Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Nine months ended December 31, 2010 and 2009

(unaudited)

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Balance Sheets
(expressed in thousands)

	December 31, 2010 (unaudited)	March 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 95,666	$ 10,608
Restricted short-term investments (note 2(b))	37,040	37,240
Other short-term investments	59,279	7,678
Accounts receivable	14,978	17,707
Prepaid expenses	6,050	6,813
Inventories	17,830	18,040
Regulatory assets (note 3)	-	4,775
	230,843	102,861
Property, plant and equipment (note 4)	1,572,445	1,644,069
Intangible assets (note 5)	32,995	26,406
Assets held for sale	200	200
Long-term loan receivable (note 7)	24,247	
Long-term land lease	33,094	33,437
	$ 1,893,824	$ 1,806,973
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 47,724	$ 38,884
Interest payable on long-term debt	15,481	18,319
Accrued employee costs	47,733	48,644
Deferred revenue	12,605	16,023
Regulatory liabilities (note 3)	697	-
Current portion of long-term debt (note 2)	18,375	9,000
Current portion of accrued employee future benefits	800	800
Current portion of obligations under capital lease	1,101	398
	144,516	132,068
Accrued employee future benefits (note 6)	11,381	11,130
Regulatory liabilities (note 3)	1,003	4,325
Long-term debt (note 2)	1,335,027	1,348,183
Obligations under capital lease (note 7)	47,968	139
Other long-term liabilities	209	172
	1,540,104	1,496,017
Shareholders' equity:		
Share capital	75,478	75,478
Retained earnings	278,242	235,478
	353,720	310,956
Commitments (note 4)		
	$ 1,893,824	$ 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 December 31		Nine months ended December 31	
	2010	2009	2010	2009
Revenue:				
Tariffs	$ 99,086	$ 96,792	$ 373,007	$ 366,171
Ferry service fees	33,954	33,614	118,892	117,462
Federal-Provincial Subsidy Agreement	6,731	6,731	20,193	20,193
Retail	17,208	17,067	65,351	65,831
Other income	5,344	5,684	21,134	20,309
	162,323	159,888	598,577	589,966
Expenses:				
Operations	96,676	95,278	315,201	305,813
Maintenance	26,815	22,781	63,289	60,613
Administration	7,531	7,812	22,365	22,274
Cost of retail goods sold	6,525	6,389	24,482	24,272
Amortization	28,059	29,508	85,188	85,211
	165,606	161,768	510,525	498,183
(Loss) earnings from operations	(3,283)	(1,880)	88,052	91,783
Gain on foreign exchange	67	37	173	74
Interest expense	(18,367)	(17,246)	(54,354)	(50,318)
Gain (loss) on disposal of capital assets	9,146	(1,310)	8,893	(1,335)
Net (loss) earnings	(12,437)	(20,399)	42,764	40,204
Other comprehensive income (note 1(d))	-	-	-	-
Net (loss) earnings and comprehensive income	(12,437)	(20,399)	42,764	40,204
Retained earnings, beginning of period	290,679	298,697	235,478	238,094
Retained earnings, end of period	$ 278,242	$ 278,298	$ 278,242	$ 278,298

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

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

	Three months ended December 31		Nine months ended December 31	
	2010	2009	2010	2009
Cash provided by (used in):				
Operations:				
Net (loss) earnings	$ (12,437)	$ (20,399)	$ 42,764	$ 40,204
Items not involving cash:				
Amortization	28,059	29,508	85,188	85,211
Other non-cash charges	(8,874)	1,604	(7,084)	1,355
Long-term regulatory costs deferred	(1,628)	2,098	(6,904)	8,352
Change in non-cash operating working capital (note 10)	7,931	6,591	(414)	(14,392)
	13,051	19,402	113,550	120,730
Financing:				
Repayment of long-term debt	-	-	(4,500)	(4,500)
Repayment of short-term loans	-	-	-	(17,956)
Repayment of capital lease obligations	(318)	(125)	(715)	(422)
	(318)	(125)	(5,215)	(22,878)
Investing:				
Proceeds from disposal of property, plant and equipment and intangible assets	11,040	1,843	11,118	1,847
Purchase of property, plant and equipment and intangible assets	(34,420)	(18,454)	(78,196)	(54,370)
Recovery of import duties and related taxes (note 4)	119,449	-	119,449	-
Reduction of debt service reserves	-	-	200	-
Advancement of long-term loan	(24,247)	-	(24,247)	-
Purchase of short-term investments	(51,382)	(7,500)	(51,601)	(7,525)
	20,440	(24,111)	(23,277)	(60,048)
Increase (decrease) in cash and cash equivalents	33,173	(4,834)	85,058	37,804
Cash and cash equivalents, beginning of period	62,493	55,040	10,608	12,402
Cash and cash equivalents, end of period	$ 95,666	$ 50,206	$ 95,666	$ 50,206

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 December 31, 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 nine months ended December 31, 2010.

(e) Financial instruments - loans and receivables:
The long-term loan receivable has been classified under loans and receivables which are initially measured at fair value and are subsequently measured at amortized cost.

1. Significant accounting policies (continued):

(f) 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. The Company has chosen the revaluation method for its land assets, which will result in a $12.2 million increase in the value of these assets at its transition date of April 1, 2011.

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.

1. Significant accounting policies (continued):

(f) Future accounting changes (continued):

The IASB has closed the current project on rate-regulated activities and plans to consult constituents in 2011 on whether issues relating to rate-regulated activities should be considered in a new project in its post-2011 agenda.

The Company expects that issues regarding rate-regulated activities will remain unresolved for some time and that regulatory assets or liabilities will not be reported on the IFRS Statement of Financial Position. Accordingly, regulatory assets or liabilities will be derecognized on the Company's transition date of April 1, 2011. As future balances of its regulatory accounts are unknown, the Company cannot reasonably estimate and conclude the impact on future financial position and results of operations with respect to accounting for rate-regulated activities.

(g) Comparative figures:

Certain comparative figures have been reclassified to conform to the presentation adopted for the current period.

(columnar dollars expressed in thousands)

2. Loans:

Long-term debt:	December 31 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%)	69,375	75,000
Tranche B (floating interest rate of CAD LIBOR plus 30 bps)	20,625	15,000
12 Year Loan, maturing June 2020		
Tranche A (effective interest rate 5.18%)	71,250	76,875
Tranche B (floating interest rate of CAD LIBOR plus 30 bps)	18,750	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	(11,098)	(11,817)
Current portion	(18,375)	(9,000)
	$ 1,335,027	$ 1,348,183

2. Loans (continued):

(a) Credit facility:

There were no draws on the $155 million credit facility as at December 31, 2010 or as at March 31, 2010. There was no interest on this facility expensed during the quarters ended December 31, 2010 or 2009 or during the nine months ended December 31, 2010 (December 31, 2009: $0.1 million). Letters of credit outstanding against this facility at December 31, 2010 totalled $0.2 million (March 31, 2010: $0.3 million).

(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 12 Year loans and the 2.95% loan 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 December 31, 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 short-term investments on the consolidated balance sheets.

(columnar dollars expressed in thousands)

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	December 31 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)	(13,131)	(9,550)
Total of first performance term accounts:	**5,970**	**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)	(304)	(16,082)
Rebates granted	8,592	6,298
Fuel price risk payments to the Province	-	1,273
Other payments from the Province	(1,214)	(1,620)
Interest payable	(268)	(267)
Balance – end of period	(2,379)	(9,185)
Tariffs in excess of price cap (b)	(5,472)	-
Performance term submission costs	181	84
Total of second performance term accounts	**(7,670)**	**(9,101)**
Total regulatory (liabilities) assets	**(1,700)**	**450**
Current regulatory (liabilities) assets	(697)	4,775
Total long-term regulatory liabilities	**$ (1,003)**	**$ (4,325)**

(a) Amortization expense:

During the quarter ended December 31, 2010 the Company recognized $1.2 million in amortization expense for first performance term accounts (December 31, 2009: $1.2 million). Amortization expense for first performance term accounts for the nine months ended December 31, 2010 totalled $3.6 million (December 31, 2009: $3.6 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 December 31, 2010 tariffs charged to customers on the Major Route Group exceeded the price cap by $5.5 million (March 31, 2010: $nil).

(columnar dollars expressed in thousands)

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

The Company is a rate-regulated entity and records regulatory assets and liabilities. As a result, net earnings for the nine months ended December 31, 2010 are $2.1 million lower (December 31, 2009: $11.5 million lower) than they would have otherwise been, as detailed below:

	Three months ended December 31,		Nine months ended December 31,	
Impact of regulatory accounts on net earnings	2010	2009	2010	2009
First performance term accounts:				
Deferred fuel costs	$ (1,156)	$ (1,156)	$ (3,469)	$ (3,469)
Performance term submission costs	(37)	(37)	(112)	(112)
Second performance term accounts:				
Deferred fuel costs	1,568	(1,795)	6,806	(10,782)
Performance term submission costs	59	-	97	-
Tariffs in excess of price cap	1,202	103	(5,472)	2,858
Total increase (decrease) in net earnings resulting from regulatory accounts	$ 1,636	$ (2,885)	$ (2,150)	$ (11,505)
Unamortized training costs (note 5)	24	(66)	94	33
Total increase (decrease) in net earnings	$ 1,660	$ (2,951)	$ (2,056)	$ (11,472)

(columnar dollars expressed in thousands)

4. Property, plant and equipment:

December 31, 2010	Cost	Accumulated amortization	Net book value
Property, plant and equipment			
Vessels	$ 1,672,738	$ 605,134	$ 1,067,604
Berths, buildings and equipment	89,788	48,234	41,554
Berths, buildings and equipment under capital lease	655,366	265,155	390,211
Land	914	-	914
Land under capital lease	5,177	-	5,177
Construction-in-progress	66,985	-	66,985
	$ 2,490,968	$ 918,523	$ 1,572,445

March 31, 2010	Cost	Accumulated amortization	Net book value
Property, plant and equipment			
Vessels	$ 1,773,172	$ 554,313	$ 1,218,859
Berths, buildings and equipment	86,483	51,461	35,022
Berths, buildings and equipment under capital lease	603,326	257,074	346,252
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 was recorded as a reduction of the cost of these assets during the quarter ended September 30, 2010. The funds were received during the current quarter ended December 31, 2010.

During the quarter ended December 31, 2010, the Company disposed of 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.

Capitalized financing costs during construction for property, plant and equipment for the nine months ended December 31, 2010 totalled $1.7 million (December 31, 2009: $2.2 million).

Amortization expense for assets under capital lease for the quarter ended December 31, 2010 totalled $5.1 million (December 31, 2009: $4.6 million) and the nine months ended December 31, 2010 totalled $14.5 million (December 31, 2009: $13.4 million).

In addition to the construction-in-progress referenced above, the contractual commitments at December 31, 2010 for capital assets to be constructed, totalled $25.8 million (March 31, 2010: $25.6 million).

(columnar dollars expressed in thousands)

4. Property, plant and equipment (continued):

Rental income earned from buildings held for leasing purposes for the quarter ended December 31, 2010, totalled $0.2 million (December 31, 2009: $0.2 million) and nine months ended December 31, 2010, totalled $0.6 million (December 31, 2009: $0.7 million). These buildings have a cost and accumulated amortization of $13.5 million and $1.6 million respectively, as at December 31, 2010.

5. Intangible assets:

December 31, 2010		Cost		Accumulated amortization		Net book value
Intangible assets subject to amortization						
Acquired software and licenses	$	35,015	$	19,330	$	15,685
Internally developed software and website		22,496		15,085		7,411
Work-in-progress		9,899		-		9,899
	$	67,410	$	34,415	$	32,995

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 nine months ended December 31, 2010 or the year ended March 31, 2010.

Capitalized financing costs during construction for intangible assets for the nine months ended December 31, 2010 totalled $0.3 million (December 31, 2009: $0.3 million).

Included in the cost of intangible assets as at December 31, 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 nine months ended December 31, 2010 intangible assets totaling $9.1 million (December 31, 2009: $6.1 million) were acquired and $1.3 million (December 31, 2009: $2.9 million) were internally developed. Amortization expense for the three months ended December 31, 2010 totalled $1.4 million (December 31, 2009: $1.8 million). Amortization expense for the nine months ended December 31, 2010 totalled $3.8 million (December 31, 2009: $4.7 million).

6. Accrued employee future benefits:

During the quarter ended December 31, 2010 the Company recognized total defined benefit costs of $0.3 million (December 31, 2009: $0.3 million) and during the nine months ended December 31, 2010 the Company recognized total defined benefit costs of $1.0 million (December 31, 2009: $0.9 million).

(columnar dollars expressed in thousands)

7. Head office property and other capital leases:

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.

Loan and purchase option:

During the quarter ended December 31, 2010, the Company's wholly-owned subsidiary, Pacific Marine Leasing Inc., advanced $24.2 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 price of $24.2 million. The purchase option expires at the end of the loan term.

Future minimum lease payments and obligation:

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	$ 1,161	$ 340	$ 600	$ 221	$ 95	$ 11	$ 305
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	$ 99,127	$ 21,924	$ 28,357	$ 48,846	$ 362	$ 139	$ 49,069
Current portion				(902)			(1,101)
				$ 47,944			$ 47,968

(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 December 31, 2010 interest rate support received and recorded as a reduction of interest expense totalled $0.1 million (December 31, 2009: $1.3 million). During the nine months ended December 31, 2010 interest rate support received and recorded as a reduction of interest expense totalled $0.3 million (December 31, 2009: $3.9 million) and a further $0.1 million (December 31, 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 nine months ended December 31, 2010, the Company paid $17,161 (December 31, 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:

(a) Changes in non-cash operating working capital:	Three months ended December 31 2010	Three months ended December 31 2009	Nine months ended December 31 2010	Nine months ended December 31 2009
Change in working capital				
Accounts receivable	$ 125,987	$ 3,395	$ 2,729	$ (2,914)
Prepaid expenses	1,833	139	763	2,523
Inventories	954	1,781	210	(658)
Accounts payable and accrued liabilities	4,482	6,151	8,832	(8,060)
Interest payable on long-term debt	(2,892)	(2,826)	(2,838)	(2,794)
Accrued employee costs	2,057	1,930	(911)	(1,333)
Deferred revenue	(461)	98	(3,418)	(2,005)
Regulatory liabilities	(1,202)	(103)	5,472	(2,858)
Change in non-cash working capital	130,758	10,565	10,839	(18,099)
Change attributable to capital asset acquisitions	(122,827)	(3,974)	(11,253)	3,707
Change in non-cash operating working capital	$ 7,931	$ 6,591	$ (414)	$ (14,392)
(b) Cash paid during the period for interest	$ 21,944	$ 21,414	$ 58,561	$ 58,644
(c) Non-cash transactions:				
Capital assets acquired under capital lease	$ -	$ -	$ 49,247	$ -