

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

**For the fiscal year ended March 31, 2009  
Dated May 20, 2009**



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**Management's Discussion & Analysis  
of Financial Condition and Results of Operations  
For the fiscal year ended March 31, 2009  
Dated May 20, 2009**

The following is our discussion and analysis of the financial condition and results of operations for British Columbia Ferry Services Inc. as of May 20, 2009. This should be read in conjunction with our audited consolidated financial statements and related notes for the years ended March 31, 2009 (fiscal 2009) and March 31, 2008 (fiscal 2008). These documents are available on SEDAR at [www.sedar.com](http://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 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.

We provide a wide and varied range of ferry services for our customers. In fiscal 2009, we provided more than 187,000 sailings, carrying 20.7 million passengers and 8.1 million vehicles.

Over the last three years, we spent \$1.2 billion in total capital expenditures, reflecting significant investments in our infrastructure to revitalize our fleet and our terminal facilities. Of this, \$1.0 billion was spent on new vessels, vessel upgrades and modifications, adding seven new vessels to our fleet and extending the operating life of a further three vessels. As a result of these investments, and as expected, our amortization and financing costs have increased sharply over the last couple of years, reducing our net earnings. Our reported earnings in fiscal 2009 have declined as expected. The most significant portion of our vessel replacement program is now complete.

Our traffic levels, which had been relatively stable, decreased in fiscal 2009. Vehicle and passenger traffic were lower than the prior year by 5.2% and 4.9% lower, respectively. These reductions are due at least in part to the declines in the British Columbia and local economies experienced in fiscal 2009. We believe that the decreasing level of economic activity, reduced level of tourism, rising unemployment, reduced consumer confidence and higher vehicle fuel prices earlier in fiscal 2009, have all negatively impacted our commercial and discretionary travel markets. In addition, in the month of December, traditionally a busy month, we experienced a decrease of 10% in traffic mainly due to severe weather. For three weeks, our service areas were faced with high winds, record snowfalls, black ice, freezing rain and impassable roads. We continue to review and update our financial and operating plans to respond to current economic uncertainties and reduced traffic levels. (See "Outlook–Traffic" and "Outlook–Corporate Restructuring" below for more detail.)

Significant events during or subsequent to fiscal 2009:

New vessels and major vessel upgrades (See "Investing in our Capital Assets" below for more detail):

- On June 16, 2008, the second of three new Super C-class vessels, the *Coastal Inspiration*, commenced service on the Duke Point–Tsawwassen route following crew training and familiarization in the operation of this state-of-the-art vessel.

On November 21, 2008, the third and final new Super C-class vessel, the *Coastal Celebration*, commenced service on the Swartz Bay–Tsawwassen route.

These vessels are among 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. This propulsion system and other technological and environmental features of the Super C-class vessels contributed to winning the prestigious ShipPax<sup>1</sup> award for outstanding ferry technology for 2008.

The total project budget for the three new Super C-class vessels was \$542 million. The project was completed on schedule and \$26 million under budget.

- On February 19, 2009, the *Island Sky*, our new intermediate class ferry, commenced service on the Earls Cove–Saltery Bay route. This 102-metre vessel accommodates up to 125 vehicles and 600 passengers. A \$47 million contract with Vancouver Shipyards constitutes the majority of the total project budget of \$57 million.
- On April 3, 2009, the 45-year-old *Queen of New Westminster*, which formerly operated on our Duke Point–Tsawwassen route, returned to service on our Tsawwassen–Swartz Bay route following an extensive \$54 million upgrade to prepare it for another 13 years of service.
- On May 18, 2009, the new *Northern Expedition* made its inaugural voyage on our northern route through the Inside Passage from Port Hardy to Prince Rupert. This 150-metre vessel, which replaced the 43-year-old *Queen of Prince Rupert*, has 55 staterooms and accommodates up to 130 vehicles and 600 passengers. The total project budget for this vessel was \$200 million. The project was completed on schedule and on budget.

Vessels removed from service:

- On May 23, 2008, a Purchase and Sale Agreement was completed for the sale of the *Queen of Esquimalt* which served on our Major Routes. 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. On November 18, 2008, the *Queen of Saanich* was decommissioned. The *Queen of Vancouver* and the *Queen of Prince Rupert* were decommissioned on April 15, 2009 and April 20, 2009, respectively. These three vessels, ranging in age from 43 to 47 years old, have been offered for sale. We do not expect a material gain or loss arising from the disposition of these vessels.

Other items:

- In May 2008, to coincide with conditional acceptance of the *Coastal Celebration*, we received \$90 million in proceeds under the loan agreement with the KfW bank group (KfW). This is a 12-year amortizing loan, at a fixed interest rate of 4.98%. The agreement defers the

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<sup>1</sup> ShipPax Information is an internationally recognized marine industry publisher with the largest database of passenger shipping information in the world.

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.

- 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, allowing 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 several locations and allow for operating efficiencies by combining all departments under one roof. The relocation is scheduled for August 2010. Our wholly-owned subsidiary company, Pacific Marine Leasing Inc., has agreed to advance up to \$25 million to the developer of the new head office property for a term of 15 years, secured by a second mortgage on the property. The developer has also granted us a purchase option for up to 50% of its interest in the new building at a maximum price of \$25 million which expires at the end of the loan term.
- On December 19, 2008, we completed a private placement of a \$140 million, five-year senior secured bond issue. These bonds bear interest at 6.21%, payable semi-annually. 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. Our credit ratings at March 31, 2009 were A low (DBRS) and A- (Standard & Poor's) and both rating agencies have assessed our rating outlook as positive. (See "Liquidity and Capital Resources" below for more detail.)
- On December 19, 2008, a fare reduction and service restoration agreement was made with the Province to provide \$19.6 million in funding to allow a 33% reduction on fares for all routes during the months of December 2008 and January 2009 and for our Prince Rupert-Skidegate route during February 2009. It also provided \$1.2 million additional funding for reimbursement of costs to reinstate previously eliminated off-peak sailings during fiscal 2009. (See "Outlook-Traffic" below for more detail).
- On January 20, 2009, we announced a significant restructuring of our management and administrative staff, which resulted in the elimination of approximately 77 positions. This included the termination or early-retirement of 28 non-union staff, including several vice-presidents, senior managers and director-level employees and the termination of 7 union staff. The remaining positions were eliminated through attrition. These changes have been made in order to align our expenses with our revenues. (See "Outlook-Corporate Restructuring" below for more detail).
- On January 26, 2009, to coincide with conditional acceptance of the *Northern Expedition*, we received \$108 million in proceeds under a further loan agreement with the KfW bank group. This is a 12-year amortizing loan, at a fixed interest rate of 2.95%, payable semi-annually. The proceeds were applied toward the purchase of the new vessel.
- Fuel surcharges and rebates were implemented throughout the year as follows. (See "Expenses - Deferred Fuel Cost Accounts" below for more detail):
  - On August 1, 2008, fuel surcharges (excluding the Northern Routes) went into effect due to a dramatic increase in fuel prices;
  - On November 4, 2008, existing fuel surcharges were reduced by 50% due to dropping fuel prices;
  - On December 19, 2008, for the Major Routes and December 5, 2008, for all other routes, all remaining fuel surcharges were eliminated in order to reflect the continuing decline in fuel prices; and
  - On February 12, 2009, fuel rebates of up to 5% were put into effect on many of our routes, with the exception of our Major and Northern Routes, due to balances in the deferred fuel cost accounts for these routes.

## **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, among other things, the number of round trips that must be provided for each regulated ferry service route in exchange for specified fees (ferry transportation fees). In anticipation of the deployment of new vessels on our Northern Routes, higher ferry transportation fees were negotiated with the Province commencing with fiscal 2008, the final year of the first performance term of the contract. Subsequently, the contract was amended to, among other things, establish the ferry service levels and ferry transportation fees for the second performance term commencing April 1, 2008. 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 British Columbia Ferries Commissioner (the Commissioner) was created under the *Coastal Ferry Act*, enacted by the Province on April 1, 2003. Commencing with the second performance term, the Commissioner establishes price caps for designated ferry route groups for the purpose of regulating our tariffs. For the first performance term, price caps 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.

Our first performance term ended March 31, 2008, and our second performance term will end March 31, 2012. The price cap increase authorized by the Commissioner for the second performance term 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 each April 1 for the subsequent three years, the price cap increases 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. On April 1, 2009, the price cap increased by 3.74% on the Major Routes and 7.25% 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		
	2009	2008	2007
Total revenue	681.8	640.7	596.3
% Growth	6.4%	7.4%	3.0%
Expenses	624.2	569.6	528.4
Earnings from operations	57.6	71.1	67.9
Interest and other	48.6	34.0	19.1
Net earnings before extraordinary gain	9.0	37.1	48.8
Extraordinary gain	-	-	61.3
Net earnings and comprehensive income	9.0	37.1	110.1
	As at March 31		
	2009	2008	2007
Total assets	1,841.9	1,550.5	1,215.8
Total long-term financial liabilities	1,369.0	1,059.5	766.3
Cash dividends	6.0	6.0	6.0

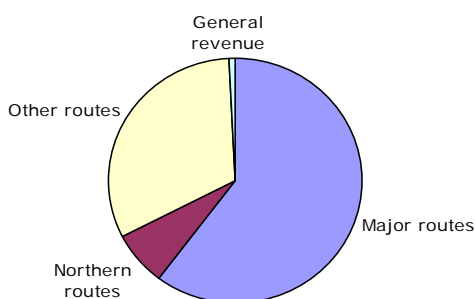
Our earnings from operations in fiscal 2009 were \$13.5 million lower and net earnings were \$28.1 million lower than in fiscal 2008. As expected, these reductions reflect increased amortization and financing costs as a result of new capital assets entering service as we near the completion of our fleet and asset renewal program for our Major and Northern Routes.

Our ridership has been negatively impacted by current economic conditions. The negative revenue impact of this lower passenger and vehicle traffic was largely offset by reductions in operating expenses from previously planned levels.

Net earnings in fiscal 2008 were \$11.7 million lower than net earnings before extraordinary gain in the previous year. In fiscal 2007, we recorded an extraordinary gain of \$61.3 million as a result of insurance proceeds from the loss of the *Queen of the North*.

## Revenue

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



In fiscal 2009, the greatest portion of our revenues, 60%, was earned on our three Major Routes connecting Vancouver Island to Vancouver and the Lower Mainland. The revenue from the Northern Routes contributed 7% and Other Routes contributed 32%. General revenue, 1%, consists mainly of marketing rights and interest earned.

Revenue (\$ millions)	Year ended March 31		
	2009	2008	2007
<b>Direct Route Revenue</b>			
Vehicle traffic (volume)	8,130,356	8,578,703	8,521,915
Vehicle tariff	269.1	240.6	227.3
Passenger traffic (volume)	20,727,493	21,788,461	21,664,953
Passenger tariff	160.0	141.6	135.9
Social program fees	19.3	17.3	16.0
Catering & on-board	76.4	77.4	71.0
Other revenue	20.7	24.0	23.5
<b>Total Direct Route Revenue</b>	<b>545.5</b>	<b>500.9</b>	<b>473.7</b>
<b>Indirect Route Revenue</b>			
Ferry transportation fees	105.2	105.5	92.4
Federal-Provincial subsidy	26.3	25.8	25.3
<b>Total Route Revenue</b>	<b>677.0</b>	<b>632.2</b>	<b>591.4</b>
Other general revenue	4.8	8.5	4.9
<b>Total Revenue</b>	<b>681.8</b>	<b>640.7</b>	<b>596.3</b>

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. The price caps increased by 3.74% on the Major Routes and 7.25% on all other routes on April 1, 2009.

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 allowed increase in any one period.



Both vehicle traffic and passenger traffic have declined from the prior year. Dramatically higher vehicle fuel prices earlier in the year, lower levels of tourism, and the decline within the British Columbia and local economies have contributed to this reduction.

On December 19, 2008, a fare reduction agreement was made with the Province to provide \$19.6 million in funding to allow a 33% reduction on fares for all routes during the months of December 2008 and January 2009 and for our Prince Rupert-Skidegate route during February 2009. Fares were reduced and this \$19.6 million was recorded in tariff revenue. This fare reduction was expected to stimulate traffic; however, traffic in the month of December was negatively impacted by three weeks of severe weather conditions which resulted in a 10% decrease in traffic.

As a result of the dramatic increase in fuel prices over the first part of fiscal 2009, fuel surcharges were implemented on August 1, 2008. Subsequently, approval was received from the Commissioner to reduce these fuel surcharges by 50% on November 4, 2008, in order to reflect a drop in fuel prices. These fuel surcharges were further reduced to zero on the Major Routes on December 19, 2008 and the Other Routes on December 5, 2008. On February 12, 2009, fuel rebates of up to 5% were put into effect on many of our routes with the exception of our Major and Northern routes due to balances in the deferred fuel cost accounts for these routes.

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 2009 – 2008

### Major Routes

Direct Route Revenue (\$ thousands)	Fiscal year ended March 31			
	2009	2008	Increase (Decrease)	
Vehicle traffic (volume)	3,696,322	3,912,269	(215,947)	(5.5%)
Vehicle tariff	203,192	182,280	20,912	11.5%
Passenger traffic (volume)	10,664,158	11,304,042	(639,884)	(5.7%)
Passenger tariff	117,617	104,292	13,325	12.8%
Social program fees	9,907	8,790	1,117	12.7%
Catering & on-board	62,302	63,785	(1,483)	(2.3%)
Reservation fees	12,038	14,035	(1,997)	(14.2%)
Parking	3,229	3,110	119	3.8%
Assured loading	2,040	2,662	(622)	(23.4%)
Other revenue	1,538	1,209	329	27.2%
<b>Total Direct Route Revenue</b>	<b>411,863</b>	<b>380,163</b>	<b>31,700</b>	<b>8.3%</b>
Gross margin - catering & on-board	38,102	39,115	(1,013)	(2.6%)

Both vehicle traffic and passenger traffic decreased in fiscal 2009 from the prior year. The impact on total tariff revenue of these lower traffic levels was more than offset by the increase in average tariffs. The increase in average tariff revenue per vehicle was \$8.38 or 18.0% while the increase in average tariff revenue per passenger was \$1.80 or 19.5%. Most of this increase 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 fiscal 2008, these surcharges paid by customers amounted to \$24.1 million. 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 resulted in a total increase of \$34.2 million in tariff revenue.

Included in tariff revenue is \$15.0 million (\$9.6 million for vehicles and \$5.4 million for passengers) in funding provided by the Province to allow a 33% reduction of fares during the months of December 2008 and January 2009.

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.

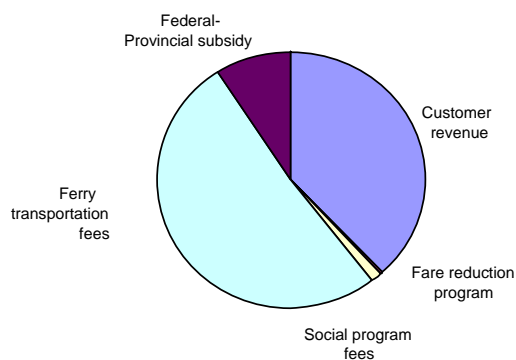
All of our vessels that provide service on our Major Routes have a gift shop and options for food service. In fiscal 2009, the average spending per passenger for food services increased by 4.2% while the average spending per passenger for gift shop items remained at the same level. The increase in average spending per passenger was more than offset by the reduction in revenue caused by lower traffic levels.

Fees for reservations and assured loading revenue also declined as a result of lower traffic levels. Parking revenue increased while other revenue decreased as a result of reduced video and vending revenues partially offset by retail commissions.

## Northern Routes

Direct Route Revenue (\$ thousands)	Fiscal year ended March 31			
	2009	2008	Increase (Decrease)	
Vehicle traffic (volume)	31,739	33,789	(2,050)	(6.1%)
Vehicle tariff	8,253	7,053	1,200	17.0%
Passenger traffic (volume)	93,964	101,751	(7,787)	(7.7%)
Passenger tariff	7,233	6,282	951	15.1%
Social program fees	565	581	(16)	(2.8%)
Catering & on-board	2,237	2,324	(87)	(3.7%)
Reservation fees	69	80	(11)	(13.8%)
Stateroom rental	783	964	(181)	(18.8%)
Hostling <sup>2</sup> & other	211	210	1	0.5%
<b>Total Direct Route Revenue</b>	<b>19,351</b>	<b>17,494</b>	<b>1,857</b>	<b>10.6%</b>
<b>Indirect Revenue</b>				
Ferry transportation fees	25,283	27,350	(2,067)	(7.6%)
Federal-Provincial subsidy	4,463	4,389	74	1.7%
<b>Total Route Revenue</b>	<b>49,097</b>	<b>49,233</b>	<b>(136)</b>	<b>(0.3%)</b>
Gross margin - catering & on-board	1,524	1,246	278	22.3%

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



Fiscal 2009 revenue from our Northern Routes consisted of 38% from customers and 62% from the Province (1% social program fees, 52% transportation fees and fare reduction agreement, and 9% from payments under the Federal-Provincial subsidy agreement).

<sup>2</sup> Loading and unloading of commercial trailers that are dropped off for transportation on a ferry route.

## Northern Routes, cont'd

Both vehicle traffic and passenger traffic decreased from the prior year. The impact on total tariff revenue of these lower traffic levels was more than offset by the increase in average tariffs. The average tariff revenue per vehicle increased \$51.29 or 24.6%. The average passenger tariff revenue increase was \$15.24 or 24.7%. Most of this increase 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 fiscal 2008, these surcharges paid by customers amounted to \$2.2 million. 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 \$2.2 million.

Included in tariff revenue is \$0.3 million (\$0.2 million for vehicles and \$0.1 million for passengers) in funding provided by the Province to allow a 33% reduction of fares on all Northern Routes during the months of December 2008 and January 2009 and for our Prince Rupert-Skidegate route during February 2009.

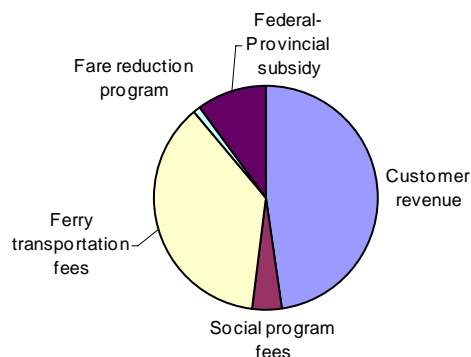
We receive ferry transportation fees for these routes under the Coastal Ferry Services Contract which relate, in part, to the capital cost of the vessels serving these routes. We were able to obtain an import duties remission for one of these vessels, the *Northern Adventure*. The decrease in ferry transportation fees reflects, in part, the reduction in the capital cost of this vessel as a result of the import duties remission and related GST. The Province agreed to pay an amount equal to the fee reduction related to the duty remission (\$1.7 million), which was applied to the deferred fuel cost accounts of the Other Routes.

Reimbursements from the Province for social program fees, revenue from catering and on-board services, fees for reservations, and stateroom rental have all decreased primarily as a result of lower traffic levels.

## Other Routes

Direct Route Revenue (\$ thousands)	Fiscal year ended March 31			
	2009	2008	Increase (Decrease)	
Vehicle traffic (volume)	4,402,295	4,632,645	(230,350)	(5.0%)
Vehicle tariff	57,638	51,319	6,319	12.3%
Passenger traffic (volume)	9,969,371	10,382,668	(413,297)	(4.0%)
Passenger tariff	35,129	31,004	4,125	13.3%
Social program fees	8,780	7,877	903	11.5%
Catering & on-board	11,128	11,276	(148)	(1.3%)
Reservation fees	1,198	1,388	(190)	(13.7%)
Parking & other	421	361	60	16.6%
<b>Total Direct Route Revenue</b>	<b>114,294</b>	<b>103,225</b>	<b>11,069</b>	<b>10.7%</b>
<b>Indirect Revenue</b>				
Ferry transportation fees	79,950	78,151	1,799	2.3%
Federal-Provincial subsidy	21,830	21,467	363	1.7%
<b>Total Route Revenue</b>	<b>216,074</b>	<b>202,843</b>	<b>13,231</b>	<b>6.5%</b>
Gross margin - catering & on-board	7,111	7,087	24	0.3%

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.



Fiscal 2009 revenue from our Other Routes consisted of 47% from customers and 53% from the Province (2% fare reduction agreement, 4% social program fees, 37% ferry transportation fees, and 10% from payments under the Federal-Provincial subsidy agreement).

## Other Routes, cont'd

Both vehicle traffic and passenger traffic decreased from the prior year. The impact on total tariff revenue of these lower traffic levels was more than offset by the increase in average tariffs. The increase in average tariff revenue per vehicle was \$2.01 or 18.1% while the average passenger tariff revenue increase was \$0.53 or 17.7%. Most of this increase 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 fiscal 2008, these surcharges paid by customers amounted to \$13.1 million. 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.

In fiscal 2009, we eliminated the sale of prepaid paper tickets on most of our Other Routes. Redemptions and exchanges of paper tickets to electronic media exceeded the liability set up at March 31, 2008 by \$3.7 million. In addition, we established a liability of \$0.6 million at March 31, 2009, to provide for further redemptions of prepaid paper tickets that may be outstanding. This resulted in a total reduction in tariff revenue of \$4.3 million relating to prepaid paper tickets.

The increased average fares, partially offset by the reduction in traffic levels and the reduction caused by prepaid ticket redemptions and exchanges, resulted in a total tariff revenue increase of \$10.4 million.

Included in tariff revenue is \$4.3 million (\$2.7 million for vehicles and \$1.6 million for passengers) in funding provided by the Province to allow a 33% reduction of fares on these routes during the months of December 2008 and January 2009.

Reimbursements from the Province for social program fees increased primarily as a result of 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 Kw'alaams route. In fiscal 2009, we recorded a \$1.1 million (\$0.5 million in fiscal 2008) reduction of maintenance expense, equal to the refit costs incurred during those periods.

Revenue from catering and on-board services and fees for reservations decreased primarily as a result of lower traffic levels.

The increase in parking and other income is mainly a result of higher retail commissions.

Ferry transportation fees are higher as a result of the renegotiated fees from the Province for the provision of service on our Northern and Other Routes.

## 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	63,785	59,009	4,776	8.1%
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	1,209	4,107	(2,898)	(70.6%)
<b>Total Direct Route Revenue</b>	<b>380,163</b>	<b>362,026</b>	<b>18,137</b>	<b>5.0%</b>
Gross margin - catering & on-board	39,115	35,536	3,579	10.1%

Revenue on the Major Routes is from customers and related social program fees, and includes no ferry transportation fees.

Both vehicle traffic and passenger traffic in fiscal 2008 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 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 also increased with the successful introduction of new apparel, gift products and a 2010 Olympic line.

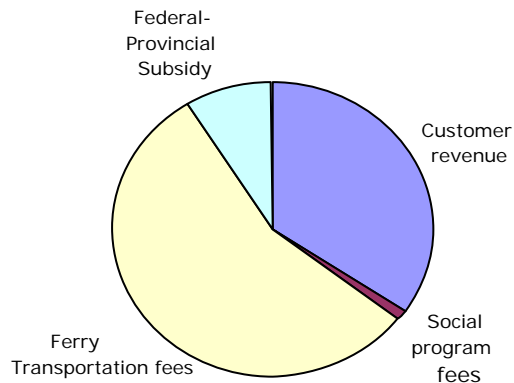
Fees for reservations increased substantially as a result of increased usage. Assured loading revenue also increased markedly as a result of both increased prices and increased usage.

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 & other	210	184	26	14.1%
<b>Total Direct Route Revenue</b>	<b>17,494</b>	<b>12,273</b>	<b>5,221</b>	<b>42.5%</b>
<b>Indirect Revenue</b>				
Ferry transportation fees	27,350	14,500	12,850	88.6%
Federal-Provincial subsidy	4,389	4,296	93	2.2%
<b>Total Route Revenue</b>	<b>49,233</b>	<b>31,069</b>	<b>18,164</b>	<b>58.5%</b>
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 increased since the resumption of full service following the loss of the *Queen of the North*, but did not reach the levels experienced during fiscal 2006.



Fiscal 2008 revenue from our Northern Routes consists of 34% from customers and 66% from the Province (1% from social program fees, 56% from ferry transportation fees and 9% from payments under the Federal-Provincial subsidy agreement). The revenue from ferry transportation fees increased 88% from fiscal 2007, reflecting resumption of full service with deployment of the new *Northern Adventure* on our northern routes.



### Northern Routes, cont'd

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 transportation 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.

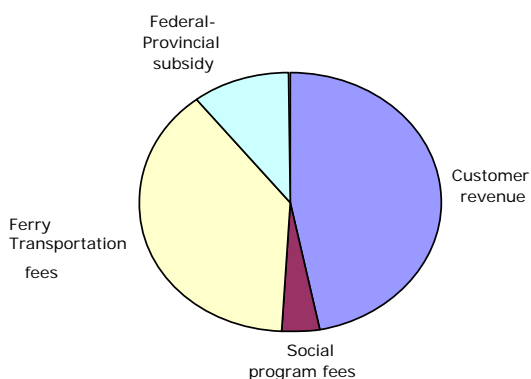
Reimbursements from the Province for social program fees increased as a result of resumption of regular service and higher fares.

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 have increased primarily as a result of the resumption of regular service.

## 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 & other	361	352	9	2.6%
<b>Total Direct Route Revenue</b>	<b>103,225</b>	<b>99,489</b>	<b>3,736</b>	<b>3.8%</b>
<b>Indirect Revenue</b>				
Ferry transportation fees	78,151	77,929	222	0.3%
Federal-Provincial subsidy	21,467	21,013	454	2.2%
<b>Total Route Revenue</b>	<b>202,843</b>	<b>198,431</b>	<b>4,412</b>	<b>2.2%</b>
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 transportation fees in the above table.



Fiscal 2008 revenue from our Other Routes consists of 47% from customers and 53% from the Province (4% from social program fees, 38% from ferry transportation 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 Kw'alaams route. At March 31, 2008, we recorded a \$0.5 million reduction of maintenance expense, equal to the refit 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.

## Expenses

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

Operating expenses (\$ millions)	Year ended March 31		
	2009	2008	2007
Operations	375.8	334.7	309.1
Maintenance	77.2	88.4	84.9
Administration	49.2	49.8	50.6
Total operations, maintenance & administration	502.2	472.9	444.6
% Increase	6.2%	6.4%	4.9%
Cost of retail goods sold	28.9	29.9	28.3
Amortization	93.1	66.8	55.5
Total expenses	624.2	569.6	528.4
% Increase	9.6%	7.8%	4.8%

Interest and other (\$ millions)	Year ended March 31		
	2009	2008	2007
Interest expense			
Bond interest	56.9	45.3	31.0
KfW loans	9.0	0.6	-
Short-term loans	0.8	0.6	1.2
Interest on deferred accounts	0.1	(0.9)	(1.5)
Structured Financing Facility Program	(2.4)	(2.1)	(4.7)
Capitalized interest	(14.3)	(10.4)	(6.7)
Total interest expense	50.1	33.1	19.3
(Gain) on foreign exchange	(0.3)	(0.1)	(0.4)
(Gain) loss on disposal of capital assets	(1.2)	1.0	0.2
Total interest and other	48.6	34.0	19.1

### ***Deferred Fuel Cost Accounts***

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 our earnings.

Commencing April 1, 2004, the Commissioner established set prices for fuel 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.

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 (including realized hedge gains and losses) 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 fiscal 2009.

For all other routes, differences in fuel costs arising from our actual price paid per litre (including realized hedge gains and losses) being higher or lower than the 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.

There is a mechanism in place to allow price cap adjustments to provide for implementation of fuel surcharges or rebates when appropriate. As a result of the dramatic increase in fuel prices over the first part of fiscal 2009, fuel surcharges were implemented on August 1, 2008 on all but the Northern Routes. In November 2008, these fuel surcharges were reduced by 50% and subsequently, in December we removed all remaining surcharges. Fuel rebates of up to 5% were implemented on the Other Routes in February 2009. At this time, fuel rebates cannot be offered on the Major Routes due to the balances in the deferred fuel cost accounts. In fiscal 2009, we collected \$16.5 million (\$39.4 million in fiscal 2008) in fuel surcharges, net of rebates, from customers. These amounts were applied to the outstanding deferred fuel cost account balances.

Under an agreement reached during fiscal 2008, the Province agreed to pay \$1.3 million for fiscal 2008 and \$1.7 million for fiscal 2009, which were applied to the deferred fuel cost accounts. This benefit is equal to the amount by which annual ferry transportation fees payable by the Province were reduced as a result of the lower cost of the *Northern Adventure* due to remission and refund of import duties paid. These reductions in the deferred fuel cost accounts will benefit our customers through reduced fuel surcharges or earlier fuel rebates.

The Commissioner considered \$18.5 million of unrecovered first performance term deferred fuel costs in determination of the price caps set for the four years beginning April 1, 2008, for which recovery will occur over this four year period. The actual closing balance in the deferral accounts at March 31, 2008 was \$11.9 million. The difference in these amounts, a credit of \$6.6 million, formed the opening balances of the deferred fuel cost accounts for the second performance term.

The balances in our deferred fuel cost accounts totalled \$16.0 million at March 31, 2009 (\$11.9 million at March 31, 2008), including \$0.9 million in unrealized fuel hedge losses (\$1.8 million unrealized fuel hedge gains at March 31, 2008).

All of the Commissioner's Orders can be viewed at [www.bcferrycommission.com](http://www.bcferrycommission.com).

## ***Year to Year Comparison of Expenses 2009 – 2008***

The \$41.1 million increase in fiscal 2009 operations expenses consists of:

- \$40.9 million increase in fuel expense reflecting higher set prices, as ordered by the Commissioner, totalling \$42.4 million, partially offset by \$1.5 million in lower fuel consumption;
- \$4.0 million increase in wages and benefits, including:
  - Approximately \$6.8 million in wage rate increases averaging about 3% in accordance with the existing Collective Agreement;
  - \$2.0 million increase in benefit costs;
  - \$0.5 million in training and familiarization; less
  - Reductions in incentive compensation, costs of illness and other paid leave, and other savings, totalling \$5.3 million.

These increases in operations expenses were partially offset by cost reduction initiatives which included the reduction of management and other shore-based positions and other discretionary expenditures, and \$1.2 million in funding from the Province for reimbursement of costs to reinstate previously eliminated off-peak sailings.

The \$11.2 million decrease in maintenance costs reflects variations in vessel refit scheduling and the reduced costs of maintaining a newer fleet, partially offset by increased maintenance on our terminals. We have completed 16 refits in fiscal 2009 with a further two in progress at March 31, 2009.

Administration expenses decreased \$0.6 million mainly as a result of reduced consulting, travel, marketing, advertising and other discretionary expenditures, partially offset by restructuring costs.

Amortization increased a total of \$26.3 million mainly as a result of additional assets coming into service, including \$16.4 million due to the *Coastal Renaissance*, the *Coastal Inspiration*, and the *Coastal Celebration* entering service in March 2008, June 2008 and November 2008, respectively; and \$4.6 million in amortization of deferred fuel cost balances. The Commissioner has included \$18.5 million of deferred performance term one fuel costs in determining the price caps for the four-year second performance term commencing April 1, 2008.

Interest expenses increased \$17.0 million primarily due to:

- \$11.2 million additional interest relating to our \$200 million and \$140 million bond series issued in January 2008 and December 2008 respectively; and
- \$8.4 million additional interest relating to our two KfW loans which partially finance the purchase of the *Coastal Inspiration* and *Coastal Celebration*; and partially offset by
- \$3.9 million of additional interest capitalized reflecting our investment in revitalizing our fleet and terminal facilities.

During the third quarter, agreements were completed that will provide us with a further \$10.7 million of interest rate support through the Structured Financing Facility Program, offered by the Government of Canada, relating to the purchase of the new intermediate vessel, the *Island Sky*, and the life-extension of the *Queen of New Westminster*. During fiscal 2009, \$2.4 million of this amount was recorded as a reduction in interest expense and \$3.6 million as a reduction of capitalized interest.

## ***Year to Year Comparison of Expenses 2008 – 2007***

The \$25.6 million increase in fiscal 2008 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;
- \$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 due to variations in vessel refit scheduling 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 due to 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.

## 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. With the receipt of the \$108 million KfW loan in January 2009, our major financing requirements are complete. Our ongoing capital expenditures are expected to be significantly lower than in the previous few years. Over the next five years, we expect our cash requirements will be met through operational cash flows and by accessing our credit facility from time to time. At March 31, 2009 our unrestricted cash and cash equivalents totalled \$12 million.

We target maintaining a strong investment-grade credit rating to allow capital market access at reasonable interest rates. Our credit ratings at March 31, 2009 were A low (DBRS) and A- (Standard & Poor's) and both rating agencies have assessed our rating outlook as positive.

### 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.

In the last three years, we completed three private placements of senior secured bond offerings. These bonds bear interest payable semi-annually. The details of each are:

- \$250 million issued March 2007 with interest at 5.02%, due March 2037;
- \$200 million issued January 2008 with interest at 5.58%, due January 2038; and
- \$140 million issued December 2008 with interest at 6.21%, due December 2013.

The net proceeds of the March 2007 issue were used to repay our credit facility while all three offerings were used to fund capital expenditures, the related debt service reserve and for general corporate purposes.

We are also party to a credit agreement with a syndicate of Canadian banks that 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. At March 31, 2009, we had drawn \$18 million on this credit facility.

In fiscal 2006 we executed two loan agreements with KfW. 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%, payable quarterly. 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.

In January 2009, to coincide with conditional acceptance of the *Northern Expedition*, we received \$108 million in proceeds under a further loan agreement with KfW. This is a 12-year amortizing loan, at a fixed interest rate of 2.95%, payable semi-annually. The proceeds were applied toward the purchase of the new vessel.



Our long-term debt is summarized below:

(\$millions)	Due	Amount outstanding as at March 31		
		2009	2008	2007
5.74% Senior Secured Bonds	May 2014	250	250	250
6.25% Senior Secured Bonds	October 2034	250	250	250
5.02% Senior Secured Bonds	March 2037	250	250	250
5.58% Senior Secured Bonds	January 2038	200	200	-
6.21% Senior Secured Bonds	December 2013	140	-	-
4.98% KfW Loan	March 2020	90	90	-
4.98% KfW Loan	June 2020	90	-	-
2.95% KfW Loan	January 2021	108	-	-
		1,378	1,040	750

### ***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 provided the Coastal Ferry Services Contract is renewed. We must manage, maintain and develop the terminals at our own cost.

Since the original transfer, a total of \$11.7 million of additional lands at Horseshoe Bay, Swartz Bay and Departure Bay have been added to the existing terminal leases in exchange for highway improvements. During fiscal 2009 we made improvements to roadways approaching the Departure Bay terminal in exchange for increased lands under the existing land lease.

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.

## Sources & Uses of Cash

Our liquidity needs are met through a variety of sources, including cash generated from operations, issuance of bonds, 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 2009 and 2008 are summarized in the table below.

(\$ millions)	Year ended March 31	
	2009	2008
Net income before extraordinary gain	9.0	37.1
Items not involving cash:		
Amortization	93.1	66.8
Other non-cash charges	(0.7)	1.5
Regulatory costs deferred	(6.0)	10.5
Change in operating working capital	(6.8)	8.7
Cash provided by operating activities	88.6	124.6
Cash provided by financing activities	347.4	256.5
Cash used in investing activities	(539.9)	(437.6)
Total (decrease) in cash	(103.9)	(56.5)

In fiscal 2009, cash provided by operating activities included an increase in non-cash working capital of \$6.8 million. This increase in working capital was primarily due to:

- \$11.6 million reduction in payables and accrued liabilities relating to refit and maintenance and other operating activities;
- \$1.3 million reduction in accrued employee costs;
- \$0.9 million increase in prepaid expenses primarily due to \$0.5 million in service contracts and \$0.3 million in insurance; and
- \$0.7 million reduction in regulatory liabilities reflecting the return to customers through discount fare promotions of \$3.6 million tariff revenues collected in excess of price caps in the last quarter of fiscal 2008, partially offset by \$2.9 million in excess tariff revenues at March 31, 2009.

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

- \$4.1 million decrease in accounts receivable primarily due to:
  - \$2.5 million in social program fees receivable; and
  - \$2.0 million in commercial travel cards receivable due to lower commercial traffic and elimination of Coquihalla tolls by the Province. We administered collection of these tolls from certain of our commercial customers for a fee;
- \$2.7 million increase in interest payable relating to the incremental long-term debt;
- \$0.7 million increase in deferred revenue; and
- \$0.2 million reduction in total inventories.

Cash provided by financing activities reflects issuance of the second \$90 million and the \$108 million loans with KfW, the \$140 million Series 08-2 bond issuance, and the \$18 million draw on our \$155 million credit facility at March 31, 2009.

Cash used in investing activities consists mainly of \$530.3 million used to purchase capital assets, \$8.2 million used to fund debt service reserves on new debt issues and \$5.1 million used to acquire additional land under long-term land lease. The significant capital transactions are described below in "Investing in Our Capital Assets".

## INVESTING IN OUR CAPITAL ASSETS

Capital expenditures in fiscal 2009 totalled \$493.9 million. This level of expenditure reflects significant investments in our fleet, terminals and information systems to replace aging infrastructure and to increase customer service and operating efficiency. Total capital expenditures were:

	(\$ millions)
New vessels, vessel upgrades and modifications	424.4
Terminal marine structures	31.0
Terminal and building upgrades and equipment	24.3
Computer hardware and software development	14.2
Total capital expenditures	<u>493.9</u>

### New Vessels, Vessel Upgrades and Modifications

Capital expenditures for new vessels, vessel upgrades and vessel modifications in fiscal 2009 included the following:

	(\$ millions)
New northern vessel, the <i>Northern Expedition</i>	175.2
New <i>Coastal Inspiration</i> and <i>Coastal Celebration</i>	150.5
Life extension of the <i>Queen of New Westminster</i>	36.6
New intermediate vessel, the <i>Island Sky</i>	26.0
Upgrade and replacement of propulsion and safety equipment on the <i>Quinsam</i> , <i>Quinitsa</i> and <i>Queen of Capilano</i>	12.4
Completion of the <i>Northern Adventure</i> with post-acquisition modifications	5.3
Refurbishment of car deck on the <i>Powell River Queen</i>	5.2
Engine overhaul on the <i>Spirit of British Columbia</i>	3.6
Two-year project to install Voyage Data Recorders and navigational aids and upgrade vessel connectivity	3.5
Sewage treatment upgrade program for 13 vessels	3.0
Other projects	3.1
	<u>424.4</u>

### Major Upgrade of the *Queen of New Westminster*

The *Queen of New Westminster*, which formerly operated on our Duke Point–Tsawwassen route, was redeployed on our Tsawwassen–Swartz Bay route on April 3, 2009, following an extensive \$54 million refurbishment project. The project included 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. This project has extended the life of the 45-year-old vessel for a further 13 years of service.

### ***Coastal Renaissance, Coastal Inspiration and Coastal Celebration***

In September 2004 we entered into contracts with Flensburger Schiffbau-Gesellschaft (FSG) shipyard in Germany 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 have replaced aging vessels that were providing service on our Major Routes.

The contracts with FSG were design-build and fixed price, totalling \$325 million. The contracts 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, 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. The project for these three new state-of-the-art vessels was completed 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 commenced service on the Swartz Bay-Tsawwassen route on November 21, 2008, following crew training and familiarization.

### ***Northern Expedition***

On May 18, 2009, the new *Northern Expedition* made its inaugural voyage on our northern route through the Inside Passage from Port Hardy to Prince Rupert. This 150-metre vessel, which replaced the 43-year-old *Queen of Prince Rupert*, has 55 staterooms and has a capacity of up to 130 vehicles and 600 passengers. A \$133 million contract with FSG to build this new vessel was signed in July 2006. The import duties and taxes on this contract total approximately \$43 million. We are 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) provided us with substantial guarantees for delivery dates, performance criteria, cost certainty and quality of construction. The project was completed on schedule and on budget.

### ***Island Sky***

On February 19, 2009, the *Island Sky*, our new intermediate class ferry commenced service on the Earls Cove-Saltery Bay route. This 102-metre vessel has a capacity of up to 125 vehicles and 600 passengers. A \$47 million fixed price design-build contract with Vancouver Shipyards constituted the majority of the total project budget of \$57 million. The project was completed on budget but later than scheduled as we took delivery from Vancouver Shipyards eight months later than the contractual delivery date. The *Island Sky* features a new state-of-the-art lifesaving system as well as a variety of amenities, including a lounge and snack bar for passengers. This new intermediate vessel has allowed for the retirement and sale of the 48-year-old *Queen of Tsawwassen*.

### Terminal Marine Structures

We continued to reinvest in our terminal infrastructure during 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 \$170 million in our terminals for building and marine structure upgrades.

Capital expenditures on terminal marine structures for fiscal 2009 included the following:

Terminal	Description	(\$ millions)
Prince Rupert	New pontoon, ramp, ramp abutment and dolphin	7.3
Skidegate	New pontoon, ramp, ramp abutment and two dolphins	7.1
Bear Cove	New pontoon, ramp and ramp abutment	5.8
McLoughlin Bay	Modifications to existing pontoon and new floating lead	2.6
Duke Point	Berth upgrades to accommodate Super C-class vessels	2.3
Richmond	Berth replacement and modifications	1.3
Various	Other projects	4.6
		<u>31.0</u>

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 upgrades were completed to correspond with the in-service date for the *Northern Expedition*. We made every effort to ensure minimal service disruption for affected communities; however, it was necessary to temporarily suspend the Prince Rupert–Skidegate ferry service for a period of three weeks. We provided tug, barge and plane services to and from the Queen Charlotte Islands during this time.

### 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)
Departure Bay terminal	12.6
Security upgrades	5.2
Vehicles, machinery & equipment	3.3
Swartz Bay terminal	0.6
Richmond shipyard	0.5
Other terminal projects	2.1
	<u>24.3</u>

The most significant activity during fiscal 2009 has been at our Departure Bay terminal. A new retail building, the Departure Bay Quay, and new ticket building have been completed and the intersection realigned. The holding compound, pick-up and drop-off area, and the short-term parking are being expanded and a new waiting room will be built.

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 2010, we plan to 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. In January 2009, Transport Canada, through the Marine Security Contribution Program, approved approximately \$5.5 million of federal funding to help offset our costs of perimeter security, access control measures and training. These funds are in addition to \$3.8 million which was previously approved under this program. The program requires us to apply for reimbursement of 75% of the costs of security enhancements on approved projects as capital expenditures are incurred. To date, we have applied for reimbursement of approximately \$2.4 million.

### **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.

## FOURTH QUARTER RESULTS

This section provides an overview of our financial performance for the three months ended March 31, 2009, compared to the three months ended March 31, 2008.

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.

(\$ millions)	Three months ended March 31			
			Variance	
	2009	2008	\$	%
Total revenue	128.5	124.2	4.3	3.5%
Expenses	153.6	144.2	(9.4)	(6.5%)
Loss from operations	(25.1)	(20.0)	(5.1)	(25.5%)
Interest and other	13.3	10.5	(2.8)	(26.7%)
Net loss	(38.4)	(30.5)	(7.9)	(25.9%)

## Revenue

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

Revenue (\$ millions)	Three months ended		Increase(Decrease)	
	March 31			
	2009	2008	\$	%
<b>Direct Route Revenue</b>				
Vehicle traffic (volume)	1,628,626	1,726,422	(97,796)	(5.7%)
Vehicle tariff	49.9	44.9	5.0	11.1%
Passenger traffic (volume)	3,870,171	4,133,676	(263,505)	(6.4%)
Passenger tariff	27.6	24.5	3.1	12.7%
Social program fees	3.1	3.7	(0.6)	(16.2%)
Catering & on-board	14.0	14.3	(0.3)	(2.1%)
Other revenue	3.3	4.2	(0.9)	(21.4%)
Total Direct Route Revenue	97.9	91.6	6.3	6.9%
<b>Indirect Route Revenue</b>				
Ferry transportation fees	22.8	24.0	(1.2)	(5.0%)
Federal-Provincial subsidy	6.6	6.4	0.2	3.1%
<b>Total Route Revenue</b>	127.3	122.0	5.3	4.3%
Other general revenue	1.2	2.2	(1.0)	(45.5%)
<b>Total Revenue</b>	128.5	124.2	4.3	3.5%

We continued to experience a decrease in traffic in the last quarter of fiscal 2009 compared to the prior year. However, the reduction in total tariff revenue as a result of these decreases in traffic levels was more than offset by the increase in average tariff revenue. The increase in average tariff revenue per vehicle was \$4.63 or 17.8% while the increase in average tariff revenue per passenger was \$1.20 or 20.2%. 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 last quarter of fiscal 2008, these surcharges paid by customers amounted to \$7.4 million. 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 levels and a provision to establish a prepaid paper ticket liability of \$0.6 million at March 31, 2009, resulted in a total increase of \$8.1 million in tariff revenue.

Included in tariff revenue is \$8.6 million in funding provided by the Province to allow a 33% reduction of fares on all routes during January 2009 and for our Prince Rupert-Skidegate route during February 2009.

Social program fee increases of \$0.8 million as a result of higher tariff rates were more than offset by a \$1.4 million billing adjustment recorded during the fourth quarter of fiscal 2009.

Catering and on-board revenues and other revenue all decreased mainly as a result of lower traffic levels.

Ferry transportation fees are lower mainly as a result of the timing of the receipt of fees as a result of a renegotiated billing process with the Province.

Other general revenue decreased reflecting the higher cash balances and related interest earned in the prior year.

## Expenses

Expenses are shown in the following table.

(\$ millions)	Three months ended March 31			
	2009	2008	(Increase)Decrease	
			\$	%
Operations	84.3	84.0	(0.3)	(0.4%)
Maintenance	21.5	22.8	1.3	5.7%
Administration	15.1	13.6	(1.5)	(11.0%)
Cost of retail goods sold	5.7	5.9	0.2	3.4%
Amortization	27.0	17.9	(9.1)	(50.8%)
	153.6	144.2	(9.4)	(6.5%)
Interest & other	13.3	10.5	(2.8)	(26.7%)
Total expense	166.9	154.7	(12.2)	(7.9%)

The increase in operations costs reflects higher fuel costs, mostly offset by reductions in labour costs and discretionary spending.

The decrease in maintenance costs reflects variations in vessel refit scheduling and the reduced costs of maintaining a newer fleet, partially offset by increased maintenance on our terminals.

The increase in administration costs reflects the costs of restructuring, partially offset by reduced consulting, travel, marketing, advertising and other discretionary expenditures.

Amortization increased as a result of additional assets that came into service in fiscal 2009, including \$5.9 million reflecting the *Coastal Renaissance*, the *Coastal Inspiration*, and the *Coastal Celebration* entering service in March 2008, June 2008, and November 2008, respectively.

Interest expenses increased primarily due to a full year of interest incurred on the \$200 million bond series issued January 2008, the \$140 million bond series issued December 2008, and the two KfW loans issued during fiscal 2009, partially offset by additional interest capitalized.



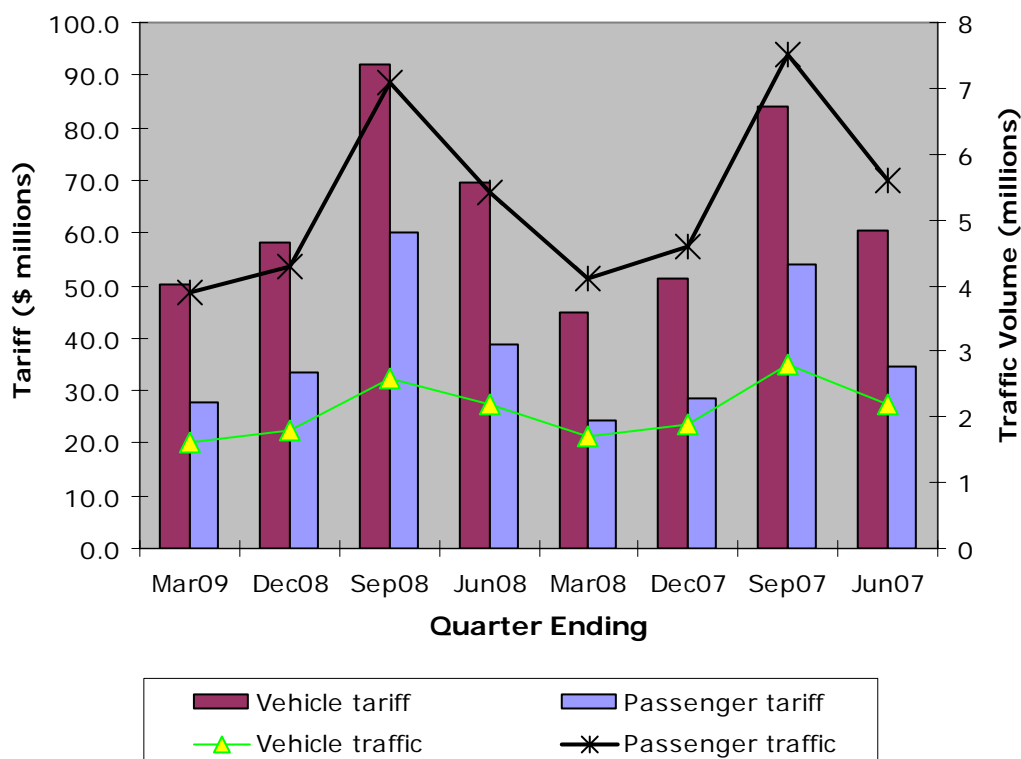
## SUMMARY OF QUARTERLY RESULTS

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

(\$ millions)	Quarter Ended (unaudited)							
	Mar 09	Dec 08	Sep 08	Jun 08	Mar 08	Dec 07	Sep 07	Jun 07
Total revenue	128.5	149.4	232.1	171.9	124.2	136.5	220.2	159.8
(Loss) earnings from operations	(25.1)	(1.7)	66.2	18.3	(20.0)	(0.4)	69.4	22.1
Net (loss) earnings and comprehensive income	(38.4)	(14.6)	53.7	8.4	(30.5)	(7.8)	61.0	14.4

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 experienced turbulence in the financial markets and a recessionary period in fiscal 2009. This had a negative impact on our operations. While our ridership had been stable over several years, we experienced a downturn in traffic in fiscal 2009 which was at least partly due to the economic conditions. In fiscal 2009, British Columbia experienced fewer housing starts, reduced tourism, plant closures in the forest product industry, falling auto sales, rising unemployment, and generally reduced consumer confidence. These and other declining economic conditions all negatively impacted our commercial and discretionary travel markets. The consensus of major Canadian banks and other economic institutions is that the Canadian and local economies will begin to recover in the second half of calendar 2009. We believe that, as the economy recovers, our ridership will also improve.

### **Corporate Restructuring**

Due to the continuing decline in traffic levels and resulting revenues, we determined the need to restructure our business to align expenses with reduced revenues while continuing to ensure that safety remains our top priority. This restructuring was in addition to our other cost savings measures that included deferral of filling staff vacancies and deferring or reducing travel, consulting, marketing, advertising and other discretionary expenditures. Approximately 77 positions were eliminated. This included termination or early retirement of 28 non-union staff, including several vice-presidents, senior management and director-level employees and 7 union staff. The remaining positions were eliminated through attrition. Should the decline in traffic continue, further changes in staffing at all levels may be considered. These proactive measures, along with other initiatives, are expected to reduce our operating expenditures by approximately \$14 million from previously planned levels in fiscal 2010.

### **Market Opportunities**

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

In March 2009, we expanded our drop-trailer service. We now offer a new, unique service to commercial customers on two of our Major Routes. Our commercial customers on these routes can now drop their trailers at one terminal and have them picked up at another. This drop-trailer service has been well received in the commercial market. It is also beneficial to us as it makes use of otherwise unutilized capacity. We expect substantial growth in this area as we add new customers and provide the service on more routes.

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.

In February 2008, to expand our new market reach, 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. At this centre, we intend to provide information on our various routes and offer travel packages that will be attractive to the tourist sector. We believe that this will expand our market reach and increase our profile in the Lower Mainland and within the tourism industry. This is expected to lead to increased traffic volumes as well as incremental non-tariff revenue. We anticipate our travel centre will open in the spring of 2010.

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. Given the current economic conditions, we do not expect significant activity in this area in the near term.

## Competition

In the commercial sector, 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 increased capacity for commercial vehicle traffic on our Major Routes with the assignment of a Super C-class vessel to each route and we introduced a new drop-trailer service offering. With these initiatives, we believe that we will continue to gain market share within the commercial sector. However, the commercial market has declined reflecting recent economic conditions. Our commercial sales team is actively pursuing new business and is implementing new integrated sales solutions for our commercial customers to continue to increase our market share.

While no passenger-only competitors have been successful at sustaining operations on our Major Routes, there are two small passenger-only competitors having a modest impact on traffic on one of our Other Routes.

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 process was 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 Expressions of Interest (RFEOI) as the first step in the process for seeking an alternative service provider for the Campbell River-Quadra Island, Quadra Island-Cortes Island, and Port McNeill-Sointula-Alert Bay routes. No respondent to the RFEOI has elected to proceed, and consequently, the process is now complete. We will continue to be the provider of service on these routes.

We expect to pursue alternative service providers on our routes north of Port Hardy. The timing of these initiatives is uncertain.

## Traffic

In fiscal 2009, we experienced a decrease in traffic compared to the prior year. Vehicle traffic was 5.2% lower and passenger traffic was 4.9% lower.

<b>Vehicle Traffic by fiscal year</b>					
(thousands)	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Major routes	3,696.3	3,912.3	3,826.5	3,790.4	3,808.8
Other routes	4,402.4	4,632.6	4,669.6	4,715.8	4,711.5
Northern routes	31.7	33.8	25.8	37.1	37.1
Total	8,130.4	8,578.7	8,521.9	8,543.3	8,557.4
(Decrease) increase	(5.2%)	0.7%	(0.3%)	(0.2%)	3.2%

<b>Passenger Traffic by fiscal year</b>					
(thousands)	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Major routes	10,664.2	11,304.0	11,146.3	11,055.9	11,222.3
Other routes	9,969.3	10,382.7	10,440.5	10,556.7	10,687.0
Northern routes	94.0	101.8	78.2	117.0	117.2
Total	20,727.5	21,778.5	21,665.0	21,729.6	22,026.5
(Decrease) increase	(4.9%)	0.6%	(0.3%)	(1.3%)	3.1%

Ferry traffic levels are affected by a number of factors, including the economy, weather, transportation costs, the value of the Canadian dollar, global security, tourism levels, disposable personal income, demographics and population growth. Over the near term, we anticipate a limited recovery in discretionary traffic levels. We also expect commercial traffic to start to improve later this fiscal year as we gain market share with our drop-trailer service and as the economy begins to recover. Over the next few years, we anticipate a modest increase in overall traffic volume on all our routes.

### **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. The recent additions to our fleet have been:

- the *Northern Adventure* and the *Kuper* in March 2007;
- the Super C-class vessels: the *Coastal Renaissance*, the *Coastal Inspiration*, and the *Coastal Celebration* in March, June, and November 2008, respectively;
- the *Island Sky* in March 2009; and
- the *Northern Expedition*, a northern vessel, in May 2009.

The entry of these vessels into service has reduced the average age of our vessels and completes the most significant portion of our asset renewal program.

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

We continue to reinvest our retained earnings into our asset renewal program. The entry of these new assets into service has resulted in an increase in amortization and financing costs, causing a decrease in our fiscal 2009 earnings. This reduced level of earnings is expected to continue over the near term.

Our vessel replacement program is now complete for the Major Routes and well underway for the Northern Routes. Our capital expenditures over the next few years are expected to be significantly lower as we transition into more of a maintenance mode. Our next significant vessel renewal program will commence for the Other Routes within the next five years.

## 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 which, together with regulations, governs the activities of Canadian vessels in all waters and all vessels in Canadian waters. The revised regulations may have an impact on the requirement for vessel upgrades. On January 1, 2009, a new Transport Canada requirement took effect whereby each domestic ferry must have a minimum safe manning document. This document dictates the minimum crew complement and crew certification required to operate the vessel at various passenger levels. To maintain existing passenger levels on our Other Routes, an increase of approximately 12 positions would be required. The cost of this increase can be mitigated by lowering passenger licence levels; however, the Coastal Ferry Services Contract requires us to maintain a minimum passenger capacity. An analysis of our options in this regard is currently underway. We also continue to address the new regulations through our planning processes and asset renewal initiatives. We anticipate that the cost of compliance with the regulations will cause an increase in future fares. 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. In anticipation of the regulations being amended, we have developed a corporate security strategy and completed location-specific security plans on the Major Routes and Northern Routes.

In January 2009, Transport Canada, through the Marine Security Contribution Program, approved approximately \$5.5 million of federal funding to help offset our costs of perimeter security, access control measures and training. These funds are in addition to \$3.8 million which was previously approved under this program. The program requires us to apply for reimbursement of 75% of the costs of security enhancements on approved projects as capital expenditures are incurred. To date, we have applied for reimbursement of approximately \$2.4 million.

Under an order issued by the Commissioner, price caps will increase on April 1, 2010 and 2011 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. On April 1, 2009, the price caps increased by 3.74% on the Major Routes and 7.25% on all other routes.

## **FINANCIAL RISKS AND FINANCIAL INSTRUMENTS**

Exposure to credit risk, liquidity risk and market risk arises in the normal course of our business. We manage market risk arising from the volatility in foreign currency, interest rate, and fuel price exposures in part through the use of derivative financial instruments including forward contracts, swaps and options. We do not utilize derivative financial instruments for trading or speculative purposes.

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. Where the market prices are not available, fair values are estimated using discounted cash flow analysis based on our current borrowing rate for similar borrowing arrangements.

### **Credit Risk**

We limit our exposure to credit risk on cash and investments by investing in liquid securities with high credit-quality counter-parties, placing limits on tenor of investment instruments and instituting maximum investment values per counter-party. We manage credit exposure related to financial instruments by dealing with high credit-quality institutions, in accordance with established credit-approval practices and by an ongoing review of our exposure to counter-parties. We do not expect any counter-parties to default on their obligations.

Our credit risk from trade customers is limited by having a large and diversified customer base and is managed through the review of third party credit reports, utilizing pre-authorized payment plans, monitoring of aging of receivables, and collecting deposits and adjusting credit terms for higher-risk customers. Amounts due from the Province are considered low credit risk. At March 31, 2009, 50% of our accounts receivable was comprised of amounts due from the Province.

### **Liquidity Risk**

We target a strong investment-grade credit rating to maintain capital market access at reasonable interest rates. Our financial position could be adversely affected if we fail to arrange sufficient and cost-effective financing to fund, among other things, capital expenditures and the repayment of maturing debt. This is subject to numerous factors, including the results of our operations, our financial position, conditions in the capital and bank credit markets, ratings assigned by rating agencies and general economic conditions. We deem this to be a low risk at this time as we do not foresee the need to access the capital markets for the next several years.

We manage liquidity risk through daily monitoring of cash balances, the use of long-term forecasting models and the maintenance of debt service reserves. Our credit ratings at March 31, 2009 were A low (DBRS) and A- (Standard & Poor's) and both rating agencies have assessed our rating outlook as positive.

### **Market Risk**

#### ***Interest Rate***

Our exposure to interest rate risk is limited to our short-term borrowings and floating rate debt and interest rate movement beyond the term of the maturity of fixed rate short-term investments. To manage this risk, we maintain between 70% and 100% of our debt portfolio in fixed rate debt, in aggregate. A 50 basis point change in interest rates would not have had a significant effect on our earnings for fiscal 2009.

### **Foreign Currency**

We are also exposed to risk from foreign currency prices on financial instruments, such as accounts payable denominated in currencies other than the Canadian dollar. To manage exposure on future purchase commitments, we review our foreign currency denominated commitments and hedge through derivative instruments as necessary. A 10% change in the US dollar or Euro foreign exchange rates would not have had a significant effect on our earnings for fiscal 2009.

### **Fuel Price**

Our exposure to fuel price risk is associated with the changes in the market price of marine diesel fuel. Fuel costs have fluctuated significantly over the past few years and there is uncertainty of the cost of fuel in the future.

We manage our exposure to fuel price volatility by entering into swap agreements in order to add a fixed component to the inherent floating nature of fuel prices. Fuel price hedging instruments are used solely for the purpose of reducing fuel price risk, not for generating trading profits. Our Commodity Risk Management Policy limits hedging to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period; a maximum of 90% of anticipated monthly fuel consumption for the 12 month period thereafter; and a maximum of 85% of anticipated monthly fuel consumption for the period thereafter to the end of the second performance term ending March 31, 2012. At March 31, 2009, we held 13 swaps that will mature prior to the end of March 2010. These fix approximately 74% of our anticipated fuel costs for the next fiscal year. Gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs.

To further mitigate the effect of volatility in fuel oil prices on our earnings, we use deferred fuel cost accounts. (See "Expenses – Deferred Fuel Cost Accounts" above for more detail).

High levels of fuel pricing could translate into significant fuel surcharges and result in unprecedented total tariff levels. There is uncertainty of 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.

### **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, 2009 and 2008.

(\$ millions)	2009		2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Commodity Fixed Price Swaps (13 swaps maturing within 1 year)	(0.9)	(0.9)	1.8	1.8
Foreign Exchange Forward Transactions (Super C-class vessels)	-	-	0.5	0.5
Foreign Exchange Forward Transactions ( <i>Northern Expedition</i> )	-	-	15.9	15.9

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, 2009, we have recorded a payable of \$0.9 million as the estimated loss to terminate the contracts as at this date.

The foreign exchange derivatives 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. Any unrealized gains or losses related to these foreign exchange forward contracts are charged to our regulatory accounts. We had no foreign exchange forward contracts in place at March 31, 2009.

**Non-Derivative Financial Instruments**

The carrying and fair values of non-derivative financial instruments at March 31, 2009 and 2008 are as follows:

(\$ millions)	2009		2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial Assets</b>				
Cash and cash equivalents	12.4	12.4	116.3	116.3
Restricted cash and cash equivalents	37.3	37.3	14.1	14.1
Short-term investments	0.1	0.1	17.0	17.0
Accounts receivable	12.9	12.9	14.5	14.5
	<u>62.7</u>	<u>62.7</u>	<u>161.9</u>	<u>161.9</u>
<b>Financial Liabilities</b>				
Accounts payable and accrued liabilities	41.1	41.1	91.3	91.3
Short-term debt	18.0	18.0	-	-
Interest payable on long-term debt	18.4	18.4	15.7	15.7
Accrued employee costs	51.9	51.9	53.2	53.2
Obligations under capital leases	1.1	1.1	1.4	1.4
Long-term debt, including current portion	1365.2	1344.0	1028.9	1080.8
Other long-term liabilities	0.2	0.2	0.1	0.1
	<u>1495.9</u>	<u>1474.7</u>	<u>1190.6</u>	<u>1242.5</u>

The fair value of all financial instruments included above, with the exception of long-term debt, approximate their carrying amounts due to the nature of the item and/or the short time to maturity.

The carrying value of long-term debt is measured at amortized cost using the effective interest rate method. Fair value is calculated by discounting the future cash flow of each debt issue at the estimated yield to maturity for the same or similar issues, or by using available quoted market prices.



## **BUSINESS 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 do not believe that material uncertainties exist in regards to our future. We have considered many items such as profitability levels, cash generating potential, cash utilization requirements including debt repayment schedules and future capital expenditures, and working capital requirements. We have taken measures to allow us to weather the economic downturn and continue to have a viable, profitable future.

### **Traffic Level and Tariff Revenue Risk**

As described above, there are many factors that affect ferry traffic levels. No assurance can be given as to the level of traffic on our system and the resulting tariff revenue.

### ***Economic Conditions***

We believe that the current economic conditions have been a major contributor to the decline in our total traffic carried. 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 and local economies begin to recover.

### ***Influenza***

On April 29, 2009, the World Health Organization (WHO) raised the level of influenza pandemic alert for the H1N1 influenza to phase 5. WHO states that the measures to be engaged at this state include "heightened surveillance, early detection and treatment of cases, and infection control in all health facilities". This may result in reduced discretionary travel, decreasing our traffic levels. We continue our measures to help reduce spread of influenza with daily cleaning routines to sanitize our vessels, offering hand sanitizer in our food services and children's play areas and posting health advisories in washrooms.

### ***Tourism***

The cost of fuel at the pump, the value of the Canadian dollar, disposable personal income and heightened global security may have a negative effect on discretionary travel and tourism. We are uncertain as to the individual or cumulative impact these items may have on our traffic levels.

### ***Tariff***

We are uncertain as to the cumulative impact that tariff rate increases and the implementation and removal of fuel surcharges may have on our traffic.

### **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 fiscal 2008. 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 involves employees in identifying areas and methods for enhancing current safety practices and ensuring that safety is our first priority each and every day.

### ***Foodborne Illness***

We have significant revenues from the sale of food services, both on our vessels and at our terminals. We are uncertain as to the cumulative impact of an incidence of a foodborne illness contracted from consuming contaminated foods or beverages purchased from our food services. We take every precaution to prevent food contamination. We purchase our products from reputable suppliers and we follow storage, handling, preparation, and cooking procedures designed to prevent such an event. Our procedures are aligned with the hazard analysis critical control point (HACCP) methodology which is a preventive approach to food safety at manufacturing plants, warehouses, and food retail facilities. The system identifies and documents risks, as well as the associated controls throughout the product cycle. HACCP is an industry-wide effort approved by the scientific community, as well as regulatory and industry practitioners.

### **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.

### **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, the discharge of storm water and the delivery of vessel fuel.

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.

### **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 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.

The occurrence of a default under the Coastal Ferry Services Contract or the Terminal Leases could have consequences, including an adjustment to ferry transportation fees from the Province or the forced sale of our vessels to the Province for net book value and termination of the Terminal Leases.

## **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. The award also has a mechanism in place that allows for the orderly transition to the next collective agreement without the ability to strike and provides 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

## **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.

## **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 this amendment were included in Bill C-10, which was cancelled when Parliament was dissolved before the 2008 federal election. However, there is no reason to believe that it will not be reintroduced. 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**

Much of British Columbia, including areas where we have operations and real property interests, is subject to claims of aboriginal use rights and/or aboriginal title. Canadian courts have recognized that aboriginal peoples may enjoy constitutionally protected rights, whether or not recognized in a treaty, in respect of land used or occupied by their ancestors. These rights vary from the right to use lands and waters to carry out traditional activities (for example, an aboriginal right to fish) to the right to exclusively occupy lands subject to aboriginal title. What kind of right might exist depends primarily upon the nature and extent of the prior aboriginal use and occupation.

At present, many aboriginal groups are seeking recognition of their right to use or occupy their traditional territories. They also expect to participate in government decision-making with respect to activities by third parties on those lands. Canadian courts have confirmed that provincial and federal governments have a duty to consult with and, if necessary, accommodate aboriginal groups asserting rights or title where these interests might be infringed by government action. Government approvals and licences, such as those required to operate existing terminal facilities or develop new ones, may trigger the government's duty to consult with any aboriginal groups whose interests might be detrimentally affected.

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 an aboriginal group a proprietary or other interest in the ferry terminal properties should that right or interest interfere 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, 2009, of \$2.1 million (\$2.7 million at March 31, 2008) 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, 2008, indicated a surplus of \$487 million.

Effective April 1, 2009, the Public Service Pension Board of Trustees increased contribution rates for plan members and employers from 7.63% to 7.78% of pensionable earnings each, primarily due to the change in the investment return and salary increase assumptions.

### ***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, 2009, was \$10.4 million (\$10.8 million at March 31, 2008).

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, 2009, we have three 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 began April 1, 2008; and
- 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.

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***

We utilize derivative financial instruments to manage market risk against the volatility in foreign currency, interest rate, and fuel price exposures. We do not utilize derivative financial instruments for trading or speculative purposes. At the inception of each hedge, we determine whether or not to apply hedge accounting.

When applying hedge accounting, we document all relationships between hedging instruments and hedged items, as well as our risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. We also assess, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. Realized and unrealized gains or losses associated with derivative instruments which have been terminated or cease to be effective prior to maturity are recognized in the period in which they have been terminated or cease to be effective.

### ***Asset Retirement Obligations***

When it can be reasonably determined, we recognize the fair value of a liability for any legal obligations associated with the retirement of long-lived assets when those obligations result from the acquisition, construction, development or normal operation of the assets. A corresponding asset retirement cost is added to the carrying amount of the related asset and amortized to expense on a systematic and rational basis.

Certain of our vessels contain undetermined amounts of asbestos. Under certain circumstances, we may be required to handle and dispose of the asbestos in a manner required by regulations. It is our intention to sell decommissioned vessels into world markets to buyers who will keep them in active service. Under these circumstances asbestos remediation would become the responsibility of the new owner.

No amount has been recorded for asset retirement obligations relating to these assets as it is not possible to make a reasonable estimate of the fair value of any such liability due to the indeterminate magnitude, likelihood or financial impact, if any, of this issue. 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, 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 5, the adoption of this section has had no impact on our consolidated financial statements.
- Section 3031, *Inventories*, 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 3 and 4, 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 future income tax regulatory assets and liabilities for 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 are monitoring ongoing standards development as issued by the International Accounting Standards Board and the CICA Accounting Standards Board as well as regulatory developments as issued by the Canadian Securities Administrators, which may affect the timing, nature or disclosure relating to our adoption of IFRS.

The transition to IFRS may materially affect our reported financial position and results of operations. As our analysis is still underway and accounting policy choices and IFRS 1 exemptions have not yet been selected, we are unable to quantify the impact of IFRS on the future financial position and results of operations.

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* (IFRS 1).

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. A full review to assess IFRS conversion impacts on our systems is also in progress. Our financial systems are currently undergoing an upgrade and we are evaluating the alternatives that will be available as part of this upgrade.

The following table includes elements of our IFRS transition plan and an assessment of progress towards achieving the key milestones. We are working through a detailed IFRS transition plan and certain project activities and milestones could change. Further, changes in regulation or timing of standard development throughout the project could result in changes to the transition plan. The following tables provide further insight into our IFRS project.

<b>Financial statement preparation</b>
<b><i>Key activities</i></b>
<ul style="list-style-type: none"> <li>• Identify differences in Canadian GAAP / IFRS accounting policies</li> <li>• Select ongoing IFRS policies</li> <li>• Select IFRS 1 elections</li> <li>• Develop financial statement format</li> <li>• Quantify effects of change at April 1, 2010 (for fiscal 2011 comparative financial statements)</li> </ul>
<b><i>Status</i></b>
<ul style="list-style-type: none"> <li>• Scoping and diagnostic phase completed in fiscal 2009, with high-level review of the major differences between Canadian GAAP and IFRS</li> <li>• Highest areas of impact identified and review of IFRS prioritized</li> <li>• In-depth analysis of issues and accounting policy choices is currently underway</li> </ul>
<b>Training, Education &amp; Communication</b>
<b><i>Key activities</i></b>
<ul style="list-style-type: none"> <li>• Determine required level of IFRS expertise within all areas of the company</li> <li>• Ensure appropriate training of key members within Finance</li> <li>• Provide appropriate education and communication to affected departments</li> <li>• Keep key stakeholders informed</li> </ul>
<b><i>Status</i></b>
<ul style="list-style-type: none"> <li>• Initial training for core IFRS project team members completed in fiscal 2009 and currently enrolled in the IFRS Award Program, Certificate Level through the CICA</li> <li>• Interdepartmental workshops provided on specific topics (property, plant and equipment; IFRS1; the Framework)</li> <li>• Ongoing identification of training requirements of other departments for inclusion in future training plans</li> </ul>



<b>Information technology infrastructure</b>
<b><i>Key activities</i></b>
<ul style="list-style-type: none"> <li>• Confirm system upgrades required for IFRS reporting</li> <li>• Review/revise data gathering processes</li> <li>• Review/revise budgeting and forecasting processes</li> </ul>
<b><i>Status</i></b>
<ul style="list-style-type: none"> <li>• IFRS project team coordinating efforts with ERP systems upgrade team (ERP upgrade currently in progress)</li> <li>• IFRS system implementation planned to be complete by March 31, 2010</li> </ul>
<b>Control environment</b>
<b><i>Key activities</i></b>
<ul style="list-style-type: none"> <li>• Accounting policy determination, documentation and implementation</li> <li>• MD&amp;A on-going communications</li> </ul>
<b><i>Status</i></b>
<ul style="list-style-type: none"> <li>• Analysis of control issues underway as part of detail implementation plan</li> </ul>
<b>Business policy assessment</b>
<b><i>Key activities</i></b>
<ul style="list-style-type: none"> <li>• Financial covenants assessment</li> <li>• Compensation arrangements assessment</li> <li>• Customer and supplier contract evaluation</li> </ul>
<b><i>Status</i></b>
<ul style="list-style-type: none"> <li>• All relevant GAAP-dependent covenants and contracts have been identified</li> </ul>

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.

## **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, the Canadian Dollar relative to the US Dollar, fuel costs, construction costs, the state of the local economy, turbulent financial markets, demographics, import duties 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.

## **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 endeavoring to ensure that all major issues affecting the business and affairs of the Company are given proper consideration.

At March 31, 2009, the Board was comprised of the following directors:

Chair: Elizabeth J. Harrison Q.C.

Vice Chair: Thomas W. Harris

Members: Mark L. Cullen, Christopher C. Gardner, David L. Hahn, Holly A. Haston-Grant, Donald P. Hayes, Brian G. Kenning, Gordon R. Larkin, Maureen V. Macarenko, A. Daniel Miller, Jane L. Peverett, Stephen E. Smith, Wayne H. Stoilen, and Graham M. Wilson

During the fiscal year ended March 31, 2009, Douglas E. Allen served as a director from April 1, 2008 until his resignation from the Board July 31, 2008.

Effective April 1, 2009, Thomas W. Harris and Maureen V. Macarenko ceased to be directors.

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 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:

<i>Elizabeth J. Harrison, Q.C.:</i>	<i>Director, Unilens Vision Inc.</i>
<i>Brian G. Kenning:</i>	<i>Director, MacDonald Dettwiler &amp; Associates Inc.</i>
<i>Jane L. Peverett:</i>	<i>Director, Canadian Imperial Bank of Commerce</i>
	<i>Director, EnCana Corporation</i>
	<i>Director, Northwest Natural Gas Company</i>
<i>Graham M. Wilson:</i>	<i>Director, ITRON Inc.</i>
	<i>Director, Naikun Wind Energy Group Inc.</i>
	<i>Director, Daylight Energy Ltd.</i>
	<i>Trustee, Hardwoods Distribution Income Trust</i>

### **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 half to full day session, usually 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 Corporate Secretary and the Chair of the Board.

## **Nomination of Directors**

The Governance & Nominating Committee has responsibility for the director nomination process. The Committee is composed entirely of directors who are independent, pursuant to the definition of independence adopted by the Board of BCF, and operates under terms of reference adopted by the Board.

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 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. The Authority views it 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 to ensure adequate skill sets and experience are available within the members of the Board of BCF.

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, 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**

Each year, the Governance and Nominating Committee reviews the compensation of directors and the Human Resources and Compensation Committee reviews the compensation of the President & CEO and members of executive management, with detailed analysis undertaken at least every second year. The Committees engage an external compensation advisor to research and provide independent advice on the level and types of compensation for directors, the President & CEO and members of executive management. In making their recommendations to the Board, the Committees take into account the types of compensation and the amounts paid by other comparable companies.

### **Board Committees**

#### ***Audit & Finance Committee (at March 31, 2009):***

Chair: Graham M. Wilson

Members: Christopher C. Gardner, Donald P. Hayes, Brian G. Kenning, and  
Wayne H. Stoilen

Effective April 1, 2009, Stephen E. Smith became a member of the Committee and Wayne H. Stoilen ceased to be a member.

The Audit & Finance 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 the Company's 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.

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 the Company's external auditor in each of the last two fiscal years were:

External Auditor Billings (\$ thousands)	Year ended March 31	
	2009	2008
Audit and audit related	136.7	182.6
Tax services	2.0	2.7
All other fees		
Advisory services (IFRS and environmental pre-assessment)	32.1	-
	<u>170.8</u>	<u>185.3</u>

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, 2009):***

Chair: A. Daniel Miller

Members: Donald P. Hayes, Gordon R. Larkin, Maureen V. Macarenko, and  
Wayne H. Stoilen

Effective April 1, 2009, Holly A. Haston-Grant became a member of the Committee, and Maureen V. Macarenko ceased to be a director and member 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 & Nominating Committee (at March 31, 2009):***

Chair: Thomas W. Harris

Members: Mark L. Cullen, Christopher C. Gardner, Gordon R. Larkin, Maureen V. Macarenko, and Graham M. Wilson

Effective April 1, 2009, Thomas W. Harris ceased to be a director and Chair of the Committee, and Brian G. Kenning became Chair of the Committee. Also effective April 1, 2009, Holly A. Haston-Grant and Jane L. Peverett became members of the Committee, and Maureen V. Macarenko ceased to be a director and member of the Committee.

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 that the compensation plan for directors is adequate, suitable and 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 (at March 31, 2009):***

Chair: Mark L. Cullen

Members: Thomas W. Harris, Brian G. Kenning, and A. Daniel Miller

Effective April 1, 2009, Jane L. Peverett, Stephen E. Smith, and Wayne H. Stoilen became members of the Committee, and Thomas W. Harris ceased to be a director and member of the Committee.

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:

- regularly review, at a strategic level, the approach taken to manage the Company's human resources, including the recruitment, retention, motivation and engagement of employees in the interests and success of the Company;
- regularly review with the President & CEO his plans for the structure, development, and succession of the executive management; and
- review and recommend to the Board 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 in the past engaged an independent governance consultant to coordinate the evaluation. The Board also regularly assesses the performance of individual directors. This occurs through discussions between the individual directors and the Board Chair.

The Board evaluation undertaken in the year ended March 31, 2009 was led by the Board Chair. It involved the completion by directors of a written questionnaire and individual discussions between each director and the Board Chair on matters related to Board effectiveness. The process also included a self assessment by directors of their skills and experience in relation to those considered by the Board as being important for the good governance of the Company. The Board Chair presented the results of the evaluation together with recommendations for action to the Board. The Board will take action to implement the recommendations in the upcoming year.