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

For the three and six months ended September 30, 2008
Dated October 29, 2008

BCFerries

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Management's Discussion & Analysis
of Financial Condition and Results of Operations
For the three and six months ended September 30, 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 September 30, 2008. This should be read in conjunction with our unaudited interim consolidated financial statements and related notes for the three and six month periods ended September 30, 2008 and 2007, and our annual audited consolidated financial statements and related notes together with our fiscal 2008 Management's Discussion and Analysis. These documents are available on our Investor webpage at http://www.bcferries.com/about/investors/index.html and on SEDAR at www.sedar.com.

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 36 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 British Columbia.

Our 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 earnings of the year. 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.

We are a versatile company, providing a wide range of ferry services for our customers. During the three months ended September 30, 2008 (the second quarter of fiscal 2009), we provided more than 46,000 sailings, carrying 7.1 million passengers and 2.6 million vehicles. We have experienced a decrease in traffic in the first and second quarters of fiscal 2009 compared to the prior year and, because of the uncertainty of future traffic levels, we have revised our financial and operating plans to reduce overall operating costs from previously planned levels. (See "Outlook-Traffic" below for more detail).

Significant events during or subsequent to our second quarter of fiscal 2009:

- On July 22, 2008, the British Columbia Ferries Commissioner (the Commissioner) amended the automatic fuel surcharge/rebate mechanism to allow for the early implementation of a fuel surcharge as a result of the dramatic rise in fuel prices. Fuel surcharges of 10.3% on our major routes; 9.2% on our Horseshoe Bay-Langdale route and 17.6% on our other routes (excluding the northern routes) went into effect on August 1, 2008. Subsequently, approval was received to reduce these fuel surcharges by 50% in order to reflect the more recent drop in fuel prices. The reduction will be effective November 4, 2008. Fuel surcharges on our northern routes are not required at this time as a result of an agreement with the Province (See "Outlook-Traffic" below for more detail). All of the Commissioner's Orders can be viewed at www.bcferrycommission.com.

- On August 25, 2008, we reached an agreement for the sale of our existing head office building for approximately $11 million. We also signed a 15-year lease with renewal options for up to an additional 20 years. This will allow for the relocation of our corporate centre to a new building currently under development in downtown Victoria. This relocation will provide approximately the same space as we currently occupy in separate locations and allow for efficiencies by combining all departments under one roof. The relocation is scheduled for July 2010. We have also entered into a letter of intent to advance up to $25 million to the developer of the new head office property, secured by a second mortgage of the property, and to obtain an option to purchase a one-half interest in the property.

- On September 10, 2008, a Purchase and Sale Agreement was completed for the sale of the fully amortized *Queen of Tsawwassen* for nominal proceeds. The agreement states that the buyer cannot sell or scrap the vessel for three years from the date of the agreement. Delivery took place on September 29, 2008. We also intend to retire the *Queen of Vancouver* and *Queen of Saanich* from service prior to the end of fiscal 2009 and have offered these vessels for sale.

- On September 25, 2008, the new *Northern Expedition* was launched at Flensburger Schiffbau-Gesellschaft (FSG) in Germany. The *Northern Expedition* will 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. (See "Investing in our Capital Assets" below for more detail).

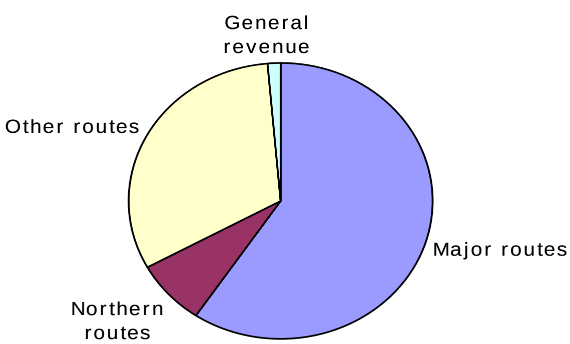
- On October 22, 2008, the Province announced that it would provide funding to allow a 33 per cent reduction on fares for all routes during the months of December 2008 and January 2009. Additional funding will also be provided to reimburse the costs of reinstating previously eliminated off-peak sailings. (See "Outlook-Traffic" below for more detail).

- We have experienced a decrease in traffic in the first and second quarters of fiscal 2009 compared to the same period in the prior year. Vehicle traffic was 6.1% lower in the second quarter (4.2% year to date) and passenger traffic was 5.3% lower in the second quarter (4.0% year to date). (See "FINANCIAL AND OPERATIONAL OVERVIEW-Revenue" and "Outlook–Traffic" below for more detail.)

FINANCIAL AND OPERATIONAL OVERVIEW
This section provides an overview of our financial and operational performance for the three and six months ended September 30, 2008 and 2007.

	Three Months Ended September 30			Six Months Ended September 30		
($ millions)	2008	2007	Variance	2008	2007	Variance
Total revenue	232.1	220.2	11.9	404.0	379.9	24.1
Expenses	(165.9)	(150.8)	(15.1)	(319.4)	(288.4)	(31.0)
Earnings from operations	66.2	69.4	(3.2)	84.6	91.5	(6.9)
Interest and other	(12.5)	(8.4)	(4.1)	(22.5)	(16.1)	(6.4)
Net earnings & comprehensive income	53.7	61.0	(7.3)	62.1	75.4	(13.3)

Revenue
Our total revenues in the six months ended September 30, 2008 increased over the previous year as shown in the table below.



During the six months ended September 30, 2008, the greatest portion of our revenues, 61%, 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 30%. General revenue, 1%, consists mainly of interest earned and retail commissions.

Total Revenue

Revenue ($ millions)	Three months ended September 30 2008	2007	Increase (Decrease)	Six months ended September 30 2008	2007	Increase (Decrease)
Direct Route Revenue						
Vehicle traffic (volume)	2,593,155	2,761,749	(168,594)	4,747,153	4,952,762	(205,609)
Vehicle tariff	91.8	84.0	7.8	161.3	144.4	16.9
Passenger traffic (volume)	7,125,479	7,522,058	(396,579)	12,536,475	13,060,986	(524,511)
Passenger tariff	60.2	54.0	6.2	98.7	88.7	10.0
Social program fees	6.0	4.8	1.2	11.4	9.5	1.9
Catering & on-board	26.5	27.4	(0.9)	45.8	46.4	(0.6)
Other revenue	8.2	9.1	(0.9)	13.3	14.8	(1.5)
Total Direct Route Revenue	192.7	179.3	13.4	330.5	303.8	26.7
Indirect Route Revenue						
Ferry transportation fees	31.8	32.0	(0.2)	58.1	58.5	(0.4)
Federal-Provincial subsidy	6.6	6.5	0.1	13.1	12.9	0.2
Total Route Revenue	231.1	217.8	13.3	401.7	375.2	26.5
Other general revenue	1.0	2.4	(1.4)	2.3	4.7	(2.4)
Total Revenue	232.1	220.2	11.9	404.0	379.9	24.1

Our largest revenue source is vehicle and passenger tariffs. The price cap increase authorized by the Commissioner was 7.3% on the major routes and 4.0% on all other routes effective April 1, 2008, starting from a level which included fuel surcharges in place at March 31, 2008. On April 1, we implemented tariff increases in line with these price cap adjustments. 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. 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.

As a result of the dramatic increase in fuel prices over the first part of this year, fuel surcharges were implemented on August 1, 2008. Subsequently, approval was received from the Commissioner to reduce these fuel surcharges by 50% in order to reflect the more recent drop in fuel prices. The reduction will be effective November 4, 2008. In the second quarter, we collected $10.6 million in fuel surcharges from customers and in the six months ending September 30, 2008, we invoiced the Province $2.4 million for fuel costs on the northern routes. These amounts were applied to the outstanding deferred fuel cost account balances. The balance in the deferred fuel cost accounts at September 30, 2008 was $14.0 million ($11.9 million at March 31, 2008).

Year to year changes for the three and six months ended September 30 for the major, northern and other routes are discussed separately below.

Major Routes

Direct Route Revenue ($ thousands)	Three months ended September 30			Six months ended September 30		
	2008	2007	Increase (Decrease)	2008	2007	Increase (Decrease)
Vehicle traffic (volume)	1,216,591	1,306,624	(90,033)	2,194,054	2,304,402	(110,348)
Vehicle tariff	67,632	62,899	4,733	120,327	108,824	11,503
Passenger traffic (volume)	3,785,881	4,052,440	(266,559)	6,553,995	6,917,723	(363,728)
Passenger tariff	42,926	39,103	3,823	71,220	64,761	6,459
Social program fees	3,079	2,629	450	5,783	5,030	753
Catering & on-board	20,651	21,441	(790)	36,533	37,098	(565)
Reservation fees	4,782	5,417	(635)	7,822	8,658	(836)
Parking	1,131	997	134	1,886	1,739	147
Assured loading	693	938	(245)	1,181	1,547	(366)
Other revenue	765	734	31	1,073	1,292	(219)
Total Direct Route Revenue	141,659	134,158	7,501	245,825	228,949	16,876
Gross margin – catering & on-board	12,691	13,291	(600)	22,493	22,935	(442)

Revenue on the major routes is from customers and related social program fees. No ferry transportation fees are received for service provided on these routes.

Both vehicle traffic and passenger traffic decreased over the prior year. The reduction in total tariff revenue as a result of these volume decreases was more than offset by the increase in average tariff revenue. The increase in average tariff revenue per vehicle in the second quarter was $7.45 or 15.5% ($7.62 or 16.1% year-to-date) while the increase in average tariff revenue per passenger in the second quarter was $1.69 or 17.5% ($1.51 or 16.1% year-to-date). A significant portion of these increases represents fuel surcharges previously paid by customers and credited to fuel cost deferral accounts, which are now included in tariff revenue by order of the Commissioner. During the second quarter of fiscal 2008, these surcharges paid by customers amounted to $10.0 million ($16.2 million for the six months ended September 30, 2007). The April 1, 2008 price cap increase on the major routes was 7.3% starting from a level which included fuel surcharges in place at March 31, 2008. The higher average fares, partially offset by the decrease in traffic and significant use of promotional discount fares during the first quarter, resulted in a total increase of $8.6 million ($18.0 million year-to-date) 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 mainly as a result of higher fares.

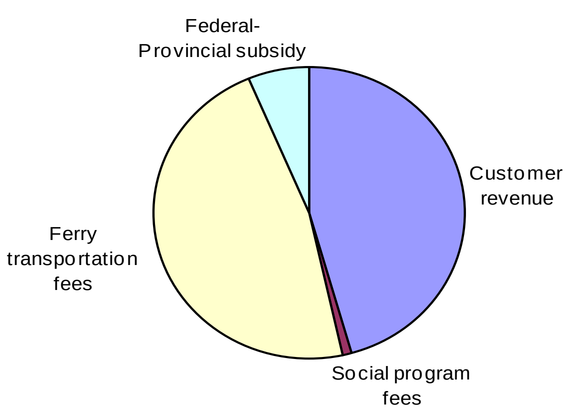
All of our vessels that provide service on our major routes have a gift shop and options for food service. Although the spending per passenger on catering and on-board services increased 3.9% (increase of 3.5% in gross margin) for the six months ended September 30, 2008, this increase was more than offset by a decrease in overall sales as a result of the lower number of passengers carried. The lower fees for reservations and assured loading revenue also reflect the lower traffic levels.

Parking revenue has increased significantly in the second quarter of fiscal 2009 and other revenue is higher as a result of retail commissions arising from the opening of the Departure Bay Quay.

Northern Routes

Direct Route Revenue ($ thousands)	Three months ended September 30			Six months ended September 30		
	2008	2007	Increase (Decrease)	2008	2007	Increase (Decrease)
Vehicle traffic (volume)	16,114	16,808	(694)	24,123	24,915	(792)
Vehicle tariff	4,552	3,868	684	6,701	5,617	1,084
Passenger traffic (volume)	52,637	55,437	(2,800)	74,693	78,762	(4,069)
Passenger tariff	4,620	4,058	562	6,351	5,492	859
Social program fees	208	196	12	400	325	75
Catering & on-board	1,411	1,456	(45)	1,932	1,994	(62)
Reservation fees	32	33	(1)	47	52	(5)
Stateroom rental	431	488	(57)	628	668	(40)
Hostling[1]	43	45	(2)	88	90	(2)
Other revenue	14	18	(4)	27	31	(4)
Total Direct Route Revenue	11,311	10,162	1,149	16,174	14,269	1,905
Indirect Route Revenue						
Ferry transportation fees	9,731	11,575	(1,844)	16,164	18,771	(2,607)
Federal-Provincial subsidy	1,114	1,097	17	2,232	2,195	37
Total Route Revenue	22,156	22,834	(678)	34,570	35,235	(665)
Gross margin – catering & on-board	1,062	888	174	1,457	1,122	335

Our northern routes consist of three regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island.



In the six months ended September 30, 2008, revenue from our northern routes consists of 46% from customers, 1% from social program fees, 47% from ferry transportation fees paid by the Province, and 6% from payments under the Federal-Provincial subsidy agreement.

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

Northern Routes, continued

The average tariff revenue per vehicle in the second quarter increased $52.36 or 22.8% ($52.33 or 23.2% year-to-date). The average passenger tariff revenue increase in the second quarter was $14.59 or 19.9% ($15.30 or 21.9% year-to-date). A significant portion of these increases represents fuel surcharges previously paid by customers and credited to fuel cost deferral accounts, which are now included in tariff revenue by order of the Commissioner. During the second quarter of fiscal 2008, these surcharges paid by customers amounted to $1.4 million ($1.9 million to September 30, 2007). The April 1, 2008 price cap increase on the northern routes was 4.0% starting from a level which included fuel surcharges in place at March 31, 2008. The higher average tariff, partially offset by lower traffic, resulted in a total tariff revenue increase of $1.2 million in the second quarter ($1.9 million year-to-date).

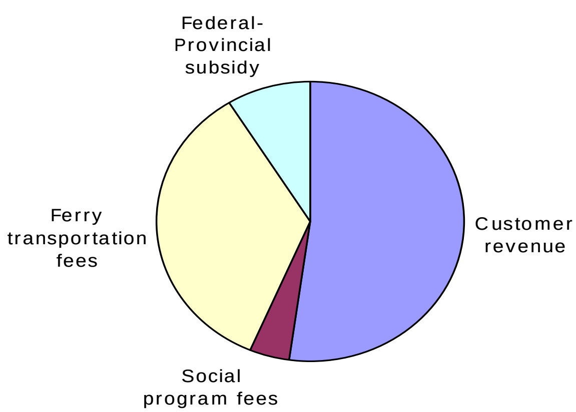
We receive ferry transportation fees for these routes under the Coastal Ferry Services Contract. The decrease in fees to the end of September compared to the prior year reflects a reduction in the cost of the *Northern Adventure* with the receipt of import duties remission and related GST in the later part of fiscal 2008. It is also affected by a change in the timing of the payment of ferry transportation fees in the second performance term which better reflects the seasonality of our business.

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

Other Routes

Direct Route Revenue ($ thousands)	Three months ended September 30			Six months ended September 30		
	2008	2007	Increase (Decrease)	2008	2007	Increase (Decrease)
Vehicle traffic (volume)	1,360,450	1,438,317	(77,867)	2,528,976	2,623,445	(94,469)
Vehicle tariff	19,647	17,242	2,405	34,243	30,003	4,240
Passenger traffic (volume)	3,286,961	3,414,181	(127,220)	5,907,787	6,064,501	(156,714)
Passenger tariff	12,617	10,866	1,751	21,148	18,401	2,747
Social program fees	2,692	2,018	674	5,224	4,155	1,069
Catering & on-board	3,969	3,939	30	6,704	6,649	55
Reservation fees	618	725	(107)	926	1,042	(116)
Parking & other	149	197	(48)	253	291	(38)
Total Direct Route Revenue	39,692	34,987	4,705	68,498	60,541	7,957
Indirect Route Revenue						
Ferry transportation fees	22,100	20,420	1,680	41,888	39,756	2,132
Federal-Provincial subsidy	5,460	5,367	93	10,915	10,733	182
Total Route Revenue	67,252	60,774	6, 478	121,301	111,030	10,271
Gross margin – catering & on-board	2,579	2,515	64	4,357	4,312	45

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 transportation fees in the above table.



In the six months ended September 30, 2008, revenue from our other routes consisted of 52% from customers, 4% from social program fees, 35% from ferry transportation fees paid by the Province and 9% from payments under the Federal-Provincial subsidy agreement.

We experienced a continued decrease in vehicle and passenger traffic levels on our other routes in the second quarter of fiscal 2009. The reduction in total tariff revenue as a result of lower traffic levels was more than offset by the increase in average vehicle and passenger tariff revenue.

Other Routes, continued

The increase in average tariff revenue per vehicle in the second quarter was $2.45 or 20.4% ($2.10 or 18.4% year-to-date) while the average passenger tariff revenue increase in the second quarter was $0.66 or 20.8% ($0.55 or 18.2% year-to-date). A significant portion of these increases represents fuel surcharges previously paid by customers and credited to fuel cost deferral accounts, which are now included in tariff revenue by order of the Commissioner. During the second quarter of fiscal 2008, these surcharges paid by customers amounted to $5.1 million ($8.7 million to September 30, 2007). The April 1, 2008 price cap increase on our other regulated routes was 4.0% starting from a level which included fuel surcharges in place at March 31, 2008. The increased average fares, partially offset by the reduction in traffic levels, resulted in a total tariff revenue increase of $4.2 million ($7.0 million year-to-date).

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

We receive ferry transportation fees for these routes under the Coastal Ferry Services Contract. The increase in fees reflects a change in the timing of the payment of ferry transportation fees in the second performance term which better reflects the seasonality of our business.

Fees for reservations have decreased as a result of lower traffic. The decrease in other income is mainly a result of additional revenue from charters in the second quarter of the prior year.

Expenses
Expenses for the three and six months ended September 30, 2008 and 2007 are summarized in the table below.

($ millions)	Three months ended September 30 2008	2007	(Increase) Decrease $	Six months ended September 30 2008	2007	(Increase) Decrease $
Operations	105.8	91.0	(14.8)	201.7	172.9	(28.8)
Maintenance	16.5	20.7	4.2	34.8	42.1	7.3
Administration	11.4	12.4	1.0	23.3	23.6	0.3
Cost of retail goods sold	9.7	10.1	0.4	16.9	17.4	0.5
Amortization	22.5	16.6	(5.9)	42.7	32.4	(10.3)
Total expenses	165.9	150.8	(15.1)	319.4	288.4	(31.0)
Interest & other						
(Gain) loss on foreign exchange	(0.1)	(0.0)	0.1	(0.2)	(0.1)	0.1
Interest expense	12.6	8.3	(4.3)	23.8	16.1	(7.7)
Loss (gain) on disposal of capital assets	0.0	0.1	0.1	(1.1)	0.1	1.2
Total interest and other	12.5	8.4	(4.1)	22.5	16.1	(6.4)

The $14.8 million ($28.8 million year-to-date) increase in operations expenses reflects:

- $12.3 million ($22.7 million year-to-date) increase in fuel expense reflecting the increase in the per litre cost of fuel, partially offset by $0.6 million due to a reduction in litres consumed in the six months ended September 30, 2008 as a result of our fuel reduction strategy. For Performance Term 2, the Commissioner increased the price of fuel to be included in the determination of price caps by 81.3% from the prior year in order to reflect higher fuel prices;

- $2.2 million ($5.2 million year-to-date) increase in wages and benefits, including:
  - Approximately $1.3 million ($2.4 million year-to-date) in bargaining unit wage rate increases averaging about 3%;
  - $1.2 million ($2.3 million year-to-date) increase in benefit costs; and
  - $0.1 million ($0.9 million year-to-date) in additional training costs.

  These increases were partially offset by reductions resulting from the deferral of filling staff vacancies; and

- $0.1 million ($0.8 million year-to-date) increase in safety and security costs as we continue with our SailSafe program — a joint initiative with the BC Ferry & Marine Workers' Union to identify areas and methods for enhancing current safety practices.

Maintenance costs are $4.2 million ($7.3 million year-to-date) lower than the prior year. We plan to undertake 20 vessel refits in fiscal 2009, compared to 26 in the prior year.

Administration expenses decreased $1.0 million ($0.3 million year-to-date) mainly as a result of the deferral of filling staff vacancies and deferring or reducing travel, consulting, marketing, advertising and other discretionary expenditures.

Amortization increased a total of $5.9 million ($10.3 million year-to-date) mainly as a result of additional assets coming into service, including $4.0 million ($6.0 million year-to-date) reflecting the *Coastal Renaissance* entering service in March 2008 and the *Coastal Inspiration* entering service in June 2008; and $1.2 million ($2.3 million year-to-date) in amortization of deferred fuel cost balances. The Commissioner has included $18.5 million of deferred performance term one fuel costs in determination of the price caps set for the four-year second performance term commencing April 1, 2008.

Interest expenses increased $4.3 million ($7.7 million year-to-date) primarily due to:

- $2.8 million ($5.6 million year-to-date) additional interest relating to our $200 million bond series issued in January 2008;
- $2.3 million ($4.1 million year-to-date) additional interest relating to the two $90 million KfW loans;
- $0.8 million ($1.6 million year-to-date) reduction in funds received from the Structured Financing Facility Program offered by the Government of Canada; and
- $0.3 million ($0.7 million year-to-date) reduction in interest on deferred fuel cost accounts.

These increases were partially offset by $2.2 million ($4.5 million year-to-date) of additional interest capitalized reflecting our investment in revitalizing our fleet and terminal facilities.

We reported a $1.2 million gain from the sale of the *Queen of Esquimalt* in the three months ended June 30, 2008.

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 currently expect operating cash flows to fund more than one-half of the capital expenditures over the next five years, with the balance funded by borrowings.

In May 2008, we negotiated an extension of the $155 million credit facility by one year. The new maturity of this facility is May 12, 2013. At September 30, 2008 we had drawn $11 million on this credit facility.

In May 2008, to coincide with conditional acceptance of the *Coastal Celebration*, we received $90 million in proceeds under the loan agreement with KfW, a German export credit bank. This is a 12-year amortizing loan, at a fixed interest rate of 4.98%. The agreement defers the principal payments for the first three years to a second tranche on which interest only is payable at a floating rate. This principal is due June 2020.

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 the three and six months ended September 30, 2008 and 2007 are summarized in the table below.

($ millions)	Three months ended September 30 2008	2007	Six months ended September 30 2008	2007
Net earnings	53.7	61.0	62.1	75.4
Items not involving cash:				
Amortization	22.5	16.6	42.7	32.4
Other non-cash charges	(0.1)	0.2	(0.9)	0.3
Regulatory costs deferred	1.7	4.1	0.8	4.9
Change in operating working capital	(4.3)	(1.6)	(25.5)	(13.2)
Cash provided by operating activities	73.5	80.3	79.2	99.8
Cash provided (used) by financing activities	10.8	(0.1)	100.4	(24.8)
Cash used in investing activities	(76.5)	(44.3)	(280.3)	(119.0)
Total increase (decrease) in cash	7.8	35.9	(100.7)	(44.0)

Three Months Ended September 30, 2008
In the three months ended September 30, 2008, cash provided by operating activities reflected an increase in non-cash working capital of $4.3 million. This increase in working capital was primarily due to:

- $5.9 million reduction in deferred revenue as a result of:
  - $5.2 million in reservation liability reflecting the seasonal nature of our traffic;
  - $0.2 million in prepaid fare media; and
  - $0.5 million in other deferred revenues.

- $5.5 million reduction in payables and accrued liabilities relating to refit and maintenance and other operating activities; and

- $0.4 million reduction in accrued employee costs.

The above items, which increased working capital, were partially offset by:

- $5.0 million reduction in prepaid expenses primarily due to:
  - $1.4 million in property taxes;
  - $2.1 million in prepaid fuel;
  - $1.1 million in insurance and other contracts; and
  - $0.4 million in other prepaid costs;

- $1.3 million reduction in inventories of fuel and materials;

- $1.1 million growth in interest payable due to timing of interest payments; and

- $0.2 million reduction in accounts receivable resulting mainly from:
  - $1.9 million in fuel hedge proceeds received; and
  - $1.5 million recovery from the Province of the *Nicola* refit costs,

  partially offset by increases due to:
  - $2.3 million recoverable from the Province, primarily for social program fees, ferry transportation fees and fuel costs for the northern routes; and
  - $0.9 million in commercial travel cards receivable.

Cash provided by financing activities reflects the $11.0 million draws on our $155.0 million credit facility.

Cash used in investing activities consists mainly of $88.3 million used to purchase capital assets. The significant capital transactions are described below in "Investing in Our Capital Assets".

Six Months Ended September 30, 2008
In the six months ended September 30, 2008, cash provided by operating activities was reduced by an increase in non-cash working capital of $25.5 million. This increase in working capital was primarily due to:

- $13.4 million decrease in payables and accrued liabilities relating to refit and maintenance and other operating activities;

- $2.6 million increase in prepaid expenses primarily due to:
  - $1.3 million in property taxes;
  - $0.8 million in prepaid fuel; and
  - $0.7 million in insurance and other contracts as a result of annual remittances made in the first quarter.

    These increases have been partially offset by a reduction of $0.2 million in other prepaid costs;

- $3.6 million decrease in regulatory liabilities reflecting the return to customers through discount fare promotions of the tariff revenues collected in excess of price caps in the last quarter of fiscal 2008;

- $2.9 million increase in accounts receivable resulting mainly from;
  - $1.8 million in commercial travel cards receivable; and
  - $3.9 million receivable from the Province for social program fees, ferry transportation fees and fuel costs for the northern routes,

  partially offset by decreases of:
  - $1.3 million in GST receivables primarily due to the receipt of $0.8 million GST on duty remission for the *Northern Adventure*; and
  - $1.5 million in other receivables.

- $1.3 million decrease in accrued employee costs;

- $1.2 million decrease in deferred revenue; and

- $0.1 million increase in inventories, comprising a $1.1 million increase in fuel inventories, offset by reductions in retail inventories and materials for refits.

Cash provided by financing activities reflects issuance of the second $90 million loan agreement with KfW, a German export credit bank, and $11 million draws on our $155 million credit facility.

Cash used in investing activities consists mainly of $283.9 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 the three months ended September 30, 2008 totalled $56.0 million ($246.1 million in the six months ended September 30, 2008). This level of expenditure reflects significant investments in our fleet, terminals and information systems to increase customer service and operating efficiency. Total capital expenditures for the three and six months ending September 30, 2008 were:

	September 30, 2008	
($ millions)	3 Months	6 Months
New vessels, vessel upgrades and modifications	37.4	209.3
Terminal marine structures	8.6	16.9
Terminal and building upgrades and equipment	7.9	15.4
Computer hardware and software development	2.1	4.5
Total Capital Expenditures	56.0	246.1

New Vessels, Vessel Upgrades and Modifications

Capital expenditures for new vessels, vessel upgrades and vessel modifications for the three and six months ending September 30, 2008 included the following:

	September 30, 2008	
($ millions)	3 Months	6 Months
New *Coastal Inspiration* and *Coastal Celebration*	7.9	144.8
Life extension of the *Queen of New Westminster*	14.4	28.0
New northern vessel, the *Northern Expedition*	9.6	16.6
Upgrade and replacement of propulsion and safety equipment on the *Quinitsa*	0.5	6.0
Refurbishment of car deck on the *Powell River Queen*	0.7	5.3
Sewage treatment plant upgrade program	1.7	2.2
New intermediate vessel, the *Island Sky*	0.8	1.5
Other projects	1.8	4.9
	37.4	209.3

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 early 2009 and be redeployed on our Tsawwassen–Swartz Bay route.

Coastal Renaissance, Coastal Inspiration and Coastal Celebration

In September 2004 we entered into contracts with Flensburger Schiffbau-Gesellschaft (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. This propulsion system and other technological and environmental features of the *Coastal Renaissance* contributed to winning the prestigious ShipPax award for outstanding ferry technology for 2008. These Super C-class vessels are replacing aging vessels that have been providing service on our major routes.

The contracts with FSG were design-build and fixed price, totalling $325 million. The contracts have provided 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, formed 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. The project for these three new state-of-the-art vessels has come in on schedule and under 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 June 16, 2008, it commenced service on the Duke Point-Tsawwassen route, following crew training and familiarization.

Construction of the *Coastal Celebration* began in April 2007 and the vessel was launched in December 2007. It arrived in British Columbia on June 18, 2008. The vessel is expected to commence service on the Swartz Bay-Tsawwassen route before the end of 2008.

Northern Expedition

In July 2006, 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 was launched on September 25, 2008 in Germany. 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.

Island Sky

We expect to take delivery of the *Island Sky*, our new intermediate class ferry, before the end of 2008. The $46 million contract with Vancouver Shipyards constitutes the majority of the total project budget of $57 million. The new intermediate vessel has allowed for the retirement and sale of the 48-year-old *Queen of Tsawwassen*. The new vessel measures 102 metres in length and has a capacity of approximately 600 passengers and 125 vehicles. It features a new state-of-the-art lifesaving system as well as a variety of amenities, including a lounge and snack bar for passengers.

Terminal Marine Structures

We continued to reinvest in our terminal infrastructure in the first six months of fiscal 2009. We made significant upgrades to many of our terminals and made preparations for the arrival of the new Super C-class vessels and the *Northern Expedition*. 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 the periods ending September 30, 2008 included the following:

($ millions) Terminal	Description	September 30, 2008 3 Months	6 Months
Prince Rupert	New pontoon, ramp, ramp abutment and dolphin[2]	2.9	4.0
Skidegate	New pontoon, ramp, ramp abutment and two dolphins	1.2	3.4
Bear Cove	New pontoon, ramp and ramp abutment	1.5	2.8
Duke Point	Berth upgrades to accommodate Super C-class vessels	0.4	2.1
McLoughlin Bay	Modifications to existing pontoon and new floating lead	0.3	0.5
Various	Other projects	2.3	4.1
		8.6	16.9

Marine upgrades at Skidegate, Prince Rupert, Bear Cove and McLoughlin Bay have a total budget of $31 million of which $7.5 million was completed in the prior year. These projects are expected to be completed by spring 2009 to correspond with the in-service date for the *Northern Expedition*.

Terminal and Building Upgrades and Equipment

In addition to upgrades to terminal marine structures, many other terminal upgrades are underway to provide better service to our customers and improve operational efficiencies. Capital expenditures on terminal and building upgrades and equipment included the following:

($ millions)	September 30, 2008 3 Months	6 Months
Departure Bay terminal	4.7	10.0
Security upgrades	0.7	0.9
Alliford Bay / Skidegate erosion control	0.3	0.6
Swartz Bay terminal	0.1	0.6
Richmond warehouse	0.4	0.4
Other terminal projects	1.7	2.9
	7.9	15.4

The most significant activity in the first six months of fiscal 2009 has been at our Departure Bay terminal. At Departure Bay terminal a new retail building, the Departure Bay Quay, and

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

new ticket building have been completed. The holding compound, pick-up and drop-off area, and the short-term parking are being expanded, a new waiting room and washrooms are being built and the intersection realigned.

At Swartz Bay terminal, the holding compound and pre-ticket area have been expanded, new ticket booths built, the radar maintenance building relocated and the exit realigned. In fiscal 2009, we will improve our waste water treatment by building independent equalization storage facilities, a pumping station and a connection to a local unified treatment plant.

At nine terminals, mainly serving our major and northern routes, we continue our 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 and database security.

Other ongoing projects include enhanced reporting initiatives, better external and internal communications, replacement of obsolete technology and security projects. These projects focus on obtaining efficiencies, improving safety and security and providing better service to our customers.

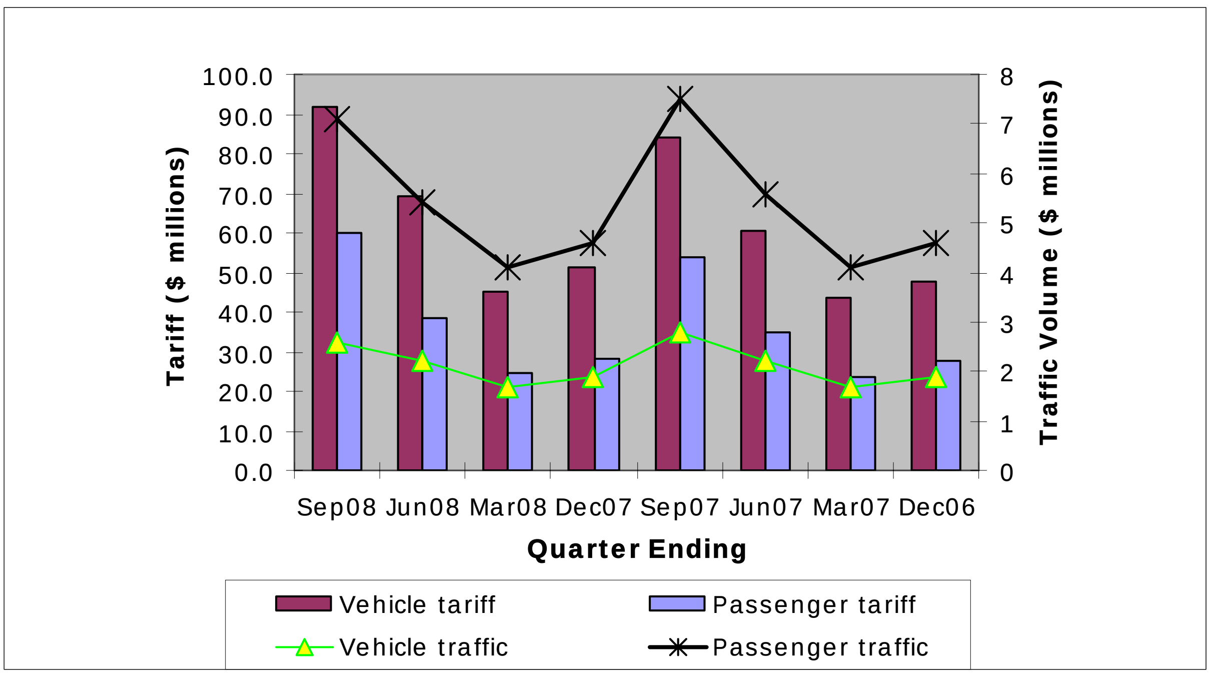
SUMMARY OF QUARTERLY RESULTS

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

	Quarter Ended (unaudited)							
($ millions)	Sep 08	Jun 08	Mar 08	Dec 07	Sep 07	Jun 07	Mar 07	Dec 06
Total revenue	232.1	171.9	124.2	136.5	220.2	159.8	119.0	128.4
Earnings (loss) from operations	66.2	18.3	(20.0)	(0.4)	69.4	22.1	(27.7)	2.5
Net earnings (loss) and comprehensive income	53.7	8.4	(30.5)	(7.8)	61.0	14.4	(33.2)	(1.8)

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

Economic Outlook

The Canadian economy is not immune to the current turbulence in financial markets and the deepening recession in major economies around the world. This has had a negative impact on our operations. For example, while our ridership has been stable over several years, we are experiencing a downturn in traffic which is at least in part due to the current economic condition. The duration of this recession is uncertain and we believe it is unlikely that the impact on our operations will reverse until such time as world economies begin to recover.

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.

For the northern routes, the per litre cost of fuel included in the determination of price caps (the set price) and one-half of the first 5 cents per litre of difference between the actual price paid per litre and the set price are recorded in expense. The remaining one-half of the first 5 cents per litre of difference is recorded in the deferred fuel cost accounts. Any difference beyond 5 cents per litre is recovered from or paid to the Province. The total to be recovered from the Province relating to fuel costs on the northern routes was $2.4 million for the six months ended September 30, 2008.

For all other routes, 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 less one-half of the first 5 cents per litre of difference are charged or credited to the deferred fuel cost accounts.

The balances in our deferred fuel cost accounts totalled $14.0 million at September 30, 2008 ($11.9 million at March 31, 2008). Included in the September 30, 2008 balance is $3.4 million in unrealized fuel hedge losses on fuel forward contracts entered into to fix the price of future purchases.

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.

As fuel costs continued a dramatic rise, we requested and received approval from the Commissioner to allow for the early implementation of fuel surcharges, effective August 1, 2008 on all but the northern routes. Subsequently, approval was received to reduce these fuel surcharges by 50% in order to reflect the more recent drop in fuel prices. The reduction will be effective November 4, 2008. We anticipate further reductions may be made if fuel prices remain low.

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 have experienced a decrease in traffic in the first and second quarters of fiscal 2009 compared to the prior year. With the increase in transportation costs as a result of fuel prices, the tariff rate increase of April 1, 2008, fuel surcharges and the current economic uncertainties, we are uncertain as to the cumulative impact these events may have on our traffic. As a result of this uncertainty and of the continued reduction in traffic in the second quarter, we have revised our financial and operating plans to reduce overall overhead and other operating costs from previously planned levels. One measure taken was an elimination of some off-peak sailings which historically have had low utilization. On October 22, 2008, the Province announced that it would provide funding to allow a 33 per cent reduction on fares for all routes during the months of December 2008 and January 2009. Additional funding will also be provided by the Province to reimburse the costs of reinstating the previously eliminated off-peak sailings.

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 the level of annual operational training we conduct. We increased training from approximately 11,000 person days in fiscal 2007 to 14,200 in fiscal 2008. We expect to increase this training further, to 15,600 person days, in fiscal 2009. We are on target to accomplish this with 8,200 days complete to September 30, 2008.

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. In the first phase of the action plan, we expect to implement 48 recommendations, of which three are complete at the end of September 2008.

We are proactive in ensuring environmental regulations are met or exceeded and in developing strategies that demonstrate our commitment to sound 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 improve fuel efficiency and reduce emissions from 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

We have one of the largest fleets in the world. The average age of our assets was among the oldest of major ferry operators worldwide. To address this, we instituted a major fleet and asset renewal program. As part of this, in March 2007, we added the *Northern Adventure* and the *Kuper* to our fleet. The first two Super C-class vessels, the *Coastal Renaissance* and the *Coastal Inspiration* commenced service in March and June 2008, respectively and we have taken possession of the third and last Super C-class vessel. In addition to this last Super C-class vessel, the *Coastal Celebration*, over the five-year period ending June 2013, we will bring the following three vessels into service:

- a northern vessel, the *Northern Expedition*;
- 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.

Market Opportunities

Notwithstanding the pressure on traffic volumes generally, we see opportunities for growth in certain segments of our business.

In March 2007, we established Pacific Marine Ventures Inc. (PMV) as a wholly owned subsidiary to pursue strategic business opportunities related to commercial traffic, tourism and terminal management. In September 2007, PMV assumed management of the Sidney International Ferry terminal. Under a 40-year lease, PMV is managing and developing the town's 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. PMV is also pursuing other 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 an agreement to lease a 250 square metre 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* has joined the recently upgraded *Queen of Alberni* on our Duke Point–Tsawwassen route – the route most frequently used by commercial truckers. In the six months ended September 30, 2008, we realized an 18.5% increase in commercial traffic revenue compared to the prior year, reflecting a marginal increase in traffic levels. 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.

In September 2008, we established BCF Global Services Inc. (BCF Global) as a wholly owned subsidiary to provide consulting and management services both domestically and internationally. BCF Global will take advantage of our expertise and long history in the marine transportation business to pursue new business opportunities relating to the development, operation and maintenance of ferry systems.

Regulation

Transport Canada regulates the safety of our vessels by authority of the *Canada Shipping Act 2001,* which came into effect on July 1, 2007. This is the principal legislation governing the activities of Canadian vessels in all waters and of all vessels in Canadian waters. The revised regulations may have an impact on the useful life of some of our vessels and/or the requirement for vessel upgrades. 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. Amendments to the existing regulations have been proposed, the intent of which is to include domestic ferries and facilities within the *Marine Transportation Security Act* framework. If these amendments are 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 received approval for $3.8 million of federal funding under our first application to help offset the costs of perimeter security, access control measures and training. We have made further applications for federal funding 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 transportation 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 have competition in the commercial sector, where three companies, including ourselves, are 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 have increased capacity for both commercial and passenger vehicle traffic on two of our major routes with the assignment of a Super C-class vessel to each route. The third Super C-class vessel will add capacity on the third major route. We have also improved traffic efficiency at the Horseshoe Bay terminal and are continuing with improvements at the Departure Bay terminal. New service offerings are also being investigated.

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 us, could provide safe, reliable and high quality service that is more cost-effective.

A Request for Proposal (RFP) process has now been completed for the Brentwood Bay-Mill Bay route. We performed an extensive assessment of the proposal received from an alternative service provider and an external, independent party was engaged to review our evaluation. It was concluded that we can operate this route in a more cost-effective manner than that proposed by the potential alternative service provider and we continue to be the service provider for this route.

In August 2008, we issued 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. Based on the response to this RFEOI, we expect to issue an RFP later this year. 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.

The carrying value and fair value of our non-derivative financial instruments by class and of our derivative instruments by type are included in note 9 of our interim consolidated financial statements.

RISK MANAGEMENT

Understanding and managing risk are important parts of our business. We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business.

A discussion of enterprise wide risk management can be found in our fiscal 2008 annual Management's Discussion & Analysis. Our risk profile is substantially unchanged during the six months ended September 30, 2008.

The management of the credit, liquidity and market risk arising from our financial instruments is discussed in note 8 of our interim consolidated financial statements.

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 March 31, 2008 and September 30, 2008 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.

Discussion of the most critical accounting policies and estimates that we have used in the preparation of our consolidated financial statements can be found on pages 40 through 42 of our fiscal 2008 Management's Discussion & Analysis. The following describes the changes to critical accounting policies we have used in the preparation of our consolidated financial statements for the six months ended September 30, 2008 or expect to use in the future.

Adoption of New Accounting Standards

Effective April 1, 2008, we adopted the following CICA Handbook Sections:

- 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. Other than the additional disclosure in note 10, the adoption of this section has had no 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. Other than the change in disclosure in Note 1, the adoption of this section has had no 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. Other than the additional disclosure in notes 8 and 9, the adoption of this section has had no impact on our consolidated financial statements.

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

Future Accounting Changes
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 fewer intangible assets being recognized on the balance sheet. We are continuing to assess the financial reporting impact of the adoption of this section.

- Amendments to Sections 1100 *Generally Accepted Accounting Principles*, 3465 *Income Taxes* and Accounting Guideline AcG-19 *Disclosures by Entities Subject to Rate Regulation* are to be applied prospectively. 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. We are continuing to assess the financial reporting impacts of the adoption of IFRS and, at this time, the impact on the future financial position and results of operations is not reasonably determinable or estimable.

We commenced our IFRS conversion project in 2007 and have established a formal project governance structure with regular reporting. We have also engaged a quality assurance advisor to assist in the project.

Our IFRS conversion project consists of three phases: scoping and diagnostic; analysis and development; and implementation and review. The first phase, which has been completed, involved project planning and resourcing, identification of differences between current Canadian GAAP and IFRS and priority setting. The areas identified to have the highest potential to significantly impact us are rate regulated operations; property plant and equipment, intangible assets and asset impairment; and initial adoption of IFRS under the provisions of IFRS 1 *First-Time Adoption of IFRS*.

The second phase, which involves detailed analysis and evaluation of options and alternative methodologies available under IFRS and the financial impact of these options, is currently in progress. We anticipate that the adoption of IFRS will have an impact on our system requirements; however the degree of impact is not reasonably determinable at this stage of the project. We will continue to closely monitor the proposed and continuing projects of the International Accounting Standards Board and any International Financial Reporting Interpretations Committee initiatives that may potentially impact rate-regulated accounting under IFRS.

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, the Canadian Dollar relative to the US Dollar, fuel costs and the fuel reduction program, construction costs, the state of the local economy, turbulent financial markets, 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 traffic volume and tariff revenue risk, safety and security, 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.