Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Six months ended September 30, 2010 and 2009

(unaudited)

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Balance Sheets
(expressed in thousands)

	September 30, 2010 (unaudited)	March 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 62,493	$ 10,608
Restricted cash equivalents and short-term investments (note 2(b))	37,040	37,240
Other short-term investments	7,897	7,678
Accounts receivable	140,965	17,707
Prepaid expenses	7,883	6,813
Inventories	18,784	18,040
Regulatory assets (note 3)	-	4,775
	275,062	102,861
Property, plant and equipment (note 4)	1,563,614	1,644,069
Intangible assets (note 5)	32,754	26,406
Assets held for sale	200	200
Long-term land lease	33,208	33,437
	$ 1,904,838	$ 1,806,973
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 43,234	$ 38,884
Interest payable on long-term debt	18,373	18,319
Accrued employee costs	45,676	48,644
Deferred revenue	13,066	16,023
Regulatory liabilities (note 3)	1,899	-
Current portion of long-term debt (note 2)	14,625	9,000
Current portion of accrued employee future benefits	800	800
Current portion of obligations under capital lease	1,161	398
	138,834	132,068
Accrued employee future benefits	11,440	11,130
Regulatory liabilities (note 3)	1,437	4,325
Long-term debt (note 2)	1,338,536	1,348,183
Obligations under capital lease (note 7)	48,225	139
Other long-term liabilities	209	172
	1,538,681	1,496,017
Shareholders' equity:		
Share capital	75,478	75,478
Retained earnings	290,679	235,478
	366,157	310,956
Commitments (note 4)		
Subsequent events (note 11)		
	$ 1,904,838	$ 1,806,973

See accompanying notes to consolidated financial statements.

On behalf of the Board:

"Donald P. Hayes"
Director

"Brian G. Kenning"
Director

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Statements of Earnings, Comprehensive Income and Retained Earnings (unaudited)
(expressed in thousands)

	Three months ended September 30		Six months ended September 30	
	2010	2009	2010	2009
Revenue:				
Tariffs	$ 155,709	$ 161,336	$ 273,921	$ 269,379
Ferry service fees	46,408	45,614	84,939	83,848
Federal-Provincial Subsidy Agreement	6,731	6,731	13,462	13,462
Retail	28,052	28,875	48,142	48,764
Other income	9,115	9,267	15,790	14,625
	246,015	251,823	436,254	430,078
Expenses:				
Operations	114,908	110,076	218,524	210,535
Maintenance	12,623	14,130	36,475	37,832
Administration	7,317	7,016	14,834	14,462
Cost of retail goods sold	10,277	10,350	17,957	17,883
Amortization	28,441	28,748	57,129	55,703
	173,566	170,320	344,919	336,415
Earnings from operations	72,449	81,503	91,335	93,663
Gain on foreign exchange	31	34	106	37
Interest expense	(17,959)	(17,307)	(35,987)	(33,072)
Loss on disposal of capital assets	(239)	(25)	(253)	(25)
Net earnings	54,282	64,205	55,201	60,603
Other comprehensive income (note 1 (d))	-	-	-	-
Net earnings and comprehensive income	54,282	64,205	55,201	60,603
Retained earnings, beginning of period	236,397	234,492	235,478	238,094
Retained earnings, end of period	$ 290,679	$ 298,697	$ 290,679	$ 298,697

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Statements of Cash Flows (unaudited)
(expressed in thousands)

	Three months ended September 30		Six months ended September 30	
	2010	2009	2010	2009
Cash provided by (used in):				
Operations:				
Net earnings	$ 54,282	$ 64,205	$ 55,201	$ 60,603
Items not involving cash:				
Amortization	28,441	28,748	57,129	55,703
Other non-cash charges	1,401	467	1,790	(249)
Long-term regulatory costs deferred	(2,927)	3,529	(5,276)	6,254
Change in non-cash operating working capital (note 10)	2,957	(19,189)	(8,345)	(20,983)
	84,154	77,760	100,499	101,328
Financing:				
Repayment of long-term debt	(4,500)	(4,500)	(4,500)	(4,500)
Repayment of short-term loans	-	(19,990)	-	(17,956)
Repayment of capital lease obligations	(286)	(142)	(397)	(297)
	(4,786)	(24,632)	(4,897)	(22,753)
Investing:				
Proceeds from disposal of property, plant and equipment and intangible assets	52	-	78	4
Purchase of property, plant and equipment and intangible assets	(23,137)	(13,456)	(43,776)	(35,916)
Reduction of debt service reserves	200	-	200	-
Purchase of short-term investments	(57)	(25)	(219)	(25)
	(22,942)	(13,481)	(43,717)	(35,937)
Increase in cash and cash equivalents	56,426	39,647	51,885	42,638
Cash and cash equivalents, beginning of period	6,067	15,393	10,608	12,402
Cash and cash equivalents, end of period	$ 62,493	$ 55,040	$ 62,493	$ 55,040

Supplemental cash flow information (note 10)

See accompanying notes to consolidated financial statements.

British Columbia Ferry Services Inc. (the "Company") was incorporated under the *Company Act* (British Columbia) by way of conversion on April 2, 2003, and now validly exists under the *Business Corporations Act* (British Columbia). The Company's primary business activity is the provision of coastal ferry services in British Columbia.

The interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP"). The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the fiscal year ended March 31, 2010 except as disclosed below. The disclosures provided below are incremental to those included with the annual consolidated financial statements. The interim consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto for the year ended March 31, 2010.

The Company's business is seasonal in nature, with the highest activity in the summer (second quarter) and the lowest activity in the winter (fourth quarter), due to the high number of leisure travellers and their preference to travel during the summer months. The Company also takes advantage of the low activity during the winter months to perform a significant portion of the required annual maintenance on vessels and terminals.

1. Significant accounting policies:

(a) Basis of presentation:

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles.

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Pacific Marine Leasing Inc. ("PML"), BCF Captive Insurance Company Ltd. ("BCF Captive"), Pacific Marine Ventures Inc. ("PMV"), and BCF Global Services Inc. ("Global"). All inter-company balances and transactions have been eliminated on consolidation.

(b) Inventories:

Inventories, which consist of materials and supplies, catering stores and fuel, are valued at the lower of weighted-average cost and net realizable value.

(c) Embedded derivatives:

As at September 30, 2010, the Company has no embedded derivatives that meet the requirements of Section 3855 which would require that they be separated from host contracts and valued separately at fair value.

(d) Comprehensive income:

The Company has not recognized any adjustments through other comprehensive income for the six months ended September 30, 2010.

1. Significant accounting policies (continued):

(e) Future accounting changes:

International Financial Reporting Standards ("IFRS"):

The Company's changeover date for the conversion to IFRS was originally April 1, 2011. The Canadian Accounting Standards Board ("AcSB") has amended Part 1 of the CICA Handbook – Accounting to require:

- Qualifying entities with rate-regulated activities to adopt IFRSs for the first time no later than annual periods beginning on or after January 2012; and
- Entities electing to defer the first-time adoption of IFRSs to disclose the fact.

The Canadian Securities Administrators' regulations have also been amended to incorporate the AcSB's one-year deferral option. The Company has elected this option which defers the changeover date for conversion to IFRS to April 1, 2012.

Transition to IFRS will require the restatement for comparative purposes of amounts reported by the Company for the year prior to the changeover date. While the Company is continuing to assess the adoption of IFRS, the financial reporting impact of the transition cannot be reasonably estimated at this time.

The areas that have the highest potential to significantly impact the Company are rate-regulated operations; property plant and equipment; intangible assets and asset impairment; and initial adoption of IFRS under the provisions of IFRS 1 "*First-Time Adoption of IFRS*". The Company is monitoring any International Accounting Standards Board ("IASB") initiatives with the potential to impact rate-regulated accounting under IFRS.

The IASB published an amendment to IFRS 1 on May 6, 2010 which provides an exemption for property, plant and equipment and intangible assets used in operations subject to rate regulation. A first-time adopter may elect to use, on an item by item basis, the previous GAAP carrying amount of such items as deemed cost at the date of transition to IFRS. The Company has assessed the impact of the options available as a result of this IFRS 1 amendment and has decided to adopt the exemption for all its intangible assets and the majority of its items of property, plant and equipment.

In September 2010, the IASB staff released Agenda Paper 12 on rate-regulated activities. In the staff's opinion, while the impact of regulators may have an economic impact on entities subject to rate-regulation:

- Regulatory assets do not meet the definition of a financial asset nor the definition of an intangible asset as specified in IAS 38; and
- Regulatory liabilities do not meet the definition of a financial liability nor the definition of a provision as specified in IAS 37.

The IASB staff recommended closing the current project on rate-regulated activities.

1. Significant accounting policies (continued):

(e) Future accounting changes (continued):

The IASB is currently re-assessing the continuation of this project. They have stated that potential future steps include, but are not limited to:

- A disclosure only standard;
- An interim standard to grandfather previous GAAP accounting practices with some limited improvements;
- A medium term project focused on the effects of rate-regulation;
- A comprehensive project on intangible assets.

The continued uncertainty regarding IFRS treatment of regulatory assets and liabilities has resulted in an inability to reasonably estimate and conclude the impact of IFRS on the Company's future financial position and results of operations with respect to differences, if any, in accounting for rate-regulated activities.

(columnar dollars expressed in thousands)

2. Loans:

Long-term debt:		September 30 2010		March 31 2010
5.74% Senior Secured Bonds, Series 04-1, due May 2014 (effective interest rate 5.92%)	$	250,000	$	250,000
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (effective interest rate 6.41%)		250,000		250,000
5.02% Senior Secured Bonds, Series 07-1, due March 2037 (effective interest rate 5.06%)		250,000		250,000
5.58% Senior Secured Bonds, Series 08-1, due January 2038 (effective interest rate 5.62%)		200,000		200,000
6.21% Senior Secured Bonds, Series 08-2, due December 2013 (effective interest rate 6.33%)		140,000		140,000
12 Year Loan, maturing March 2020				
Tranche A (effective interest rate 5.17%)		71,250		75,000
Tranche B (floating interest rate of CAD LIBOR plus 30 bps)		18,750		15,000
12 Year Loan, maturing June 2020				
Tranche A (effective interest rate 5.18%)		73,125		76,875
Tranche B (floating interest rate of CAD LIBOR plus 30 bps)		16,875		13,125
2.95% Loan, maturing January 2021 (effective interest rate 3.08%)		94,500		99,000
		1,364,500		1,369,000
Less: Deferred financing costs and unamortized bond discounts		(11,339)		(11,817)
Current portion		(14,625)		(9,000)
	$	1,338,536	$	1,348,183

(a) Credit facility:
There were no draws on the $155 million credit facility as at September 30, 2010 or as at March 31, 2010. Interest expensed during the quarter ended September 30, 2010: $nil (September 30, 2009: $nil). Interest expensed during the six months ended September 30, 2010: $nil (September 30, 2009: $0.1 million). Letters of credit outstanding against this facility at September 30, 2010 totalled $0.2 million (March 31, 2010: $0.3 million).

(columnar dollars expressed in thousands)

2. Loans (continued):

(b) Debt service reserves:

The Company is required to maintain debt service reserves for the Series 04-1, 04-4, 07-1, 08-1 and 08-2 bonds equal to not less than six months forecasted debt service, to be increased under certain conditions. Further debt service reserves are required to be maintained for the 4.98% and 2.95% loans equal to the first six months of debt service. As permitted under the terms of the 2.95% loan, during the quarter ended September 30, 2010, the Company withdrew $0.2 million from the debt service reserves representing six months interest on the principal paid to date on this loan.

As at September 30, 2010, debt service reserves of $37.0 million (March 31, 2010: $37.2 million) were held in short-term investments and have been classified as restricted cash equivalents and short-term investments on the consolidated balance sheets.

3. Financial statement effect of rate regulation:

Accounting for the impacts of rate regulation has resulted in recording the following regulatory assets and liabilities in the consolidated balance sheets:

Regulatory accounts	September 30 2010	March 31 2010
First performance term accounts:		
Balance at March 31, 2008:		
Deferred fuel costs	$ 18,501	$ 18,501
Performance term submission costs	600	600
	19,101	19,101
Accumulated amortization (a)	(11,938)	(9,550)
Total of first performance term accounts:	**7,163**	**9,551**
Second performance term accounts:		
Deferred fuel costs		
Balance – beginning of period	(9,185)	1,213
Fuel costs deferred (including realized hedge gains and losses)	(875)	(16,082)
Rebates granted	7,123	6,298
Fuel price risk payments to the Province	-	1,273
Other payments from the Province	(778)	(1,620)
Interest payable	(232)	(267)
Balance – end of period	(3,947)	(9,185)
Tariffs in excess of price cap (b)	(6,674)	-
Performance term submission costs	122	84
Total of second performance term accounts	**(10,499)**	**(9,101)**
Total regulatory (liabilities) assets	**(3,336)**	**450**
Current regulatory (liabilities) assets	(1,899)	4,775
Total long-term regulatory (liabilities) assets	**$ (1,437)**	**$ (4,325)**

(columnar dollars expressed in thousands)

3. Financial statement effect of rate regulation (continued):

(a) Amortization expense:
During the quarter ended September 30, 2010 the Company recognized $1.2 million in amortization expense for first performance term accounts (September 30, 2009: $1.2 million). Amortization expense for first performance term accounts for the six months ended September 30, 2010 totalled $2.4 million (September 30, 2009: $2.4 million).

(b) Tariffs in excess of price cap:
The Coastal Ferry Act (the "Act") contains provisions which ensure that if tariffs charged by the Company exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. At September 30, 2010 tariffs charged to customers on the Major Route Group exceeded the price cap by $6.7 million (March 31, 2010: $nil).

The Company is a rate-regulated entity and records regulatory assets and liabilities. As a result, net earnings for the six months ended September 30, 2010 are $3.7 million lower (September 30, 2009: $8.5 million lower) than they would have otherwise been, as detailed below:

	Three months ended September 30,		Six months ended September 30,	
Impact of regulatory accounts on net earnings	2010	2009	2010	2009
First performance term accounts:				
Deferred fuel costs	$ (1,157)	$ (1,157)	$ (2,313)	$ (2,313)
Performance term submission costs	(37)	(37)	(75)	(75)
Second performance term accounts:				
Deferred fuel costs	2,882	(6,262)	5,238	(8,987)
Performance term submission costs	45	-	38	-
Unrealized fuel hedge gains and losses	-	6,767	-	-
Tariffs in excess of price cap	(6,674)	9,253	(6,674)	2,755
Total (decrease) increase in net earnings resulting from regulatory accounts	$ (4,941)	$ 8,564	$ (3,786)	$ (8,620)
Unamortized training costs (note 5)	109	176	70	99
Total (decrease) increase in net earnings	$ (4,832)	$ 8,740	$ (3,716)	$ (8,521)

(columnar dollars expressed in thousands)

4. Property, plant and equipment:

September 30, 2010	Cost	Accumulated amortization	Net book value
Property, plant and equipment			
Vessels	$ 1,662,256	$ 586,946	$ 1,075,310
Berths, buildings and equipment	92,177	54,284	37,893
Berths, buildings and equipment under capital lease	653,636	260,218	393,418
Land	6,583	-	6,583
Construction-in-progress	50,410	-	50,410
	$ 2,465,062	$ 901,448	$ 1,563,614

March 31, 2010	Cost	Accumulated amortization	Net book value
Property, plant and equipment			
Vessels	$ 1,772,870	$ 554,304	$ 1,218,566
Berths, buildings and equipment	91,957	51,722	40,235
Berths, buildings and equipment under capital lease	598,154	256,822	341,332
Land	1,406	-	1,406
Construction-in-progress	42,530	-	42,530
	$ 2,506,917	$ 862,848	$ 1,644,069

At the end of September 2010, the Company received confirmation that a request for $119.4 million of duty remission, including related GST, for the purchase of four vessels built in Germany was granted by the Government of Canada. This amount has been recorded as a reduction of the cost of these assets.

Capitalized financing costs during construction for property, plant and equipment and intangible assets for the six months ended September 30, 2010 totalled $1.2 million (September 30, 2009: $2.1 million).

Amortization expense for assets under capital lease for the quarter ended September 30, 2010 totalled $4.8 million (September 30, 2009: $4.3 million) and the six months ended September 30, 2010 totalled $9.4 million (September 30, 2009: $8.8 million).

In addition to the construction-in-progress referenced above, the contractual commitments at September 30, 2010 for capital assets to be constructed, totalled $27.6 million (March 31, 2010: $25.6 million).

Rental income earned from buildings held for leasing purposes for the quarter ended September 30, 2010, totalled $0.2 million (September 30, 2009: $0.3 million) and six months ended September 30, 2010, totalled $0.4 million (September 30, 2009: $0.5 million). These buildings have a cost and accumulated amortization of $13.5 million and $1.5 million respectively, as at September 30, 2010.

(columnar dollars expressed in thousands)

5. Intangible assets:

September 30, 2010		Cost		Accumulated amortization		Net book value
Intangible assets subject to amortization						
Acquired software and licenses	$	33,989	$	18,390	$	15,599
Internally developed software and website		23,062		15,659		7,403
Work-in-progress		9,752		-		9,752
	$	66,803	$	34,049	$	32,754

March 31, 2010		Cost		Accumulated amortization		Net book value
Intangible assets subject to amortization						
Acquired software and licenses	$	28,812	$	16,810	$	12,002
Internally developed software and website		22,531		14,831		7,700
Work-in-progress		6,704		-		6,704
	$	58,047	$	31,641	$	26,406

There was no impairment of intangible assets during the six months ended September 30, 2010 or the year ended March 31, 2010.

Included in the cost of intangible assets as at September 30, 2010 is $0.8 million of unamortized training costs (March 31, 2010: $0.7 million). If the Company was not a rate-regulated entity, these training costs would be expensed in the period incurred.

During the six months ended September 30, 2010 intangible assets totaling $7.5 million (September 30, 2009: $4.7 million) were acquired and $1.2 million (September 30, 2009: $2.2 million) were internally developed. Amortization expense for the six months ended September 30, 2010 totalled $2.4 million (September 30, 2009: $2.9 million).

6. Accrued employee future benefits:

During the quarter ended September 30, 2010 the Company recognized total defined benefit costs of $0.4 million (September 30, 2009: $0.3 million) and during the six months ended September 30, 2010 the Company recognized total defined benefit costs of $0.7 million (September 30, 2009: $0.6 million).

(columnar dollars expressed in thousands)

7. Obligations under capital lease:

During the quarter ended September 30, 2010, the agreements which constitute a capital lease for space in a new downtown Victoria, BC head office building took effect following the completion of construction of the new building.

The initial term of the new building lease is for fifteen years, with four renewal options of five years each. The Company's wholly-owned subsidiary, 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 fifteen years, secured by a second mortgage of the property. The loan agreement provides for interest equal to one-half of the net cash flow from the property, subject to minimum and maximum percentage rates of interest. Over the term of the loan, interest is expected to approximate the market rate when the loan was made. Incidental to the loan, the Company was granted an option to purchase up to fifty percent of the owner's equity interest in the new building at a maximum price of $25 million. The purchase option expires at the end of the loan term.

Future minimum lease payments and obligation under the head office and other capital leases are as follows:

	Head office lease				Other leases		
Year ended March 31	Minimum lease payments	Executory costs	Imputed interest (5.04%)	Obligation	Minimum lease payments	Executory costs and imputed interest	Total obligation
2011	$ 2,323	$ 680	$ 1,203	$ 440	$ 205	$ 23	$ 622
2012	4,648	1,361	2,373	914	172	45	1,041
2013	4,648	1,361	2,327	960	77	65	972
2014	4,648	1,361	2,279	1,008	18	18	1,008
2015	4,648	1,361	2,228	1,059	-	-	1,059
Thereafter	55,127	16,140	18,550	20,437	-	-	20,437
Purchase option	24,247	-	-	24,247	-	-	24,247
Total	$ 100,289	$ 22,264	$ 28,960	$ 49,065	$ 472	$ 151	$ 49,386
Current portion				(892)			(1,161)
				$ 48,173			$ 48,225

(columnar dollars expressed in thousands)

8. Interest rate support:

During the quarter ended September 30, 2010, the Government of Canada agreed to provide $1.0 million in the form of interest rate support to the Company for major refurbishment of one vessel.

During the quarter ended September 30, 2010 interest rate support received and recorded as a reduction of interest expense totalled $0.1 million (September 30, 2009: $1.3 million) and $0.1 million (September 30, 2009: $nil) was recorded as a reduction of capitalized interest. During the six months ended September 30, 2010 interest rate support received and recorded as a reduction of interest expense totalled $0.2 million (September 30, 2009: $2.6 million) and a further $0.1 million (September 30, 2009: $0.6 million) was recorded as a reduction of capitalized interest.

The Company has no requirement to repay these funds, other than as a result of an event of default under the agreement with the Government of Canada.

9. Related party transactions:

In accordance with the Act, the Company is responsible for paying any expenses that are incurred by its parent, B.C. Ferry Authority ("the Authority") without charge. During the six months ended September 30, 2010, the Company paid $4,028 (September 30, 2009: $1,130) of such expenses.

The Province owns the Company's 75,477 non-voting preferred shares but has no voting interest in either the Company or the Authority.

10. Supplemental cash flow information:

	Three months ended September 30		Six months ended September 30	
(a) Changes in non-cash operating working capital:	2010	2009	2010	2009
Change in working capital				
Accounts receivable	$ (123,274)	$ (4,138)	$ (123,258)	$ (6,309)
Prepaid expenses	4,913	3,812	(1,070)	2,384
Inventories	(599)	(838)	(744)	(2,439)
Accounts payable and accrued liabilities	2,150	(5,572)	4,350	(14,211)
Interest payable on long-term debt	3,130	3,053	54	32
Accrued employee costs	(1,875)	(1,861)	(2,968)	(3,263)
Deferred revenue	(5,053)	(5,094)	(2,957)	(2,103)
Regulatory liabilities	6,674	(9,253)	6,674	(2,755)
Change in non-cash working capital	(113,934)	(19,891)	(119,919)	(28,664)
Change attributable to capital asset acquisitions	116,891	702	111,574	7,681
Change in non-cash operating working capital	$ 2,957	$ (19,189)	$ (8,345)	$ (20,983)
(b) Cash paid during the period for interest	$ 15,249	$ 15,613	$ 36,617	$ 37,230
(c) Non-cash transactions:				
Capital assets acquired under capital lease	$ 49,247	$ -	$ 49,247	$ -

11. Subsequent events:

(a) Head office building loan receivable:

On November 1, 2010, the Company's wholly owned subsidiary, Pacific Marine Leasing Inc., advanced $24.2 million to the developer of the new head office building in downtown Victoria, BC for a term of 15 years secured by a second mortgage on the property.

(b) Sale of former head office building:

On November 1, 2010, the Company sold its former head office building located at 1112 Fort Street, Victoria for $11.0 million, resulting in a gain on sale of $9.3 million.