Measurement,* CICA Handbook Section 3861, *Financial Instruments – Disclosure and Presentation*, and CICA Handbook Section 3865, *Hedges*. These new Handbook sections provide comprehensive requirements for the recognition and measurement of financial instruments, as well as standards on when and how hedge accounting may be applied. Handbook Section 1530 also establishes standards for reporting and displaying comprehensive income. Comprehensive income is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income but that are excluded from net income calculated in accordance with generally accepted accounting principles.

Under these new standards, all financial instruments are classified into one of the following five categories: held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are included on the consolidated balance sheet and are initially measured at fair value. Subsequent measurement and recognition of changes in fair value of financial instruments depends on their initial classification. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in net income in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in other comprehensive income until the asset is removed from the balance sheet. Loans and receivables, investments held-to-maturity and other financial liabilities are measured at amortized cost.

The standards require derivative instruments to be recorded as either assets or liabilities measured at their fair value unless exempted from derivative treatment as a normal purchase and sale. Certain derivatives embedded in other contracts must also be measured at fair value. All changes in the fair value of derivatives are recognized in earnings unless specific hedge criteria are met, which requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting.

The adoption of these standards has the following effect on the consolidated financial statements for fiscal 2008:

(a) Recognition of foreign currency forward contracts as derivative assets and liabilities in the consolidated financial statements;
(b) Restatement of opening retained earnings at April 1, 2007, to recognize the prior years' earnings effect of accounting for long-term debt using the effective interest rate method; and
(c) Reclassification of deferred financing costs to long-term debt.

We also de-designated all previously designated hedges on June 30, 2007 under Section 3865 – Hedges. All of these hedges, which were entered into to provide greater certainty of the cost of new vessel acquisitions denominated in foreign currency, were effective at the time of de-designation. All hedges are recorded at fair value with unrealized gains and losses recorded to the regulatory asset or liability accounts on the balance sheet.

We have no embedded derivatives that meet the requirements of Section 3855 which would require that they be separated from host contracts and valued separately at fair value.

We have not recognized any adjustments through other comprehensive income for fiscal 2008.

The adoption of these sections is done prospectively without restatement of the consolidated financial statements of prior periods. As at April 1, 2007, the impact on the consolidated financial statements of recording foreign currency forward contracts as derivative assets and liabilities, measuring the long-term debt using the effective interest rate method and reclassifying the deferred financing costs directly attributable to the issuance of the long-term debt, is summarized in the table below:

($ millions)	April 1, 2007	March 31, 2007	Net Impact
Derivative assets	8.6	-	8.6
Other assets - deferred financing costs	1.0	9.6	(8.6)
Derivative liabilities	18.6	2.8	15.8
Long-term debt	740.6	749.6	(9.0)
Retained earnings	204.0	203.5	0.5

In the table above, the remaining balance of deferred financing costs at April 1, 2007, represents costs incurred for long-term debt arranged for but not yet issued.

Future Accounting Changes

The following CICA Handbook Sections will be effective for us beginning April 1, 2008:

- Section 1535, *Capital Disclosures* establishes standards for disclosing information about our capital and how it is managed. The standard requires disclosure of our objectives, policies and processes for managing capital, the quantitative data about what we regard as capital, whether we have complied with any capital requirements and if we have not complied, the consequences of such non-compliance. We do not expect application of this section to have a significant impact on our consolidated financial statements.

- Section 3031, *Inventory*, replacing Section 3030 provides guidance on the determination of inventory cost, subsequent recognition as expense, and write-downs to net realizable value. We do not expect application of this section to have a significant impact on our consolidated financial statements.

- Section 3862, *Financial Instruments – Disclosure* requires disclosures, by class of financial instrument that enable users to evaluate the significance of financial instruments on financial position and performance, including disclosures about fair value. In addition, disclosure is required of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk, and market risk. The quantitative disclosures must also include a sensitivity analysis for each type of market risk to which an entity is exposed, showing how net earnings and other comprehensive income would have been affected by reasonably possible changes in the relevant risk variable. We do not expect application of this section to have a significant impact on our consolidated financial statements.

- Section 3863, *Financial Instruments – Presentation* carries forward existing requirements on presentation of financial instruments. We do not expect application of this section to have any impact on our consolidated financial statements.

We have not yet adopted the following CICA Handbook Sections which will be effective for us beginning April 1, 2009:

- Section 3064, *Goodwill and Intangible Assets* does not substantively change the requirement pertaining to goodwill. The changes in requirements pertaining to intangible assets primarily relate to recognition criteria for purchased and internally developed assets which will result in few intangible assets being recognized on the balance sheet. We are assessing the impact of this section on our consolidated financial statements.

- To be applied prospectively, are amendments to Sections 1100 *Generally Accepted Accounting Principles*, 3465 *Income Taxes* and Accounting Guideline AcG-19 *Disclosures by Entities Subject to Rate Regulation*. With release of these amendments, a temporary exemption that permitted assets and liabilities arising from rate regulation to be recognized and measured on a basis other than in accordance with the primary sources of generally accepted accounting principles will be removed. In addition, accounting recommendations have been amended to require recognition of future income tax liabilities and assets as well as offsetting regulatory assets and liabilities at entities subject to rate regulation. We do not expect application of these amendments to have any impact on our consolidated financial statements. We will continue to monitor any additional implications on our financial reporting related to accounting for rate regulated operations.

In 2006, the Canadian Accounting Standards Board (AcSB) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian generally accepted accounting principles with International Financial Reporting Standards (IFRS) over an expected five year transitional period. During March 2008, the AcSB confirmed the transition dates for conversion to IFRS. Our transition date for the conversion to IFRS is April 1, 2011 and will require the restatement for comparative purposes of amounts reported by us for the year ended March 31, 2011. While we have begun assessing the adoption of IFRS, the financial reporting impact of the transition cannot be reasonably estimated at this time.

CORPORATE STRUCTURE AND GOVERNANCE

Our Board of Directors and management consider good corporate governance to be central to the effective, efficient and prudent operation of the Company. Both management and the Board have monitored and, where appropriate, responded to regulatory developments aimed at improving corporate governance practices, increasing corporate accountability and enhancing the transparency of public company disclosure and will continue to monitor the developments in corporate governance practices.

In 2005, National Instrument 58-101 *Disclosure of Corporate Governance Practices* (the “Instrument”) and a related National Policy 58-201 *Corporate Governance Guidelines* (the “Guidelines”) issued by the Canadian Securities Administrators came into effect. The Guidelines and Instrument require reporting issuers to disclose annually their approach to corporate governance with reference to specific matters. See Schedule A for the disclosure in accordance with this Instrument.

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 our 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. Some of the market conditions and factors that have been considered in formulating the assumptions upon which forward looking statements are based include traffic, rising Canadian Dollar relative to US Dollar, fuel costs and the fuel reduction program, construction costs, the state of the local economy, demographics, duty remission, GST reduction, and the requirements of the Coastal Ferry Services Contract.

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 safety and security, traffic volume and tariff revenue risk, asset risk, accident 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.

SCHEDULE A
Corporate Structure and Governance

Board of Directors

The Board has assumed responsibility for the stewardship of British Columbia Ferry Services Inc. (BCF or the Company) by overseeing the conduct of the business, supervising Management, which is responsible for the day-to-day conduct of the business, and endeavouring to ensure that all major issues affecting the business and affairs of the Company are given proper consideration.

At March 31, 2008, the Board was comprised of the following directors:

Chair: Elizabeth J. Harrison Q.C.
Vice Chair: Thomas W. Harris
Members: Douglas E. Allen, Mark L. Cullen, Sandy M. Fulton, David L. Hahn, Donald P. Hayes, John R. Henderson, Doreen J. Hewitt, Brian G. Kenning, Gordon R. Larkin, Maureen V. Macarenko, Robert W. McCaskill, A. Daniel Miller, Wayne H. Stoilen and, Graham M. Wilson

Effective April 1, 2008, Sandy M. Fulton, John R. Henderson, Doreen J. Hewitt and Robert W. McCaskill ceased to be directors and Christopher C. Gardner became a director.

The Board Governance Manual articulates the governance framework under which the Board fulfills its stewardship responsibilities. The manual assembles in one document the essential elements for providing an appropriate level of governance for the organization. It includes, among other things, terms of reference for the Board, chair, directors, committees and committee chairs, and serves as a practical guide for the Board and management in fulfilling their respective duties and responsibilities. The governance framework is a product and responsibility of the Board.

The Board is committed to the principles of independence and accountability. The Board has adopted policies and practices that ensure it has the capacity, independent of management, to fulfill the Board's responsibilities, make objective assessments of management, and assess the merits of management initiatives. The Governance & Nominating Committee has an ongoing responsibility to ensure that the governance structures and processes continue to enable the Board to function independently.

The Board and management recognize that there is a regular need for the Board to meet without management in attendance. It is general practice to conduct a portion of every Board meeting with only independent directors present.

The Board and its committees each have the authority to retain any outside advisor, at the Company's expense, that it determines to be necessary to permit it to carry out its duties.

The recruitment of directors is undertaken with the objective of ensuring the Board is composed of a majority of strong, qualified, independent directors. The Board supports the concept that the role of the board chair is separate from that of the President & CEO and that the board chair should be an independent director. These principles are reflected in the Board Governance Manual.

The Board has adopted a definition of an independent director for members of the Audit & Finance Committee consistent with the definition of independence in Multilateral Instrument 52-110. This definition, with some modification that is consistent with Multilateral Instrument 52-110, also applies to determining the independence of other members of the Board.

The Board is responsible for determining whether directors are independent pursuant to the definition of independence adopted by the Board. To do this, the Board requires members to disclose their relationships with the Company and its subsidiaries. These disclosures are reviewed by the General Counsel, the Corporate Secretary, and the Chair of the Board. Any director who is deemed independent, and whose circumstances change such that he or she might be considered to no longer be an independent director, is required to promptly advise the Board of the change in circumstances. Directors are required annually to attest to their independence in writing.

Mr. David L. Hahn, President & CEO, is the only director who is a member of management of the Company. By virtue of his being a member of management, Mr. Hahn is not independent. The other directors of the Company, including the Chair of the Board, have been determined by the Board to be independent pursuant to the definition of independence adopted by the Board.

Directorships

The following were directors of a reporting issuer (or the equivalent) in Canada or a foreign jurisdiction, other than BCF:

Elizabeth J. Harrison, Q.C.:	*Director, Unilens Vision Inc.*
Graham M. Wilson:	*Director, ITRON Inc.*
	Director, Naikun Wind Energy Group
	Trustee, Hardwoods Income Trust
	Director, Daylight Energy Ltd.
Brian G. Kenning:	*Director, MacDonald Dettwiler & Associates Inc.*
	Director, Royal Oak Ventures

Orientation and Continuing Education

The Company has a variety of orientation and education programs in place for directors. These programs are aimed at increasing the directors' familiarity with the operation of the Company and its governance practices.

All new directors are provided with the opportunity to participate in an orientation program. The orientation program is tailored to the individual director's needs and areas of interest. The program generally involves a full day session, held prior to a new director attending his/her first BCF Board meeting, during which the new director is briefed by members of senior management and receives written information about the business and operations of BCF and Board governance practices, including the duties and obligations of directors. A copy of the Board Governance Manual is made available to all directors. This manual provides a comprehensive overview of the roles and responsibilities of the Board, its committees, and the contributions expected by each director. The Board recognizes the importance of ongoing director education and the need for each director to take personal responsibility for this process.

Responsibility for ensuring that orientation and ongoing education are provided to directors rests with the Chair of the Board. The Governance & Nominating Committee has responsibility for reviewing the orientation and education programs to ensure they are effective and meet the needs of directors.

Ethical Business Conduct

The Board of Directors approved and adopted a Code of Business Conduct and Ethics (Code) on November 10, 2004. Notice of adoption of the Code as Company policy was communicated to the Company's personnel by intra-Company information bulletin widely distributed throughout the Company. In addition, the Code has been posted on the Company's Intranet website for Company personnel, and on the Company's Internet site. The Code was filed on SEDAR on March 1, 2006. The Board has also adopted a Corporate Disclosure and Securities Trading Policy, which is also posted on the Company’s Intranet and Internet sites.

As part of the Company’s disclosure controls process, in conjunction with quarter-end financial reporting, appropriate managers are required to make representations regarding compliance with the Code and the Corporate Disclosure and Securities Trading Policy.

As part of the communication process for the reporting of questionable accounting and auditing matters, a secure telephone line and a secure e-mail address, each monitored by the executive director of Internal Audit, have been established and this has been communicated to Company employees by intra-Company information bulletin. The contact particulars are also posted with the Code on the Company's intranet site.

The Board, through the Audit & Finance Committee, monitors compliance with the Code through review of compliance reports received quarterly from management, the external auditors, and the internal auditors.

Directors and officers review the Code and acknowledge their support and understanding of the policy by signing an annual disclosure statement.

The Code requires that directors and officers disclose potential conflicts of interest at the time of their appointment and immediately upon a situation of a conflict of interest or potential conflict of interest arising. Such disclosures are communicated to and reviewed by the General Counsel, the Corporate Secretary, and the Chair of the Board.

Nomination of Directors

The B.C. Ferry Authority (the BCFA), through its Board of Directors, selects the Board of Directors of BCF. While not a requirement, it is current practice that the directors of BCFA are also directors of BCF.

The Articles of Incorporation of BCF permit a total of 20 directors of BCF, hence directors may be appointed to the Board of BCF in addition to those who are also directors of BCFA. It is viewed as desirable to maintain consistency between the two Boards so that the interests of BCFA and BCF are properly aligned. However, the ability to appoint additional directors to the Board of BCF gives flexibility in ensuring adequate skill sets and experience are available within the members of the Board of BCF.

In 2007, the BCF Board of Directors established a Nominating Committee, composed entirely of independent directors, to lead the nomination processes for BCF. Effective April 1, 2008, the responsibilities for matters related to director nomination and corporate governance were combined in a single committee, the Governance & Nominating Committee, and the Nominating Committee ceased to exist.

The Governance & Nominating Committee is composed entirely of directors who are independent, pursuant to the definition of independence adopted by the Board of BCF. The Chair of the Board of BCF is the Chair of the Governance & Nominating Committee.

Each year, the skill sets and experience of the incumbents and any retiring directors of BCF are reviewed by the Governance & Nominating Committee in the context of the skills and experience profile adopted by the BCF Board and the ongoing governance needs of BCF. Any gaps are identified. Potential conflicts of interest and other extenuating circumstances are also identified.

The skill sets and experience of the candidates for the BCFA Board, that are put forward by the nominating entities and the Province, are reviewed by the Governance & Nominating Committee to ascertain if there will be any gaps in the skill sets and experience of the Board of BCF, assuming BCFA directors also become BCF directors. If gaps are identified, the Governance & Nominating Committee, in consultation with the President & CEO, seeks out suitable candidates for nomination as directors of BCF to fill such gaps.

The Governance & Nominating Committee makes recommendations to the BCF Board of Directors on suitable candidates for appointment to the BCF Board. These recommendations take into account the talents of the existing BCF Board, and the talents of all nominees (including BCFA Board nominees and appointees who may become BCF Board members, if applicable), taking the skills and experience profile established for BCF directors into account.

The BCF Board makes its decision on prospective directors and forwards its recommendations to the BCFA Board. The BCFA Board then determines the directors of BCF and causes BCFA, as the sole holder of the single voting share of BCF, to appoint such directors to the Board of BCF.

Compensation

The compensation of directors is reviewed by the Board on a bi-annual basis. Prior to April 1, 2008, the responsibility for reviewing and making recommendations to the Board regarding the compensation of directors rested with the Governance & Human Resources Committee. Effective April 1, 2008, the Board changed the structure of the Board Committees and responsibility for matters relating to director compensation was assigned to the Governance & Nominating Committee and the Governance & Human Resources Committee ceased to exist.

The Governance & Nominating Committee operates under terms of reference adopted by the Board.

The Committee engages an external compensation advisor to research and provide independent advice on the level and types of compensation for directors. In making its recommendations to the Board, the Committee takes into account the types of compensation and the amounts paid by other comparable companies.

Board Committees

The Board reviews the structure of the Board Committees on an annual basis and, as noted above, made changes to the structure effective April 1, 2008. These changes are summarized below.

Board Committee Structure At March 31, 2008	Board Committee Structure Effective April 1, 2008
• Audit & Finance	• Audit & Finance
• Safety, Health, Environment & Security	• Safety, Health, Environment & Security
• Governance & Human Resources	• Governance & Nominating
• Nominating	• Human Resources & Compensation

***Audit & Finance Committee (at March 31, 2008)*:**

Chair: Graham M. Wilson
Members: Douglas E. Allen; Thomas W. Harris; John R. Henderson, Robert W. McCaskill

Effective April 1, 2008, Donald P. Hayes and Brian G. Kenning became members of the Committee and Thomas W. Harris ceased to be a member. Also effective April 1, 2008, Robert W. McCaskill and John R. Henderson ceased to be directors and members of the committee.

The Audit & Finance Committee (Committee) is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities. The Committee has the mandate to:

- review the financial reports and other financial information provided by the Company to its security holders;
- review the annual operating and capital budgets, modifications thereto, and details of any proposed financing;
- monitor the integrity of the financial reporting process and the system of internal controls that the Board and our management have established;
- monitor the management of the principal risks that could impact the financial reporting of the Company, and the Company's compliance with legal and regulatory requirements as they relate to the Company's financial statements;
- review and approve the audit plan, process, results, and performance of the Company's External Auditors and the Internal Audit department (the Internal Auditor) while providing an open avenue of communication between the Board, Management, External Auditors, and the Internal Auditor; and
- assess the qualifications and independence of the External Auditors, and recommend to the Board the nominations of the External Auditors and the compensation to be paid to the External Auditors.

The Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the External Auditors as well as anyone in the organization. The Committee has the authority to retain special legal, accounting, and other advisors or experts it deems necessary in the performance of its duties.

Each of the members of the Committee has been determined by the Board of Directors to be independent, that is, without any direct or indirect relationship with the Company that could reasonably interfere with the exercise of the member's independent judgment. Douglas E. Allen acted as interim Chief Executive Officer of the Company from October 16, 2002 until May 5, 2003.

All members of the Committee are financially literate within the meaning of Multilateral Instrument 52-110, that is, each has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the Company's financial statements.

Since April 1, 2003, all recommendations of the Committee to nominate or compensate an External Auditor have been adopted by the Board.

The aggregate fees billed by our external auditor in each of the last two fiscal years were:

External Auditor Billings ($ thousands)	Year ended March 31 2008	2007
Audit and audit related	182.6	172.8
Tax services	2.7	3.0
All other fees		
Advisory services (internal control certification)	-	7.5
	185.3	183.3

Pursuant to its terms of reference, the Committee must pre-approve retaining the External Auditors for any non-audit service to be provided to the Company or its subsidiaries, provided that no approval shall be provided for any service that is prohibited under the rules of the Canadian Public Accountability Board or the Public Company Accounting Oversight Board, or the Independence Standards of the Canadian Institute of Chartered Accountants.

Before retaining the External Auditors for any non-audit service, the Committee must consider the compatibility of the service with the External Auditors' independence. The Committee may pre-approve retaining of the External Auditors for the engagement of any non-audit services by establishing policies and procedures to be followed prior to the appointment of the External Auditors for the provision of such services. To date, no such policies and procedures have been established. In addition, the Committee may delegate to one or more members the authority to pre-approve retaining of the External Auditors for any non-audit services to the extent permitted by applicable law.

***Safety, Health, Environment & Security Committee (at March 31, 2008)*:**

Chair: Sandy M. Fulton

Members: Doreen J. Hewitt, Gordon R. Larkin, Maureen V. Macarenko, A. Daniel Miller, Robert W. McCaskill,

Effective April 1, 2008, Sandy M. Fulton ceased to be a director and Chair of the Committee and A. Daniel Miller became Chair of the Committee. Also effective April 1, 2008, Donald P. Hayes and Wayne H. Stoilen became members of the Committee, and Doreen J. Hewitt and Robert W. McCaskill ceased to be directors and members of the Committee.

The Safety, Health, Environment & Security Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities. The Committee has the mandate to:

- exercise due diligence over the safety, health, environmental, and security operations of the Company;
- develop, review, and make recommendations, as required, on matters related to the Company's safety, health, environmental, and security policies and practices; and
- monitor compliance with Government regulations and with the Company's commitment to these issues.

***Governance & Human Resources Committee (at March 31, 2008)*:**

Chair: Douglas E. Allen
Members: Sandy M. Fulton, John R. Henderson, Doreen J. Hewitt, Maureen V. Macarenko, Graham M. Wilson

The Governance & Human Resources Committee was appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities regarding matters related to corporate governance, human resources, and director and executive compensation. Effective April 1, 2008, responsibility for matters related to corporate governance and director compensation was assigned to the Governance & Nominating Committee, and responsibility for matters related to human resources and executive compensation was assigned to the Human Resources & Compensation Committee. The Governance & Human Resources Committee ceased to exist effective April 1, 2008.

Nominating Committee (at March 31, 2008):

Chair: Elizabeth J. Harrison, Q.C.
Members: Douglas E. Allen, Sandy M. Fulton, Graham M. Wilson

The Nominating Committee was appointed by the Board of Directors to lead the nomination processes for BCF. Effective April 1, 2008, the responsibilities for matters related to director nomination were assigned to the Governance & Nominating Committee, and the Nominating Committee ceased to exist.

Governance & Nominating Committee (effective April 1, 2008)

Chair: Elizabeth J. Harrison, Q.C.
Members: Mark L. Cullen, Thomas W. Harris, Maureen V. Macarenko, Graham M. Wilson

The Governance & Nominating Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities with respect to ensuring that the corporate governance system of BCF is effective. The Committee has the mandate to:

- review, assess, and make recommendations regarding the effectiveness of the policies and practices of the Board;
- ensure the Board's continuing ability to fulfill its legislative mandate;
- implement effective due diligence over the operations of the Company;
- ensure that the Board of BCF is comprised of Board members that collectively and individually have the skills, experience, and backgrounds to appropriately lead the organization;
- establish and implement effective processes for identifying and recommending suitable candidates for appointment as directors of BCF; and
- ensure the adequacy and suitability of the compensation plan for directors to ensure it is sufficient to enable the Company to attract and retain talented and qualified individuals to serve on the Board, at a reasonable cost.

Human Resources & Compensation Committee (effective April 1, 2008)
Chair: Douglas E. Allen
Members: Mark L. Cullen, Thomas W. Harris, Brian G. Kenning, A. Daniel Miller

The Human Resources & Compensation Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities regarding the human resources and compensation strategies and policies of BCF. The Committee has the mandate to:

- ensure, at a strategic level, that there are appropriate and effective human resources policies in place, setting the philosophy for the employment and motivation of the Company's staff and their understanding of and engagement in the interests and success of the Company;
- regularly review with the President & CEO his plans for the structure, development, and succession of executive management; and
- establish and implement a total compensation philosophy for the President & CEO and executive management that attracts and retains Executives, links total compensation to financial performance and the attainment of short and long term strategic, operational, and financial performance, and provides competitive total compensation opportunities at a reasonable cost, while enhancing the ability to fulfill the Company's overall strategies and objectives.

Assessments
As part of its dedication to best governance practices, the Board is committed to regular assessments of the effectiveness of the Board, the board chair, committees, committee chairs and individual directors.

The Governance & Nominating Committee annually reviews and makes recommendations to the Board on the method and content for annual evaluations.

The Board has engaged an independent governance consultant to coordinate the evaluation. The assessment undertaken in the year ended March 31, 2008, involved individual discussions between each director and the independent consultant on matters related to Board effectiveness. The consultant presented the results of the evaluation to the Board and has prepared recommendations for action. The Board has adopted an action plan for the upcoming year to respond to the consultant's report and recommendations.

The Board also undertakes an assessment annually of the performance of individual directors. This occurs through discussions between the individual directors and the Board Chair.