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

For the three months ended June 30, 2009
Dated July 30, 2009

BCFerries

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The following is our discussion and analysis of the financial condition and results of operations for British Columbia Ferry Services Inc. as of July 30, 2009. This should be read in conjunction with our unaudited interim consolidated financial statements and related notes for the three month periods ended June 30, 2009 and 2008, and our annual audited consolidated financial statements and related notes together with our fiscal 2009 Management's Discussion & Analysis. These documents are available on SEDAR at www.sedar.com and on our Investor webpage at http://www.bcferries.com/about/investors/index.html.

Except where indicated, all financial information herein is expressed in Canadian dollars and determined on the basis of Canadian generally accepted accounting principles.

BUSINESS OVERVIEW

British Columbia Ferry Services Inc. is an independent company providing ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world, providing frequent year-round transportation service on 25 routes, supported by 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 are a versatile company, providing a wide range of ferry services for our customers. During the three months ended June 30, 2009 (the first quarter of fiscal 2010), we provided over 46,000 sailings, carrying 5.4 million passengers and 2.1 million vehicles.

Our traffic levels have historically been relatively stable. However, during fiscal 2009, vehicle and passenger traffic were lower than the prior year by 5.2% and 4.9%, respectively. In the first quarter of fiscal 2010, we experienced a decline of 1.0% in vehicle traffic and 0.4% in passenger traffic as compared to the same period in the prior year. A factor in the decline this quarter is the current economic climate, which is having an impact on our commercial and tourism traffic.

The decrease in economic activity, lower level of international tourism and higher level of unemployment have negatively impacted discretionary travel. We continue to review and update our financial and operating plans to respond to current economic uncertainties. Over the near term, we anticipate a limited recovery in local discretionary traffic levels. We also expect commercial traffic to start to improve later this fiscal year as we gain market share with our new drop-trailer service and as the economy begins to recover.

In March 2009, we launched our drop-trailer service. We now offer a new service to commercial customers on two of our Major Routes. Our commercial customers on these routes can now drop their trailers off at one terminal and pick them up at another. This drop-trailer service has been well received in the commercial market and improves our overall productivity by utilizing otherwise unused capacity.

We are currently assessing the feasibility of enhancing our northern service to Prince Rupert by commencing periodic service from our Tsawwassen terminal on the Lower Mainland to our Port Hardy terminal on Vancouver Island with the objective of increasing tourism. We intend to consult stakeholders as part of this process.

As part of our ongoing efforts to identify and pursue opportunities that have the potential to enhance our effectiveness in delivering safe, reliable and quality ferry service, we are reviewing the feasibility of using cable technology on one of our shortest routes. Cable technology uses small engines in combination with drive and guide cables to move the vessel. Not only do cable ferries have a lower capital cost than conventional ferries but there is also potential for a reduction in operating costs.

Significant events during or subsequent to our first quarter of fiscal 2010:

- 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 $52 million upgrade to prepare it for another 13 years of service.

- On April 15, 2009, the 47-year-old *Queen of Vancouver* was decommissioned and on April 20, 2009, the 43-year-old *Queen of Prince Rupert* was decommissioned. These vessels, together with the previously decommissioned *Queen of Saanich,* have all been offered for sale.

- 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.

- On May 21, 2009, our new operations and security centre (OSC) officially began operations. The OSC is a central location for monitoring day-to-day operations and providing incident management support. The primary purpose of the OSC is to collect information from throughout the company, provide enhanced situational awareness and assessments, increased security monitoring and a coordinated response during any incidents.

- On June 12, 2009, we issued a Request for Proposal (RFP) to identify prospective alternative service providers who have the means, qualifications and experience to provide service to the mid-coast ports of Ocean Falls and Shearwater on our Northern routes.

- On July 15, 2009, fares were reduced as fuel rebates were increased from 5% to 8% on many of our routes.

- On July 23, 2009 the Province announced its intention to harmonize its existing 7% provincial sales tax with the 5% federal goods and services tax into a single harmonized sales tax (HST) of 12%, effective July 1, 2010. Although we are not yet able to quantify the full impact of the proposed HST on our business, we expect it will add costs to our operations. In response we are considering our options, including an application to our regulator to allow a fare increase to recover the added HST cost.

- On July 28, 2009 the Province announced that it was launching a review of the operations of certain independent authorities, including British Columbia Ferry Services Inc. The review is expected to be completed by September 30, 2009.

FINANCIAL AND OPERATIONAL OVERVIEW

This section provides an overview of our financial and operational performance for the three months ended June 30, 2009 and 2008.

	Three months ended June 30			
($millions)	2009	2008	Variance	
Total revenue	178.3	171.9	6.4	3.7%
Expenses	(166.1)	(153.6)	(12.5)	(8.1%)
Earnings from operations	12.2	18.3	(6.1)	(33.3%)
Interest and other	(15.8)	(9.9)	(5.9)	(59.6%)
Net (loss) earnings and comprehensive income	(3.6)	8.4	(12.0)	(142.9%)

Our quarterly results are affected by the seasonality of leisure travel patterns. The second quarter, covering the summer period, experiences the highest traffic levels and the highest earnings of the year. The third and fourth quarters reflect a seasonal downturn in traffic and we utilize these off-peak periods to perform upgrades and major maintenance and refit programs, as well as to undertake mandatory inspections on the majority of our vessels.

Our earnings from operations in the three months ended June 30, 2009, were $6.1 million lower and net earnings were $12.0 million lower than the same period in the prior year. Reductions of this magnitude were expected, reflecting 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.

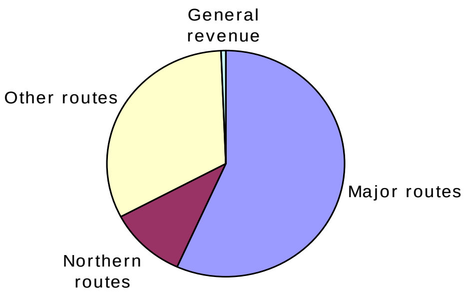
Although our earnings decreased in the quarter compared to the same period in the prior year, cash provided from operating activities remains strong. Over the next five years, we expect our cash requirements will be met through operational cash flows and by accessing our credit facility from time to time.

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

On January 1, 2009, revised regulations from Transport Canada took effect, which increased the minimum crew complement required to operate certain vessels at various passenger levels. To maintain existing passenger levels on our Other Routes, an increase of approximately 12 positions would have been required. Although the cost impact of these requirements could be mitigated on some vessels by lowering the passenger licence levels, the Coastal Ferry Services Contract requires us to maintain a minimum passenger capacity. However, multiple licence levels have been established on some of our affected vessels which are adjusted according to expected passenger levels, which in turn permits crewing levels to be adjusted. This will provide operating flexibility and minimize incremental costs while ensuring compliance with regulations and existing service contracts.

Revenue

Our total revenues in the three months ended June 30, 2009 increased over the same period in the previous year as shown in the table below.



In the three months ended June 30, 2009, the greatest portion of our revenues, 57%, was earned on our three Major Routes connecting Vancouver Island to Vancouver and the Lower Mainland. The revenue from the Northern Routes contributed 10% and Other Routes contributed 32%.

Revenue ($millions)	**Three months ended June 30**			
	2009	**2008**	**Increase (Decrease)**	
Direct Route Revenue				
Vehicle traffic (volume)	2,132,848	2,153,998	(21,150)	(1.0%)
Vehicle tariff	67.7	69.4	(1.7)	(2.4%)
Passenger traffic (volume)	5,391,803	5,410,996	(19,193)	(0.4%)
Passenger tariff	40.3	38.6	1.7	4.4%
Social program fees	6.1	5.4	0.7	13.0%
Catering & on-board	19.4	19.3	0.1	0.5%
Other revenue	4.7	5.1	(0.4)	(7.8%)
Total Direct Route Revenue	138.2	137.8	0.4	0.3%
Indirect Route Revenue				
Ferry transportation fees	32.2	26.2	6.0	22.9%
Federal-Provincial subsidy	6.8	6.6	0.2	3.0%
Total Route Revenue	177.2	170.6	6.6	3.9%
Other general revenue	1.1	1.3	(0.2)	(15.4%)
Total Revenue	178.3	171.9	6.4	3.7%

Our largest revenue source is vehicle and passenger tariffs. Effective April 1, 2009, the British Columbia Ferries Commissioner (the Commissioner) authorized a price cap increase of 3.74% on the Major Routes and 7.25% on all other routes. In response, we implemented tariff increases up to the new level authorized. On each subsequent April 1 of the four-year performance term ending March 31, 2012, the Major Route price cap will increase by 2.7% plus 0.49 times the Consumer Price Index (British Columbia) (CPI). On the other routes, the price cap will increase by 5.7% plus 0.73 times CPI.

From time to time, we utilize promotional fares designed to stimulate growth in traffic or to 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.

At April 1, 2009, fuel rebates of up to 5% of tariffs were in place on many of our routes. On July 15, 2009, these were increased to 8%, reflecting a further drop in fuel prices. No rebates were put in place on our Major and Northern Routes.

Year to year changes for the three months ended June 30 for the Major, Northern and Other Routes are discussed separately below.

Major Routes

Direct Route Revenue ($ thousands)	Three months ended June 30			
	2009	2008	Increase (Decrease)	
Vehicle traffic (volume)	962,151	977,463	(15,312)	(1.6%)
Vehicle tariff	49,376	52,695	(3,319)	(6.3%)
Passenger traffic (volume)	2,744,158	2,768,114	(23,956)	(0.9%)
Passenger tariff	28,555	28,294	261	0.9%
Social program fees	2,974	2,703	271	10.0%
Catering & on-board	15,837	15,882	(45)	(0.3%)
Reservation fees	2,700	3,040	(340)	(11.2%)
Parking	638	754	(116)	(15.4%)
Assured loading	472	488	(16)	(3.3%)
Other revenue	400	309	91	29.4%
Total Direct Route Revenue	100,952	104,165	(3,213)	(3.1%)

Our Major Routes consist of three regulated routes connecting Greater Vancouver with mid and southern Vancouver Island. Both vehicle traffic and passenger traffic decreased in the three months ended June 30, 2009, compared to the same period in the previous year. Average tariff yield per vehicle declined $2.59 or 4.8%, mainly as a result of fewer buses and commercial vehicles which carry higher individual fares. We expect commercial tariffs to improve later this year as we gain market share with our new drop-trailer service and as the economy begins to recover. The reduction in vehicle traffic, together with the reduction in average yield, resulted in $3.3 million less vehicle tariff revenue. The reduction in passenger traffic was more than offset by an increase in average tariff yield per passenger of $0.19 or 1.8%, resulting in $0.3 million higher passenger tariff revenue. The total tariff revenue for the quarter decreased by $3.1 million.

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

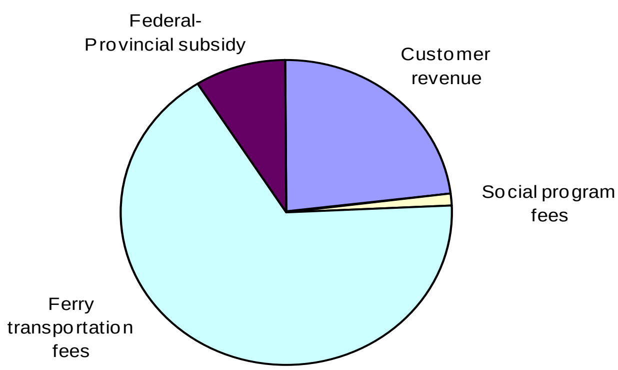
All of our vessels that provide service on our Major Routes have a gift shop and options for food service. In the three months ended June 30, 2009, the average spending per passenger for food services increased by 1.5% while the average spending per passenger for gift shop items remained at the same 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, assured loading, and parking revenue also declined as a result of lower traffic levels. Other revenue increased as a result of the opening of the Departure Bay Quay in July 2008.

Northern Routes

Direct Route Revenue ($ thousands)	**Three months ended June 30**			
	2009	**2008**	**Increase (Decrease)**	
Vehicle traffic (volume)	7,429	8,009	(580)	(7.2%)
Vehicle tariff	1,895	2,149	(254)	(11.8%)
Passenger traffic (volume)	20,103	22,056	(1,953)	(8.9%)
Passenger tariff	1,612	1,730	(118)	(6.8%)
Social program fees	226	193	33	17.1%
Catering & on-board	543	521	22	4.2%
Reservation fees	14	16	(2)	(12.5%)
Stateroom rental	241	196	45	23.0%
Hostling[1] & other	48	59	(11)	(18.6%)
Total Direct Route Revenue	4,579	4,864	(285)	(5.9%)
Indirect Revenue				
Ferry transportation fees	12,525	6,432	6,093	94.7%
Federal-Provincial subsidy	1,665	1,626	39	2.4%
Total Route Revenue	18,769	12,922	5,847	45.2%

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



In the three months ended June 30, 2009, revenue from our Northern Routes consisted of 23% from customers and 77% from the Province (1% social program fees, 67% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

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

Northern Routes, cont'd

Both vehicle traffic and passenger traffic decreased in the three months ended June 30, 2009, compared to the same period in the previous year. The average tariff yield per vehicle declined $13.24 or 4.9%, mainly as a result of fewer commercial vehicles which carry higher individual fares. The reduction in vehicle traffic, together with the reduction in average yield, resulted in $0.3 million less vehicle tariff revenue. The reduction in passenger traffic was partially offset by an increase in average tariff yield per passenger of $1.75 or 2.2%, resulting in $0.1 million less passenger tariff revenue. The total tariff revenue for the quarter decreased by $0.4 million.

Reimbursements from the Province for social program fees increased as a result of higher usage and higher average fares. Revenue from catering and on-board services has increased as a result of higher average passenger spend, partially offset by lower traffic levels. Stateroom rental revenue has increased as a result of higher usage.

Hostling and other income are lower primarily as a result of reduced commercial traffic.

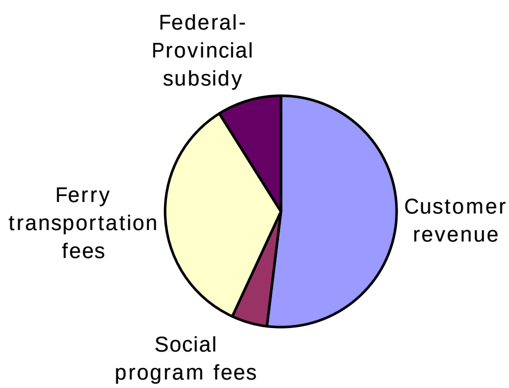
We receive ferry transportation fees for these routes under the Coastal Ferry Services Contract which relate, in part, to the capital cost of the vessels serving these routes. The fees this quarter have increased $6.1 million or 94.7% as a result of the capital cost of the new *Northern Expedition* which commenced operating May 18, 2009, on our northern route through the Inside Passage from Port Hardy to Prince Rupert. The annual ferry transportation fees this fiscal year are expected to increase $22.3 million or 88.2% to a total of $47.6 million.

The Federal-Provincial subsidy has increased by CPI.

Other Routes

Direct Route Revenue ($ thousands)	**Three months ended June 30**			
	2009	**2008**	**Increase (Decrease)**	
Vehicle traffic (volume)	1,163,268	1,168,526	(5,258)	(0.4%)
Vehicle tariff	16,423	14,597	1,826	12.5%
Passenger traffic (volume)	2,627,542	2,620,826	6,716	0.3%
Passenger tariff	10,182	8,531	1,651	19.4%
Social program fees	2,856	2,532	324	12.8%
Catering & on-board	2,804	2,735	69	2.5%
Reservation fees	332	307	25	8.1%
Parking & other	97	105	(8)	(7.6%)
Total Direct Route Revenue	32,694	28,807	3,887	13.5%
Indirect Revenue				
Ferry transportation fees	19,653	19,788	(135)	(0.7%)
Federal-Provincial subsidy	5,066	4,947	119	2.4%
Total Route Revenue	57,413	53,542	3,871	7.2%

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



In the three months ended June 30, 2009 revenue from our Other Routes consisted of 52% from customers and 48% from the Province (5% social program fees, 34% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

Other Routes, cont'd

In the three months ended June 30, 2009, the average tariff yield per vehicle increased by $1.63 or 13.0%. This was partially offset by a 0.4% decrease in vehicle traffic and resulted in a $1.8 million increase in vehicle tariff revenue. Passenger traffic increased in the quarter and, together with the increase in average tariff yield per passenger of $0.62 or 19.0%, resulted in $1.7 million higher passenger tariff revenue. The total tariff revenue for the quarter on these routes increased by $3.5 million. Average and total tariffs were significantly lower in the prior year due to redemptions of prepaid paper fare media in excess of the liability set up at March 31, 2008.

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

Revenue from catering and on-board services and fees for reservations increased primarily as a result of higher traffic levels on routes where those services are offered.

Ferry transportation fees are lower in the quarter; however the annual amount is expected to equal that of the prior fiscal year.

The Federal-Provincial subsidy increased by CPI.

Expenses
Expenses for the three months ended June 30, 2009 and 2008 are summarized in the tables below.

Operating expenses ($ millions)	**Three months ended June 30**			
	2009	**2008**	**Increase (Decrease)**	
Operations	100.5	98.7	1.8	1.8%
Maintenance	23.7	18.3	5.4	29.5%
Administration	7.4	9.1	(1.7)	(18.7%)
Total operations, maintenance & administration	131.6	126.1	5.5	4.4%
Cost of retail goods sold	7.5	7.2	0.3	4.2%
Amortization	27.0	20.3	6.7	33.0%
Total expenses	166.1	153.6	12.5	8.1%

The $1.8 million increase in operations expenses consists of:

- $2.5 million increase in wages and benefits, including:
  - Approximately $1.2 million in wage rate increases averaging about 3% in accordance with the existing Collective Agreement; and
  - $1.3 million increase in benefit costs.

This increase was partially offset by:

- $0.5 million or 2.2% decrease in fuel expense as a result of lower approved prices, partly offset by a 1.6% increase in fuel consumption reflecting new vessels in service being larger than the vessels they replaced.

The $5.4 million increase in maintenance costs reflects variations in vessel refit scheduling and $1.3 million of unanticipated maintenance on the *Queen of Burnaby* to replace a damaged propeller, partially offset by lower terminal maintenance.

Administration expenses decreased $1.7 million mainly as a result of reduced consulting, travel, marketing, advertising and other discretionary expenditures.

Amortization increased a total of $6.7 million mainly as a result of additional assets coming into service, including:

- $3.9 million due to the *Coastal Inspiration* and the *Coastal Celebration* entering service in June 2008 and November 2008, respectively;
- $1.0 million due to the $52 million *Queen of New Westminster* upgrade completed in April 2009;
- $0.7 million due to the *Northern Expedition* commencing service in May 2009; and
- $0.6 million due to the *Island Sky* commencing service in February 2009.

Interest and other ($ millions)	Three months ended June 30		
	2009	**2008**	**Increase (Decrease)**
Interest expense			
Bond interest	15.8	13.5	2.3
KfW loans	2.9	1.8	1.1
Short-term loans	0.1	0.1	-
Interest on deferred accounts	-	0.1	(0.1)
Structured Financing Facility Program	(1.3)	-	(1.3)
Capitalized interest	(1.7)	(4.2)	2.5
Total interest expense	15.8	11.3	4.5
(Gain) on foreign exchange	-	(0.1)	0.1
(Gain) on disposal of capital assets	-	(1.2)	1.2
Total interest and other	15.8	10.0	5.8

Interest expenses increased $4.5 million primarily due to:

- $2.3 million additional interest relating to our $140 million bond series issued in December 2008;
- $1.1 million additional interest relating to KfW loans which partially funded the purchase of the *Northern Expedition* and the *Coastal Celebration*; and
- $2.5 million less interest capitalized this quarter reflecting a lower capital program;

partially offset by:

- $1.3 million of interest rate support received from the Government of Canada.

During the quarter, the Government of Canada agreed to provide an additional $0.6 million of interest rate support through the Structured Financing Facility Program relating to the life extension of the *Queen of New Westminster*.

Results for the prior year included a $1.2 million gain from the sale of the *Queen of Esquimalt*.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity and Capital Resources

We fund our operations and capital acquisitions with cash flow generated from operations, as well as bank financing and debt issues. We completed our major financing requirements in fiscal 2009. 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 June 30, 2009, our unrestricted cash and cash equivalents totalled $15 million.

We target maintaining a strong investment-grade credit rating to allow capital market access at reasonable interest rates. Our credit ratings at June 30, 2009, were A low (DBRS) and A- (Standard & Poor's) and both rating agencies have assessed our rating outlook as positive.

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 the three months ended June 30, 2009 and 2008 are summarized in the table below.

($ millions)	Three months ended June 30 2009	2008
Net (loss) earnings	(3.6)	8.4
Items not involving cash:		
Amortization	27.0	20.3
Other non-cash charges	(0.7)	(1.0)
Regulatory costs deferred	2.7	(1.0)
Change in operating working capital	(1.8)	(21.8)
Cash provided by operating activities	23.6	4.9
Cash provided by financing activities	1.9	89.6
Cash used in investing activities	(22.5)	(203.0)
Total increase(decrease) in cash	3.0	(108.5)

Although our earnings decreased in the quarter compared to the same period in the prior year, cash provided from operating activities increased significantly.

In the three months ended June 30, 2009, cash provided by operating activities included an increase in non-cash working capital of $1.8 million. This increase in working capital was primarily due to:

- $3.0 million reduction in interest payable on long-term debt;
- $2.5 million increase in accounts receivable primarily due to:
  - $1.7 million in social program fees receivable; and
  - $1.0 million in commercial travel cards receivable due to increased sales volume;
- $1.6 million increase in total inventories;
- $1.4 million reduction in payables and accrued liabilities relating to refit and maintenance and other operating activities;
- $1.4 million reduction in accrued employee costs; and
- $1.4 million increase in prepaid expenses primarily due to $2.8 million in property taxes, $0.6 million in insurance and $0.7 million in IT licence fees; partially offset by a $2.6 million reduction in fuel.

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

- $3.0 million increase in deferred revenue for prepaid reservations as we approach our peak summer season; and
- $6.5 million increase in regulatory liabilities reflecting tariff revenues collected in excess of price caps in the quarter.

Cash used in investing activities consists mainly of $22.5 million used to purchase capital assets. The significant capital transactions are described below in "Investing in Our Capital Assets".

INVESTING IN OUR CAPITAL ASSETS

Capital expenditures in the three months ended June 30, 2009, totalled $17.0 million. This level of expenditure reflects the significant reduction in our capital program compared to previous years. Total capital expenditures were:

	($ millions)
New vessels, vessel upgrades and modifications	6.3
Terminal marine structures	1.5
Terminal and building upgrades and equipment	5.2
Information technology	4.0
Total capital expenditures	17.0

New Vessels, Vessel Upgrades and Modifications

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

	($ millions)
New northern vessel, the *Northern Expedition*	4.4
Sewage treatment upgrade program	0.6
Two-year project to install Voyage Data Recorders and navigational aids and upgrade vessel connectivity	0.5
Upgrade of emergency lighting system on the *Northern Adventure*	0.4
Other projects	0.4
	6.3

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 $37 million, but are uncertain as to the outcome of our application. The project was completed on schedule and on budget.

Terminal Marine Structures

Capital expenditures on terminal marine structures in the quarter included the following:

Terminal	Description	($ millions)
Tsawwassen	Replacement of six dolphins and associated catwalks	0.5
Fulford	Replacement of two dolphins and maintenance walkway	0.5
Skidegate	New pontoon, ramp, ramp abutment and two dolphins	0.3
Various	Other projects	0.2
		1.5

We have now completed the necessary preparations to accommodate the new *Northern Expedition* at Skidegate.

Terminal and Building Upgrades and Equipment

Capital expenditures on terminal and building upgrades and equipment included the following:

	($ millions)
Security upgrades	2.4
Departure Bay terminal	1.8
Vehicles, machinery & equipment	0.6
Other terminal projects	0.4
	5.2

At nine terminals, mainly serving our Major and Northern Routes, we continued 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, allocated 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 submitted claims for reimbursement of approximately $2.4 million.

In the first quarter, work continued on the new waiting room at our Departure Bay terminal. In fiscal 2009, completed terminal improvements included the Departure Bay Quay, road works, and a new ticket building.

Information Technology

The most significant project during the quarter was our enterprise resource planning (ERP) upgrade which includes financial and related operating systems. The first and largest phase of this project is expected to be completed during the second quarter. The second phase, which will include enhancements to enable reporting under International Financial Reporting Standards (IFRS), is expected to be completed this fiscal year.

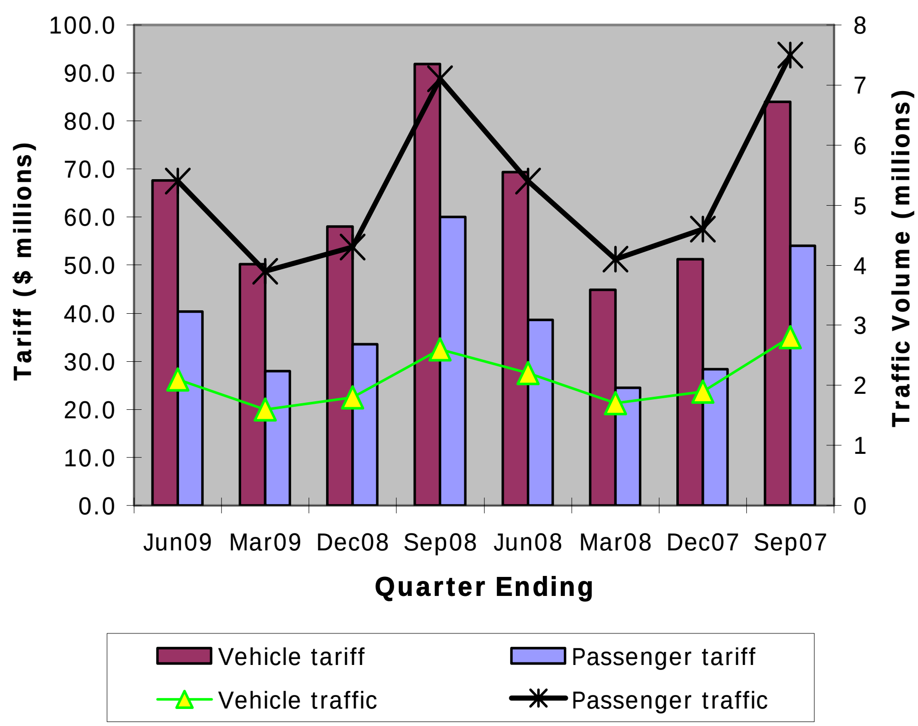
SUMMARY OF QUARTERLY RESULTS

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

	Quarter Ended (unaudited)							
($ millions)	**Jun 09**	**Mar 09**	**Dec 08**	**Sep 08**	**Jun 08**	**Mar 08**	**Dec 07**	**Sep 07**
Total revenue	178.3	128.5	149.4	232.1	171.9	124.2	136.5	220.2
Earnings (loss) from operations	12.2	(25.1)	(1.7)	66.2	18.3	(20.0)	(0.4)	69.4
Net (loss) earnings and comprehensive income	(3.6)	(38.4)	(14.6)	53.7	8.4	(30.5)	(7.8)	61.0

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.



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.

A discussion of financial risks can be found on pages 38 through 40 of our fiscal 2009 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2009.

BUSINESS RISK MANAGEMENT

Understanding and managing risk are important parts of our business. We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business. A discussion of enterprise wide risk management can be found on pages 41 through 44 of our fiscal 2009 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2009.

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.

ACCOUNTING PRACTICES

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with Canadian generally accepted accounting principles.

Our significant accounting policies are contained in note 1 to our March 31, 2009 and June 30, 2009 consolidated financial statements. Certain of these policies involve critical accounting estimates because they require us to make particularly subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts could be reported under different conditions or using different assumptions. These estimates and assumptions are subject to change as new events occur, as more experience is acquired, as additional information is obtained and as the general operating environment changes.

Discussion of the most critical accounting policies and estimates that we have used in the preparation of our consolidated financial statements can be found on pages 44 through 46 of our fiscal 2009 Management's Discussion & Analysis. The following describes the changes to critical accounting policies we have used in the preparation of our consolidated financial statements for the three months ended June 30, 2009, or expect to use in the future.

Adoption of New Accounting Standards

Effective April 1, 2009, we adopted the following CICA Handbook Sections:

- 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. Other than reclassifications and additional disclosure in Note 5, the adoption of this section has had no impact on our consolidated financial statements.

- 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 has been 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. The adoption of these amendments has had no 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.

- Emerging Issues Committee (EIC) Abstract 173 *Credit Risk and Fair Value of Financial Assets and Financial Liabilities* confirms that our own credit risk and the credit risk of our counterparties should be taken into consideration in determining the fair value of financial assets and liabilities. The adoption of this guidance has had no significant effect on our consolidated financial statements.

Future Accounting Changes
The following is a discussion of accounting changes that will be effective for us in future periods:

- 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. 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.

Financial statement preparation
Key activities • Identify differences in Canadian GAAP / IFRS accounting policies • Select ongoing IFRS policies • Select IFRS 1 elections • Develop financial statement format • Quantify effects of change at April 1, 2010 (for fiscal 2011 comparative financial statements)
Status • Scoping and diagnostic phase completed in fiscal 2009, with high-level review of the major differences between Canadian GAAP and IFRS • Highest areas of impact identified and review of IFRS prioritized • In-depth analysis of issues and accounting policy choices is currently underway

Training, Education & Communication
Key activities • Determine required level of IFRS expertise within all areas of the company • Ensure appropriate training of key members within Finance • Provide appropriate education and communication to affected departments • Keep key stakeholders informed
Status • Core IFRS project team members completed initial training in fiscal 2009 and are currently enrolled in the "IFRS Award Program, Certificate Level" through the CICA • Interdepartmental workshops provided on specific topics (property, plant and equipment; IFRS1; the Framework) • Ongoing identification of training requirements of other departments for inclusion in future training plans • Ongoing communications with key stakeholders, including direct communication with the Commissioner, our Agent Bank, and our Board of Directors, and with investors indirectly through our website

Information technology infrastructure
Key activities • Confirm system upgrades required for IFRS reporting • Review/revise data gathering processes • Review/revise budgeting and forecasting processes
Status • IFRS project team coordinating efforts with ERP systems upgrade team (ERP upgrade currently in progress) • IFRS system implementation planned to be complete by March 31, 2010

Control environment
Key activities • Accounting policy determination, documentation and implementation • MD&A on going communications
Status • Analysis of control issues underway as part of detailed implementation plan

Business policy assessment
Key activities • Financial covenants assessment • Compensation arrangements assessment • Customer and supplier contract evaluation
Status • All relevant GAAP-dependent covenants and contracts have been identified

- On July 23, 2009, the International Accounting Standards Board published Exposure Draft "Rate-regulated Activities" to define regulatory assets and regulatory liabilities, set out criteria for their recognition, specify how they should be measured and require disclosures about their financial effects. We will be reviewing this exposure draft and assessing its impact during our second quarter.

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.