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

For the fiscal year ended March 31, 2011
Dated May 19, 2011

BCFerries

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Management's Discussion & Analysis of Financial Condition and Results of Operations For the fiscal year ended March 31, 2011 Dated May 19, 2011(except where otherwise indicated)

The following is our discussion and analysis of the financial condition and results of operations for British Columbia Ferry Services Inc. This discussion and analysis has been prepared based on information available at May 19, 2011, except where otherwise indicated. This should be read in conjunction with our audited consolidated financial statements and related notes for the years ended March 31, 2011 (fiscal 2011) and March 31, 2010 (fiscal 2010). 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. On June 15, 2010, we celebrated 50 years of service. Our service started with two vessels operating between Swartz Bay and Tsawwassen. Over the years we have grown to be one of the largest and most complex ferry systems in the world, providing frequent year-round transportation service on 25 routes, supported by 35 vessels and 47 terminals.

Our service is an integral part of British Columbia's coastal transportation system and has been designated by the Province of British Columbia (the Province) as an essential service for purposes of the provincial Labour Relations Code. This designation means our services are considered necessary for the protection of the health, safety and welfare of the residents of British Columbia.

We provide a wide and varied range of ferry services for our customers. In fiscal 2011, we provided more than 185,000 sailings, carrying 20.7 million passengers and 8.1 million vehicles.

We experienced a 1.6% decline in vehicle traffic and a 1.4% decline in passenger traffic in fiscal 2011 compared to the prior year. For discussion of our traffic levels see "Outlook – Traffic Levels" below.

Significant events during or subsequent to fiscal 2011:

Regulation

- On June 24, 2010, the *Miscellaneous Statutes Amendment Act (No.3), 2010* (Bill 20), was enacted except for certain sections which were brought into force effective October 1, 2010. Bill 20 amended several statutes, including the *Coastal Ferry Act* (the Act), changing the governance and regulatory framework within which we operate. (See "Corporate Structure – Amendments to the *Coastal Ferry Act*" below for more detail).

- On August 31, 2010, we filed a submission pursuant to Section 45.1(1) of the Act and the British Columbia Ferries Commissioner's (the Commissioner) Memorandum #37, dated July 19, 2010 in which he found our drop trailer business to be a competitive service and on December 8, 2010, responded to stakeholder comments regarding our submission.

  The Commissioner issued his ruling on February 7, 2011, whereby he found our drop trailer business to have an unfair competitive advantage due to our exemption from income taxes and the regulatory framework under which we operate. Subsequently, he issued Order 11-01, introducing a minimum average allowable tariff for dropped trailers which we implemented April 1, 2011. The major provider of drop trailer services, Seaspan Ferries Corporation, filed a Notice of Application for Leave to Appeal the Commissioner's determination on March 4, 2011.

- On February 1, 2011, the Commissioner released his conditional approval of our customer complaints process, fulfilling a new requirement of the Act, as amended by Bill 20. (See "Corporate Structure – Amendments to the *Coastal Ferry Act*" below for more detail).

- On March 31, 2011, the Commissioner released his order establishing the preliminary price caps for performance term three covering the four years commencing April 1, 2012. (See "Corporate Structure – Economic Regulatory Environment" below for more detail).

- On May 19, 2011, the Province and the Commissioner announced a review of the Act to identify improvements which would better allow the Commissioner to balance the interests of ferry users with the financial sustainability of our Company. On June 2, 2011, the *Coastal Ferry Amendment Act*, *2011* (Bill 14) was enacted. This legislation provides the Commissioner with the mandate to conduct the review of the Act and the timeline established for this purpose. (See "Corporate Structure – Economic Regulatory Environment" below for more detail).

Our Assets (See "Investing in our Capital Assets" below for more detail).

- On May 18, 2010, the 28-year-old *Quinsam* returned to service following an extensive $19 million upgrade to prepare it for another 17 years of service.

- On November 1, 2010, our former corporate office building was sold for $11.0 million, resulting in a gain on sale of $9.3 million.

- On December 14, 2010, the *Queen of Cumberland* returned to service after completion of a $6 million combined refit and asset improvement project. The vessel underwent an extensive mechanical refit and dry-docking, a passenger accommodation upgrade, installation of new car deck deluge piping, and upgrades to the sewage system.

- On December 17, 2010, the *Queen of Nanaimo* returned to service after completion of a $4 million asset betterment project that included steel renewal throughout the vessel and a new exhaust system.

- On March 24, 2011, the *Quadra Queen II* returned to service after completion of a $15 million life extension project to prepare it for another 20 years of service.

- On March 31, 2011, the $32 million multi-year project for replacement and refurbishment of berth 4 at Tsawwassen terminal was completed. The project replaced all 13 dolphins and the port wingwall. The lower ramp was replaced with a new multi-apron ramp with two-lane commercial vehicle capacity and the foundations and ramp supports were upgraded and a new hydraulic lift system installed.

- On April 19, 2011, the sale of the *Queen of Prince Rupert*, decommissioned in fiscal 2010, was completed. On May 1, 2011, the 55-year-old *Mill Bay* completed operations and was sold on the following day. There was no significant gain or loss arising from the disposition of these vessels.

Other Events

- On April 1, 2010, a fuel rebate of 2% of tariffs on average was implemented on our Major Routes at which time rebates of up to 5% of tariffs on average were in place on many of our other routes. On August 17, 2010, the fuel rebates on many of our other routes were reduced to 2% and on December 1, 2010, fuel rebates were removed completely due to the increasing cost of fuel. No rebates were in place on our Northern Routes during fiscal 2011. Due to the rising cost of fuel, on May 16, 2011, we announced the implementation of fuel surcharges effective June 1, 2011. These surcharges will be 2.5% on our Major Routes and 5% on many of our other routes.

- On May 11, 2010, our new Vacations Centre in downtown Vancouver officially opened to the public. The purpose of this facility is to assist us in attracting new customers to our system and growing revenues. With the aid of an 11-metre long interactive media wall display, customers are able to view route maps, vessel schematics, and destination images to help them choose from a variety of travel package options.

- On May 26, 2010, we released the results of our 2009 Customer Satisfaction Tracking surveys, which indicated that 91% of customers surveyed reported being satisfied with their overall trip experience, up from 86% in the prior year and the highest overall level of customer satisfaction reported since we began these surveys in 2003.

- On July 1, 2010, the harmonized sales tax (HST) became effective, combining the existing 7% provincial sales tax with the 5% federal goods and services tax (GST) into a single tax of 12%. We expect this tax to add approximately $5 to $6 million annually to the cost of our operations. The HST has also increased the price to our customers of our food and certain retail offerings. Our vehicle and passenger tariffs are exempt from HST.

- On September 9, 2010, Mr. Vince Ready published his arbitration award to exclude certain senior shipboard positions that should be part of the management structure, and therefore excluded from the bargaining unit. Following discussion with the BC Ferry & Marine Workers' Union (the Union), we provided our transition plan to employees on December 1, 2010. We have planned a gradual, phased implementation of the newly excluded positions over an approximately five year timeframe to ensure the optimum retention of current staff and the orderly placement and orientation of those transitioning into the new positions.

- Throughout September and October 2010, we relocated to our new corporate office building in downtown Victoria. These premises are being leased under agreements which constitute a capital lease. The initial term of the lease is 15 years, with renewal options for up to an additional 20 years. On November 1, 2010, we loaned the developer of our new corporate office building $24.2 million for a term of 15 years, secured by a second mortgage on the property. We were granted an option to purchase up to 50% of the owner's equity interest in the new building at a price of $24.2 million. Final adjustments were made on April 15, 2011, bringing the total amount of the loan and the purchase option to $24.5 million. The purchase option expires at the end of the loan term. This relocation consolidated our head office functions, which were previously in several locations.

- On October 1, 2010, it was announced that our request for duty remission, amounting to $119.4 million including related GST, on four vessels built in Germany had been granted by the Government of Canada. One of these vessels, the *Northern Expedition*, operates on our Northern Routes which are supported by ferry transportation fees paid by the Province pursuant to the Coastal Ferry Services Contract. An agreement with the Province stipulated that these fees would be reduced if we were successful in obtaining duty remission on the *Northern Expedition*. The Province has agreed to forego this fee reduction, amounting to approximately $5.3 million for the balance of performance term two, which ends March 31, 2012.

  The duty remission, plus the contribution from the Province, has been partially utilized in an across the board fare reduction of approximately 2% effective October 18, 2010. The duty remission will also reduce future price caps otherwise determined by the Commissioner, commencing with performance term three. We have also allocated $20 million of the duty remission to upgrade key assets in the ship repair and maintenance business in British Columbia.

CORPORATE STRUCTURE

Coastal Ferry Services Contract

We operate ferry services under a regulatory regime as defined by the Act, and under the terms set out in the Coastal Ferry Services Contract. This 60-year services contract with the Province, which commenced April 1, 2003, stipulates, among other things, the number of round trips that must be provided for each regulated ferry service route in exchange for specified fees (ferry transportation fees). The contract was amended to, among other things, establish the ferry service levels and ferry transportation fees for the second performance term commencing April 1, 2008. The Coastal Ferry Services Contract also includes fees for the provision of specific social program services delivered on behalf of the Province.

Under the terms of the Coastal Ferry Services Contract, we also receive an annual amount from the Province based on its agreement with the Government of Canada to fulfill the obligation of providing ferry services to coastal British Columbia. The amount of this payment is adjusted annually based on the Consumer Price Index (CPI) (Vancouver).

Economic Regulatory Environment

The office of the Commissioner was created under the Act, enacted by the Province on April 1, 2003. The Commissioner establishes price caps for designated ferry route groups for the purpose of regulating our tariffs. The Commissioner is also responsible for regulating the reduction of service, discontinuance of routes and certain other matters. The Act requires the Commissioner to undertake regulation in accordance with several principles, including placing priority on the financial sustainability of ferry operators, encouraging ferry operators to adopt a commercial approach to ferry service delivery and moving over time to a greater reliance on a user pay system. In addition, the Commissioner is mandated to consider the interests of ferry users when establishing price caps.

Our first performance term ended March 31, 2008, and our second performance term will end March 31, 2012. The price cap increase authorized by the Commissioner for the second performance term was 7.3% on the Major Routes and 4.0% on all other routes effective April 1, 2008, starting from a level which included fuel surcharges in place at March 31, 2008. On each April 1st for the subsequent three years, the price cap increases by 2.7% plus 0.49 times the latest reported annual change in the CPI (British Columbia) on the Major Routes and 5.7% plus 0.73 times the change in the CPI (British Columbia) on all other routes. On April 1, 2011, the price cap increased by 3.38% (2.68% on April 1, 2010) on the Major Routes and 6.71% (5.68% on April 1, 2010) on all other routes. These price cap increases reflect changes in the CPI (British Columbia) of 1.39% applied April 1, 2011 (-0.03% applied April 1, 2010).

On March 31, 2011, in response to our *Performance Term Three Submission*, the Commissioner released his *Report on the Preliminary Price Cap Decision* and Order 11-02, setting preliminary price caps for the third performance term ending March 31, 2016. Under this Order, price caps will increase annually each April 1st commencing April 1, 2012 by 4.15% on the Major Routes and by 8.23% on all other routes. In making these determinations, the Commissioner excluded certain of our forecast costs and incorporated a productivity challenge effectively further reducing our allowed costs. The Commissioner invited us to respond to his preliminary decision and comment on the reasonability of his determinations on cost reductions and productivity and whether the preliminary price caps pose a significant risk to our financial sustainability during the third performance term. Our response was submitted on May 2, 2011. The Commissioner has published our response on his website at www.bcferrycommission.com and has requested comments from the public on both his preliminary decision and our response through June 30, 2011. We are also currently in negotiations with the Province on revisions to the Coastal Ferry Services Contract for the third performance term. The Act requires the results of these negotiations to be provided to the Commissioner by June 30, 2011 and the Commissioner to provide the final decision on price caps for the third performance term by September 30, 2011.

On May 13, 2011, the Commissioner wrote to the B.C. Minister of Transportation and Infrastructure proposing a review of the Act to assess how it has performed to date in achieving the original public policy objectives, including an examination of the following specific topics:

- The six principles underlying the Commissioner's regulation of ferry operators, specifically:
  - That priority be placed on the financial sustainability of the ferry operators;
  - That ferry operators be encouraged to adopt a commercial approach;
  - That ferry operators be encouraged to seek alternate service providers;
  - That ferry operators be encouraged to minimize expenses;
  - That cross subsidization from Major to other routes be eliminated; and
  - That ferry routes are to move towards a greater reliance on a user pay system.
- The Bill 20 requirement that the Commissioner consider the interests of ferry users, with an assessment of how those "interests" are defined;
- Financial parameters used to determine "financial sustainability" of the ferry operator, including evaluation of the pre-tax return on equity provisions;
- Provisions for, and oversight of, major capital expenditures;
- Adequacy of the methodology for forecasting ridership and demand elasticity;
- Complexity of the price cap calculation model and whether it is understandable to ferry users;
- Assessment of whether the Act enables opportunities for cost savings, or efficiencies in service levels;
- Ancillary revenue maximization;
- Regulation of unfair competitive advantage;
- Adequacy of the Commissioner's compliance tools; and
- The Commissioner's jurisdiction and mandate, and authority to investigate and make rulings.

On June 2, 2011, the *Coastal Ferry Amendment Act* (Bill 14) was enacted. Bill 14, among other things:

- establishes a price cap for the first year of the third performance term with an increase for each route group on April 1, 2012, of 4.15% from the weighted average of the tariffs payable as at March 31, 2012, as determined in a manner approved by the Commissioner;
- provides for the Commissioner to undertake the usual price cap review proceedings for the balance of the review performance term, being the period from April 1, 2013 to March 31, 2016;
- prevents us from obtaining extraordinary price cap increases, and requires ministerial approval (as opposed to Commissioner approval) for the discontinuance of ferry services, until October 1, 2012; and
- requires the Commissioner to undertake a review of the Act and provide recommendations by January 24, 2012, to the B.C. Minister of Transportation and Infrastructure as to how the Act could be amended to allow the Commissioner to balance the interests of ferry users with the financial sustainability needs of our Company.

These amendments to the Act provide the Commissioner with the mandate, funding and time to conduct his review before issuance of his final decision on price caps for the balance of the third performance term which will now be due by September 30, 2012. The Province has indicated that it will increase ferry transportation fees for the first year of performance term three, in order to compensate us for the legislated reduction in price caps for the non-Major route groups (from 8.23% to 4.15%). We have entered into discussions with the Province to determine the amount of the transportation service fee increase required.

Amendments to the *Coastal Ferry Act*

On June 24, 2010, the Province enacted Bill 20, amending several statutes including the Act. The amendments respond to the Comptroller General's Report on Review of Transportation Governance Models released November 6, 2009, and include changes to the governance and regulatory framework within which we operate.

Among other things, Bill 20 amendments to the Act changed the mandate of the B.C. Ferry Authority (the Authority) to include responsibility for the compensation plans of our directors and certain executive officers, such compensation plans to be comparable to public sector organizations; a requirement that effective September 30, 2010, a director of the Authority cannot also be a director of British Columbia Ferry Services Inc. (BC Ferries); and, the subjection of the records of the Authority and BC Ferries to the *Freedom of Information and Protection of Privacy Act*.

The amendments also expand the regulatory responsibilities of the Commissioner to include: consideration of the interests of ferry users; regulation of our reservation fees; approval and public disclosure of our process for handling customer complaints; and review and public disclosure of our ten year capital plan, our plan for improving efficiency in the next performance term, and our methodology for allocating costs among the regulated routes. These amendments also broaden the Commissioner's role in regulating ferry transportation services where the Commissioner determines that we have an unfair competitive advantage. The amendments have also modified the process by which the Commissioner regulates our activities in seeking additional or alternative service providers on our regulated routes; and requires the Commissioner to issue an opinion on the performance of the Authority in carrying out its legislated responsibilities.

FINANCIAL AND OPERATIONAL OVERVIEW

This section provides an overview of our financial and operational performance over the past three fiscal years.

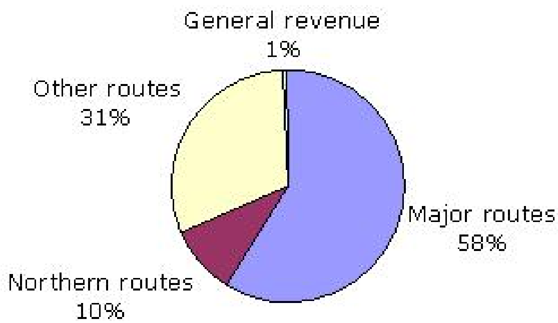
	Year ended March 31		
($ millions)	**2011**	**2010**	**2009**
Total revenue	739.3	732.3	681.8
% Growth	*1.0%*	*7.4%*	*6.4%*
Operating expenses	672.2	660.0	624.2
Earnings from operations	67.1	72.3	57.6
Interest and other	63.3	68.9	48.6
Net earnings and comprehensive income	3.8	3.4	9.0
	As at March 31		
	2011	**2010**	**2009**
Total assets	1,857.6	1,807.0	1,842.2
Total long-term financial liabilities	1,387.2	1,363.9	1,369.0
Dividends on preferred shares	6.0	6.0	6.0

Our earnings from operations in fiscal 2011 were $5.2 million lower and net earnings were $0.4 million higher than in fiscal 2010. Fiscal 2011 net earnings reflect the effects of lower than expected traffic levels, $4.2 million lower interest expense offsets received through the Government of Canada's Structured Financing Facility (SFF) program and a $9.3 million gain on sale of our former corporate office building. Earnings from operations in fiscal 2010 were $14.7 million higher and net earnings were $5.6 million lower than in the previous year reflecting increased amortization and financing costs as a result of new capital assets that entered service with the completion of our fleet and asset renewal program for our Major and Northern Routes.

Vehicle and passenger traffic declined 1.6% and 1.4% respectively this fiscal year as compared to the prior year. The general decline in vehicle traffic was partially offset by an increase in drop trailer traffic. With this service, launched in March 2009, commercial customers on two of our Major Routes can 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. On February 7, 2011, the Commissioner issued his ruling whereby he found our drop trailer business to have an unfair competitive advantage due to our tax exemption and the regulatory framework under which we operate. Subsequently, he issued Order 11-01, introducing a minimum average allowable tariff for dropped trailers, which was implemented April 1, 2011. We fully expected to remain competitive under these rules and regulations. The major provider of drop trailer services, Seaspan Ferries Corporation, filed a Notice of Application for Leave to Appeal the Commissioner's determination on March 4, 2011.

Our SailSafe program, launched in fiscal 2008, is a partnership initiative with the Union to achieve world class safety performance. SailSafe engages employees in identifying areas and methods for enhancing current safety practices and ensuring that safety is our first priority each and every day. Since the inception of SailSafe, we have seen significant improvements in overall safety performance, with the number of lost time injuries decreasing by 46% and work days lost to injury decreasing by 41%. The next phase of the program will focus on safety improvements in communications, planning, procedures, training, contractor safety, quality control and environment, health and wellness to continuously improve and sustain our safety performance.

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



In fiscal 2011, the greatest portion of our revenues, 58%, 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 31%.

Revenue ($ millions)	**Years ended March 31**		
	2011	**2010**	**2009**
Direct Route Revenue			
Vehicle traffic (volume)	*8,119,546*	*8,255,409*	*8,130,356*
Vehicle tariff	284.6	281.2	269.1
Passenger traffic (volume)	*20,746,222*	*21,035,644*	*20,727,493*
Passenger tariff	173.5	169.3	160.0
Social program fees	24.0	22.1	19.3
Catering & on-board	77.3	79.1	76.4
Other revenue	22.2	22.2	20.7
Total Direct Route Revenue	581.6	573.9	545.5
Indirect Route Revenue			
Ferry transportation fees	127.0	127.4	105.2
Federal-Provincial subsidy	26.9	26.9	26.3
Total Route Revenue	735.5	728.3	677.0
Other general revenue	3.8	4.0	4.8
Total Revenue	739.3	732.3	681.8

Our largest revenue source is vehicle and passenger tariffs. The Commissioner authorized a price cap increase on the Major Routes of 2.7% plus 0.49 times the CPI (British Columbia) and 5.7% plus 0.73 times the CPI (British Columbia) on all other routes effective on each of April 1, 2010 and April 1, 2011. On April 1, 2010, the price caps increased by 2.68% on the Major Routes and 5.68% on all other routes, which incorporated a change in the CPI (British Columbia) of -0.03%. On April 1, 2011, the price caps increased by 3.38% on the Major Routes and 6.71% on all other routes. These price cap increases reflect a change in the CPI (British Columbia) of 1.39%. In response to the changes, we implemented tariff increases up to the new levels authorized.

Effective October 18, 2010, we implemented an across the board fare reduction of approximately 2%, as a result of the $119.4 million in duty remission and related GST, announced by the Government of Canada on October 1, 2010.

From time to time, we utilize promotional fares designed to stimulate growth in traffic or direct traffic towards our less busy sailings. In calculating the price cap, vehicle and passenger tariffs are combined. The utilization of promotional fare incentives and the effects of being over or under the price cap may cause the average vehicle and passenger tariff rate to be under or over the allowed increase in any one period.

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

Year to year changes for the past two fiscal years for the Major, Northern and Other Routes are discussed separately below.

Year to Year Comparison of Revenues 2011 – 2010

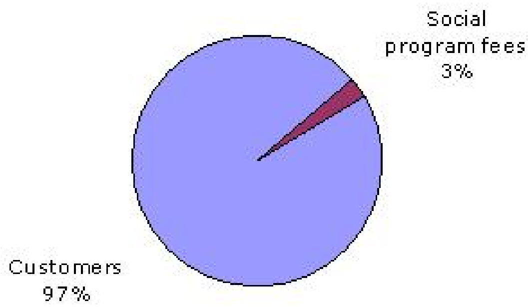
Major Routes

Direct Route Revenue ($ thousands)	**Years ended March 31**			
	2011	**2010**	**Increase (Decrease)**	
Vehicle traffic (volume)	*3,703,923*	*3,739,735*	*(35,812)*	*(1.0%)*
Vehicle tariff	211,551	209,530	2,021	1.0%
Passenger traffic (volume)	*10,738,599*	*10,804,836*	*(66,237)*	*(0.6%)*
Passenger tariff	125,948	122,697	3,251	2.6%
Social program fees	11,761	10,774	987	9.2%
Catering & on-board	63,307	64,226	(919)	(1.4%)
Reservation fees	11,826	12,245	(419)	(3.4%)
Parking	3,659	3,605	54	1.5%
Assured loading	2,365	2,365	-	-
Other revenue	2,026	2,035	(9)	(0.4%)
Total Direct Route Revenue	432,443	427,477	4,966	1.2%
Indirect Route Revenue				
Ferry transportation fees	-	-	-	-
Federal-Provincial subsidy	-	-	-	-
Total Route Revenue	432,443	427,477	4,966	1.2%

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 fiscal 2011 from the prior year. The general decline in vehicle traffic was partially offset by a 57.7% or $2.0 million increase in drop trailer traffic. Overall fiscal 2011 vehicle and passenger traffic was marginally higher, 0.2% and 0.1% respectively, than fiscal 2009.

The increase in average tariff revenue per vehicle was $1.07 or 1.9% while the increase in average tariff revenue per passenger was $0.37 or 3.3%. The higher average fares, partially offset by the decrease in traffic, resulted in a total increase of $5.3 million in tariff revenue.

Major Routes cont'd



Fiscal 2011 revenue from our Major Routes consisted of 97% from customers and 3% from social program fees.

Throughout the eight months ended November 30, 2010, fuel rebates of 2% of tariffs on average were in place on our Major Routes. On December 1, 2010, the fuel rebates were removed due to the increasing cost of fuel. Due to the rising cost of fuel, on May 16, 2011, we announced the implementation of a 2.5% fuel surcharge effective June 1, 2011.

Social program fees are reimbursements from the Province of discounts provided on fares for BC seniors, students travelling to and from school, persons with disabilities and persons travelling under the Ministry of Health Travel Assistance Program. Social program fees increased as a result of higher program usage and higher fares. Neither ferry transportation fees nor federal/provincial subsidies are received in support of services provided on our Major Routes.

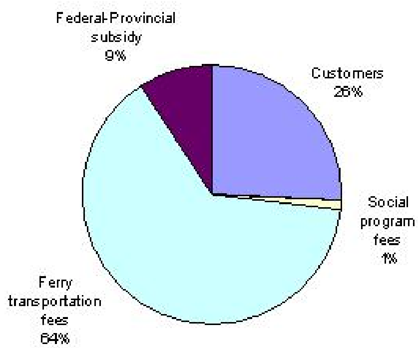
All vessels that provide service on our Major Routes have a gift shop and options for food service. Both food and gift shop sales decreased as a result of lower average spending per passenger and lower passenger traffic. The HST implemented July 1, 2010, increased the price to our customers of our food and certain retail offerings. In our gift shops, sales of quality apparel increased $0.5 million or 12.5% while, consistent with the industry trend, sales of books and magazines continued their decline.

Fees for reservations declined as a result of lower traffic levels.

Northern Routes

Direct Route Revenue ($ thousands)	**Years ended March 31**			
	2011	**2010**	**Increase (Decrease)**	
Vehicle traffic (volume)	*29,353*	*31,139*	*(1,786)*	*(5.7%)*
Vehicle tariff	7,987	8,006	(19)	(0.2%)
Passenger traffic (volume)	*85,973*	*88,190*	*(2,217)*	*(2.5%)*
Passenger tariff	7,349	7,106	243	3.4%
Social program fees	962	874	88	10.1%
Catering & on-board	2,200	2,375	(175)	(7.4%)
Stateroom rental	1,008	1,064	(56)	(5.3%)
Hostling & other	401	238	163	68.5%
Total Direct Route Revenue	19,907	19,663	244	1.2%
Indirect Route Revenue				
Ferry transportation fees	47,139	47,590	(451)	(0.9%)
Federal-Provincial subsidy	6,660	6,660	-	-
Total Route Revenue	73,706	73,913	(207)	(0.3%)

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



Fiscal 2011 revenue from our Northern Routes consisted of 26% from customers and 74% from the Province (1% social program fees, 64% transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

Total direct revenue on our Northern Routes decreased marginally from the prior year.

Both vehicle and passenger traffic decreased from fiscal 2010. The average tariff revenue per vehicle increased $14.99 or 5.8% while the average passenger tariff revenue increased $4.90 or 6.1%. The higher average tariff rates and lower traffic resulted in a total tariff revenue increase of $0.2 million.

Social program fees increased as a result of higher fares and increased program usage.

Catering and on-board revenue and stateroom rental decreased as a result of lower average spending per passenger and lower passenger traffic. .The HST implemented July 1, 2010, increased the price to our customers of our food and certain retail offerings.

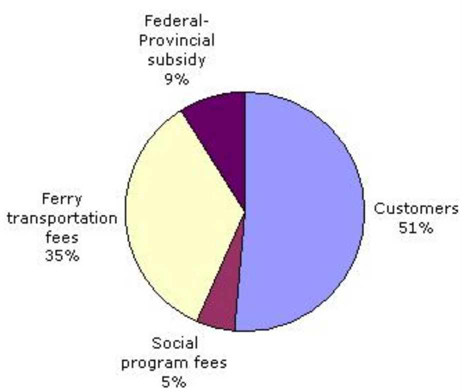
We receive ferry transportation fees for these routes under the Coastal Ferry Services Contract, which relate, in part, to the capital cost of the vessels serving these routes. The fees decrease as the vessel assets are amortized.

The total Federal-Provincial subsidy is equal to the prior year reflecting no change in the annual CPI (Vancouver).

Other Routes

Direct Route Revenue ($ thousands)	Years ended March 31			
	2011	2010	Increase (Decrease)	
Vehicle traffic (volume)	*4,386,270*	*4,484,535*	*(98,265)*	*(2.2%)*
Vehicle tariff	64,981	63,646	1,335	2.1%
Passenger traffic (volume)	*9,921,650*	*10,142,618*	*(220,968)*	*(2.2%)*
Passenger tariff	40,232	39,523	709	1.8%
Social program fees	11,295	10,411	884	8.5%
Catering & on-board	10,811	11,395	(584)	(5.1%)
Reservation fees	1,403	1,333	70	5.3%
Parking & other	496	490	6	1.2%
Total Direct Route Revenue	129,218	126,798	2,420	1.9%
Indirect Route Revenue				
Ferry transportation fees	79,866	79,858	8	-
Federal-Provincial subsidy	20,264	20,264	-	-
Total Route Revenue	229,348	226,920	2,428	1.1%

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



Fiscal 2011 revenue from our Other Routes consisted of 51% from customers and 49% from the Province (5% social program fees, 35% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

Both vehicle and passenger traffic decreased from the prior year. The increase in average tariff revenue per vehicle was $0.62 or 4.4% while the average passenger tariff revenue increase was $0.15 or 3.8%. The increased average fares, partially offset by the decrease in traffic, resulted in a total tariff revenue increase of $2.0 million.

Due to the rising cost of fuel, on May 16, 2011, we announced the implementation of fuel surcharges of 5% on many of these regulated routes effective June 1, 2011.

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

Revenue from catering and on-board services decreased as a result of lower average spending per passenger and lower passenger traffic. .The HST implemented July 1, 2010, increased the price to our customers of our food and certain retail offerings.

Fees for reservations increased primarily as a result of higher usage.

Total Federal-Provincial subsidy is equal to the prior year reflecting no change in the annual CPI (Vancouver).

Year to Year Comparison of Revenues 2010 – 2009

Major Routes

Direct Route Revenue ($ thousands)	**Years ended March 31** **2010**	**2009**	**Increase (Decrease)**	
Vehicle traffic (volume)	*3,739,735*	*3,696,322*	*43,413*	*1.2%*
Vehicle tariff	209,530	203,192	6,338	3.1%
Passenger traffic (volume)	*10,804,836*	*10,664,158*	*140,678*	*1.3%*
Passenger tariff	122,697	117,617	5,080	4.3%
Social program fees	10,774	9,907	867	8.8%
Catering & on-board	64,226	62,302	1,924	3.1%
Reservation fees	12,245	12,038	207	1.7%
Parking	3,605	3,229	376	11.6%
Assured loading	2,365	2,040	325	15.9%
Other revenue	2,035	1,538	497	32.3%
Total Direct Route Revenue	427,477	411,863	15,614	3.8%
Indirect Route Revenue				
Ferry transportation fees	-	-	-	-
Federal-Provincial subsidy	-	-	-	-
Total Route Revenue	427,477	411,863	15,614	3.8%

Both vehicle traffic and passenger traffic increased in fiscal 2010 from the prior year. The increase in average tariff revenue per vehicle was $1.06 or 1.9% while the increase in average tariff revenue per passenger was $0.33 or 3.0%. The higher average fares and increase in traffic resulted in a total increase of $11.4 million in tariff revenue.

Social program fees increased as a result of higher program usage, higher fares and a $0.4 million billing correction in fiscal 2009.

Both food and gift shop sales increased as a result of higher traffic and higher average spending per passenger. In our gift shops, sales of quality apparel increased more than 20% while, consistent with the industry trend, sales of books and magazines declined. The *Coastal Celebration* was in service during fiscal 2010 for a full year, adding more lounge seating capacity and increasing revenue from usage of the seating lounge by more than 15%.

Fees for reservations and assured loading revenue increased, mainly as a result of higher traffic levels. Parking revenue increased mainly due to expansion at the Departure Bay terminal.

Other revenue increased mainly as a result of hostling[1] fees from our new drop trailer service for commercial customers.

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

Northern Routes

Direct Route Revenue ($ thousands)	**Years ended March 31**			
	2010	**2009**	**Increase (Decrease)**	
Vehicle traffic (volume)	*31,139*	*31,739*	*(600)*	*(1.9%)*
Vehicle tariff	8,006	8,253	(247)	(3.0%)
Passenger traffic (volume)	*88,190*	*93,964*	*(5,774)*	*(6.1%)*
Passenger tariff	7,106	7,233	(127)	(1.8%)
Social program fees	874	565	309	54.7%
Catering & on-board	2,375	2,237	138	6.2%
Stateroom rental	1,064	783	281	35.9%
Hostling & other	238	280	(42)	(15.0%)
Total Direct Route Revenue	19,663	19,351	312	1.6%
Indirect Route Revenue				
Ferry transportation fees	47,590	25,283	22,307	88.2%
Federal-Provincial subsidy	6,660	6,505	155	2.4%
Total Route Revenue	73,913	51,139	22,774	44.5%

Total direct revenue on our Northern Routes increased marginally from the prior year.

Both vehicle and passenger traffic decreased from fiscal 2009. The average tariff revenue per vehicle decreased $2.92 or 1.1% while the average passenger tariff revenue increased $3.60 or 4.7%. These changes in average tariff revenue reflect lower tourist traffic which pays a higher fare than local travellers. The lower traffic and changes in average tariff rates resulted in a total tariff revenue decrease of $0.4 million.

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

Social program fees increased as a result of higher fares, increased program usage and a $0.1 million billing adjustment in fiscal 2009.

The *Northern Expedition* commenced operating on our northern route through the Inside Passage from Port Hardy to Prince Rupert on May 18, 2009. Stateroom rental increased with the additional capacity provided (50 additional staterooms) and catering and on-board revenue increased with the provision of additional services.

The ferry transportation fees have increased as a result of the capital cost of the new *Northern Expedition*.

The total Federal-Provincial subsidy has increased by the CPI (Vancouver).

Other Routes

Direct Route Revenue ($ thousands)	**Years ended March 31**			
	2010	**2009**	**Increase (Decrease)**	
Vehicle traffic (volume)	*4,484,535*	*4,402,295*	*82,240*	*1.9%*
Vehicle tariff	63,646	57,638	6,008	10.4%
Passenger traffic (volume)	*10,142,618*	*9,969,371*	*173,247*	*1.7%*
Passenger tariff	39,523	35,129	4,394	12.5%
Social program fees	10,411	8,780	1,631	18.6%
Catering & on-board	11,395	11,128	267	2.4%
Reservation fees	1,333	1,198	135	11.3%
Parking & other	490	421	69	16.4%
Total Direct Route Revenue	126,798	114,294	12,504	10.9%
Indirect Route Revenue				
Ferry transportation fees	79,858	79,950	(92)	(0.1%)
Federal-Provincial subsidy	20,264	19,789	475	2.4%
Total Route Revenue	226,920	214,033	12,887	6.0%

Both vehicle and passenger traffic increased from the prior year. The increase in average tariff revenue per vehicle was $1.10 or 8.4% while the average passenger tariff revenue increase was $0.37 or 10.6%.

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

The increased average fares, the increase in traffic levels, and the reduction in fiscal 2009 caused by prepaid ticket redemptions and exchanges resulted in a total tariff revenue increase of $10.4 million.

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

Reimbursements from the Province for social program fees increased as a result of higher usage, higher fares and a $0.7 million billing adjustment in fiscal 2009.

Revenue from catering and on-board services, fees for reservations, and parking increased primarily as a result of higher traffic levels.

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

Operating expenses ($ millions)

	Year ended March 31		
	2011	**2010**	**2009**
Operations	411.1	398.8	387.8
Maintenance	85.7	85.6	77.2
Administration	31.2	30.3	37.2
Total operations, maintenance & administration	528.0	514.7	502.2
% Increase	*2.6%*	*2.5%*	*6.2%*
Cost of retail goods sold	29.7	30.1	28.9
Amortization	114.5	115.2	93.1
Total operating expenses	672.2	660.0	624.2
% Increase	*1.8%*	*5.7%*	*9.6%*

Restructuring
In response to the decline in traffic levels and resulting revenues in fiscal 2009, we determined the need to restructure our business to align expenses with reduced revenues while continuing to ensure that safety remains our top priority. This restructuring was in addition to our other cost savings measures that included deferral of filling staff vacancies and reduction of discretionary expenditures. Approximately 77 positions were eliminated. This included termination or early retirement of 28 non-union staff, including several vice-presidents, senior management and director-level employees and 7 union staff. The remaining positions were eliminated through attrition. In fiscal 2010, these proactive measures, along with other initiatives, reduced our operating expenditures by approximately $14 million from previously planned levels. Throughout fiscal 2011, we continued our focus on cost savings measures and reduction of discretionary expenditures.

Interest and other ($ millions)

	Year ended March 31		
	2011	**2010**	**2009**
Interest expense			
Bond interest	63.3	63.3	56.9
KfW bank group (KfW) loans	10.5	11.2	9.0
Interest on capital lease	1.2	-	-
Short-term loans	0.2	0.3	0.8
Interest on deferred accounts	0.3	0.3	0.1
Structured Financing Facility program	(0.5)	(4.7)	(2.4)
Capitalized interest	(2.9)	(2.8)	(14.3)
Total interest expense	72.1	67.6	50.1
(Gain) on foreign exchange	(0.2)	(0.1)	(0.3)
(Gain) loss on disposal of capital assets	(8.6)	1.4	(1.2)
Total interest and other	63.3	68.9	48.6

Year to Year Comparison of Expenses 2011 – 2010

The $12.3 million increase in fiscal 2011 operations expenses consists of:

- $6.7 million increase in wages and benefits, including:
  - Approximately $6.4 million in bargaining unit wage rate increases (averaging about 3%) in accordance with the current Collective Agreement; $0.4 million increase in long-term disability premiums; $1.5 million additional labour for the full year operation of the operations and security centre, opening of our travel centre and expanded drop trailer operations; partially offset by a $1.5 million reduction in incentive compensation; and
- $2.9 million or 3.1% increase in fuel expense as a result of higher fuel prices, partially offset by a 0.5% decrease in fuel consumption;
- $2.7 million increase consisting of $0.4 million due to the July 1, 2010 implementation of HST; $0.3 million in credit card service fees; $0.3 million in lease costs; and a further $1.7 million in a number of miscellaneous items.

The $0.1 million increase in maintenance costs reflects an estimated $2.6 million increase due to the implementation of HST; mainly offset by reductions due to variations in vessel refit scheduling and lower costs with maximizing maintenance performed while vessels were afloat. We completed 19 refits in fiscal 2011 and had a further four in progress at March 31, 2011.

Administration expenses increased $0.9 million mainly as a result of an estimated $0.3 million incurred to implement the changes arising from Bill 20; $0.2 million due to the implementation of HST; and costs relating to the move to the new corporate office building.

Amortization decreased $0.7 million reflecting $4.5 million lower amortization of our four vessels built in Germany due to the reduced capital cost resulting from the receipt of $119.4 million in duty remission and related GST; partially offset by higher amortization resulting from the new capital assets entering service during fiscal 2011.

Interest expenses increased $4.5 million primarily due to:

- $4.2 million in lower interest rate support through the SFF program offered by the Government of Canada, reflecting the completion of the funding related to the purchase of the *Island Sky* and the life extension of the *Queen of New Westminster*; partially offset by funding related to the life extension of the *Quinsam*;
- $1.2 million interest on capital lease of the new corporate office building;

partially offset by;

- $0.7 million less interest due to lower interest rates on the Tranche B than on the Tranche A components of the 12-year KfW loans and the $9 million principal repayment on the 2.95% loan. (See “Liquidity and Capital Resources – Long-Term Debt” below for more detail).

On November 1, 2010, our former corporate office building was sold for $11.0 million, resulting in a gain on sale of $9.3 million. This gain was partially offset by the $0.2 million write down of the *Queen of Prince Rupert,* reflecting market conditions and management expectations and $0.5 million relating to several other asset disposals.

Year to Year Comparison of Expenses 2010 – 2009

The $11.0 million increase in fiscal 2010 operations expenses consists of:

- $10.0 million increase in wages and benefits, including:
  - Approximately $6.3 million in wage rate increases averaging about 3% in accordance with the existing Collective Agreement; $1.8 million increase in incentive compensation; and $1.2 million increase in long-term disability premiums; and
- $3.1 million increase consisting of $0.8 million in credit card service fees; $0.6 million in property taxes; and a further $1.7 million in a number of miscellaneous items.

These increases were partially offset by:

- $2.1 million or 2.2% decrease in fuel expense as a result of the operation of the fuel pricing mechanism approved by the Commissioner, partly offset by a 1.7% increase in fuel consumption, reflecting new vessels in service being larger than the vessels they replaced.

The $8.4 million increase in maintenance costs reflects variations in vessel refit scheduling and $2.0 million of unanticipated maintenance on the *Queen of Burnaby* to replace a damaged propeller. We completed 18 refits in fiscal 2010 and had a further three in progress at March 31, 2010.

Administration expenses decreased $6.9 million mainly as a result of:

- $4.4 million decrease in wages and benefits, including:
  - $2.0 million additional restructuring costs incurred in fiscal 2009;
  - $1.9 million reduction in fiscal 2010 reflecting the lower number of exempt positions from the restructuring;
  - $0.5 million in reduced incentive compensation; and
- $2.5 million mainly due to transition costs incurred in fiscal 2009 to move IT systems support to an in-house model and reductions in discretionary expenditures.

Amortization increased a total of $22.1 million, mainly as a result of additional assets coming into service, including:

- $7.2 million due to the *Northern Expedition* commencing service in May 2009;
- $7.0 million due to the *Coastal Inspiration* and the *Coastal Celebration* entering service in June 2008 and November 2008, respectively;
- $3.7 million due to the $52 million *Queen of New Westminster* upgrade completed in April 2009; and
- $2.3 million due to the *Island Sky* commencing service in February 2009.

Interest expenses increased $17.5 million primarily due to:

- $6.4 million additional interest relating to our $140 million bond series issued in December 2008;
- $2.2 million additional interest relating to our $108 million KfW loan received in January 2009, to partially finance the purchase of the *Northern Expedition*;
- $11.5 million less interest capitalized reflecting the substantial completion of our vessel replacement program for our Major and Northern Routes;

partially offset by;

- $2.3 million in additional interest rate support through the SFF program, reflecting the fiscal allocation relating to the purchase of the *Island Sky* and the life extension of the *Queen of New Westminster*. In October 2009, we received approval for up to $1.0 million of interest rate support payments through the SFF program relating to the life extension of the *Quinsam.*

In the third quarter of fiscal 2010, we wrote down the book values of the three vessels held for sale, the *Queen of Saanich,* the *Queen of Vancouver* and the *Queen of Prince Rupert*. The write-downs totalled $2.9 million, reflecting market conditions and management expectations. In the fourth quarter, the *Queen of Saanich* and the *Queen of Vancouver* were sold for nominal proceeds. The loss on write-down of these vessels was partially offset by a $1.8 million gain on sale of surplus land adjacent to our ship repair facility in Richmond, BC. Results in the prior year included a $1.2 million gain from the sale of the *Queen of Esquimalt* and a $0.7 million loss from the sale of the *Queen of Tsawwassen.*

Deferred Fuel Cost Accounts

In September 2004, the Commissioner issued an Order authorizing our use of deferred fuel cost accounts to mitigate the effect of volatility in fuel oil prices on our earnings.

Commencing April 1, 2004, the Commissioner established set prices for fuel for each of the years until March 31, 2008. At the start of each fiscal year, the set prices increased by the CPI (Vancouver). On March 30, 2007, the Commissioner authorized the continued use of inflation-adjusted set prices and deferred fuel cost accounts for the second performance term beginning April 1, 2008 and on March 31, 2011, authorized their continuation for the third performance term beginning April 1, 2012.

For the Northern Routes, the per litre cost of fuel included in the determination of price caps (the set price) and one-half of the first 5 cents per litre of difference between the actual price paid per litre (including realized hedge gains and losses) and the set price are recorded in expense. The remaining one-half of the first 5 cents per litre of difference is recorded in the deferred fuel cost accounts. Any difference beyond 5 cents per litre is recovered from or paid to the Province. The total to be received from the Province relating to fuel costs on the Northern Routes was $1.6 million for fiscal 2011 ($1.3 million paid to the Province for fiscal 2010).

For all other routes, differences in fuel costs arising from our actual price paid per litre (including realized hedge gains and losses) being higher or lower than the set price included in base tariffs less one-half of the first 5 cents per litre of difference are charged or credited to the deferred fuel cost accounts.

There is a mechanism in place to allow price cap adjustments to provide for implementation of fuel surcharges or rebates when appropriate. Throughout the first eight months of fiscal 2011, fares on many of our routes with the exception of our Northern Routes were reduced by fuel rebates ranging from 2% to 5% on average. In fiscal 2011, we refunded $8.6 million in fuel rebates to customers while in fiscal 2010 we refunded $6.3 million in rebates. These amounts were applied to the outstanding deferred fuel cost account balances. There were no fuel rebates or surcharges on our Northern Routes. Due to the rising cost of fuel, on May 16, 2011, we announced the implementation of fuel surcharges effective June 1, 2011. These surcharges will be 2.5% on our Major Routes and 5% on many of our other routes.

Under an agreement reached during fiscal 2008, the Province has agreed to pay benefits which are applied to the deferred fuel cost accounts. These benefits, totalling $1.6 million for each of fiscal 2011 and fiscal 2010, are equal to the amount by which annual ferry transportation fees payable by the Province were reduced as a result of the lower cost of the *Northern Adventure* due to remission and refund of import duties paid. These reductions in the deferred fuel cost accounts benefit our customers through reduced fuel surcharges or earlier fuel rebates.

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

The balances in our deferred fuel cost accounts totalled $2.8 million at March 31, 2011 (less than $0.1 million at March 31, 2010).

All of the Commissioner's orders can be viewed at www.bcferrycommission.com.

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. On October 1, 2010, it was announced that our request for duty remission for vessels built in Germany totalling $119.4 million (including related GST) had been granted. These funds were received from the Government of Canada in December 2010.

Our ongoing capital expenditures are expected to be significantly lower than in the previous few years. Over the next five years, we expect our cash requirements will be met through operational cash flows and by accessing our credit facility from time to time. At March 31, 2011, our unrestricted cash and cash equivalents totalled $33 million and short-term investments totalled $64 million.

We target maintaining a strong investment-grade credit rating to allow capital market access at reasonable interest rates. Our credit ratings at March 31, 2011, were A (DBRS) with a stable trend and A+ (Standard & Poor's) with a stable outlook.

Long-Term Debt

Our long-term debt is summarized below:

($millions)	Effective interest rate	Amount outstanding as at March 31 2011	2010	2009
Senior Secured Bonds				
5.74%, Due May 2014	5.92%	250	250	250
6.25%, Due October 2034	6.41%	250	250	250
5.02%, Due March 2037	5.06%	250	250	250
5.58%, Due January 2038	5.60%	200	200	200
6.21%, Due December 2013	6.33%	140	140	140
12 Year Loans				
Tranche A, Due March 2020	5.17%	68	75	82
Tranche B, Due March 2020	1.39%*	22	15	8
Tranche A, Due June 2020	5.18%	69	77	84
Tranche B, Due June 2020	1.38%*	21	13	6
2.95% Loan, Due January 2021	3.08%	90	99	108
		1,360	1,369	1,378

* Floating rate as at March 31, 2011:

In May 2004 we entered into a master trust indenture. This indenture established common security and a set of common covenants for the benefit of our lenders. Our financing plan encompasses an ongoing program capable of accommodating a variety of corporate debt instruments and borrowings ranking *pari passu*. We do not currently view common share equity as a potential source of capital and have no intention of offering common shares to the public or other investors.

We are also party to a credit agreement with a syndicate of Canadian banks that is secured under the master trust indenture. Under this agreement, we have available a revolving facility in the amount of $155 million. The facility, maturing May 12, 2013, is available to fund capital expenditures and other general corporate purposes. At March 31, 2011, draws on this credit facility totalled $3.9 million, bearing interest at 3.00% with letters of credit outstanding of $0.2 million.

We have issued five senior secured bond offerings to date with interest payable semi-annually. The bonds are redeemable in whole or in part, at our option.

Secured under the master trust indenture, we entered into three 12-year amortizing loan agreements with KfW. Two of these loans are at a fixed interest rate of 4.98%, payable quarterly. These agreements defer the principal payments for the first three years to a second tranche on which interest is payable at a floating rate and the principal is due at maturity. The third loan is at a fixed interest rate of 2.95%, payable semi-annually.

Terminal Leases
We entered into a master agreement with the BC Transportation Financing Authority (BCTFA) effective March 31, 2003, as part of the restructuring of our company. In return for the transfer of ownership interest in all ferry terminals from the former British Columbia Ferry Corporation to the BCTFA at the time of the corporate restructuring, we received recognition of prepayment of rent under terminal leases.

The leases grant us exclusive access and use of ferry terminal properties for a period of 60 years commencing April 1, 2003. The leases are renewable for an additional period of 20 years at a total cost of $20 per lease provided the Coastal Ferry Services Contract is renewed. We must manage, maintain and develop the terminals at our own cost.

Since the original transfer, a total of $11.7 million of additional lands at Horseshoe Bay, Swartz Bay and Departure Bay have been added to the existing terminal leases in exchange for highway improvements.

If we fail to meet our obligations under the terminal leases or default under the Coastal Ferry Services Contract, the BCTFA may at its option re-enter and take possession of the ferry terminal properties and at its option terminate the leases. The BCTFA has entered into an acknowledgement agreement with the Trustee under the master trust indenture, which sets out certain limitations on the use of this option.

Other Long-Term Liabilities
Other long-term liabilities consist primarily of accrued post-retirement and post-employment benefits.

Sources & Uses of Cash

Our liquidity needs are met through a variety of sources, including cash generated from operations, issuance of bonds, and borrowings under our credit facility. Our primary uses of funds are operational expenses, capital asset acquisitions and upgrades, and payments on our long-term debt.

Sources and uses of cash and cash equivalents for fiscal 2011 and 2010 are summarized in the table below:

	Year ended March 31	
($ millions)	**2011**	**2010**
Net earnings	3.8	3.4
Items not involving cash:		
Amortization	114.5	115.2
Other non-cash charges	(6.7)	1.8
Regulatory costs deferred	(7.5)	10.3
Change in non-cash operating working capital	2.7	(9.4)
Cash provided by operating activities	106.8	121.3
Cash used in financing activities	(12.1)	(33.5)
Cash used in investing activities	(72.0)	(89.6)
Total increase (decrease) in cash	22.7	(1.8)

In fiscal 2011, cash provided by operating activities included $7.5 million of cash used to reduce long-term regulatory liabilities as follows:

- $8.6 million in fuel rebates granted;
- $0.3 million in fuel and interest costs deferred; and
- $0.1 million in performance term three submission costs;

partially offset by:

- $1.5 million in other payments from the Province credited to deferred fuel accounts.

Cash provided by operating activities also included a decrease in non-cash operating working capital of $2.7 million. This decrease in non-cash operating working capital was primarily due to:

- $3.4 million increase in payables and accrued liabilities relating to refit and maintenance and other operating activities;
- $1.0 million decrease in regulatory assets reflecting tariff revenues collected in excess of price caps at March 31, 2011; and
- $0.9 million decrease in accounts receivable, mainly due to social program fees receivable.

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

- $2.2 million increase in total operating inventories reflecting a $1.6 million increase in general inventories for refits and maintenance items and $0.8 million in fuel reflecting both a higher volume and higher price of fuel on the vessels; and
- $0.4 million decrease in deferred revenue.

Cash used in financing activities reflects the $9.0 million principal repayment on the 2.95% loan; payment of the $6.0 million dividend on preferred shares; and $1.0 million payment of capital lease obligations; partially offset by $3.9 million in draws on our $155 million credit facility.

Cash used in investing activities consisted of:

- $122.2 million used to purchase capital assets (See "Investing in Our Capital Assets" below for detail of significant purchases);
- $56.4 million used to purchase short-term investments; and
- $24.2 million advanced to the developer of our new corporate office building;

partially offset by:

- $119.4 million received for remission of import duties and related GST;
- $11.2 million in proceeds primarily from the sale of our former corporate office building; and
- $0.2 million reduction in debt service reserve.

FOURTH QUARTER RESULTS

The following provides an overview of our financial performance for the three months ended March 31, 2011, compared to the three months ended March 31, 2010.

The fourth quarter reflects a seasonal reduction in traffic levels which we utilize to perform upgrades and major maintenance and refit programs as well as to undertake mandatory inspections on the majority of our vessels.

	Three months ended March 31			
			Variance	
($ millions)	**2011**	**2010**	**$**	**%**
Total revenue	140.7	142.3	(1.6)	(1.1%)
Operating expenses	161.7	161.8	0.1	0.1%
Loss from operations	(21.0)	(19.5)	(1.5)	(7.7%)
Interest and other	18.0	17.3	(0.7)	(4.0%)
Net loss	(39.0)	(36.8)	(2.2)	(6.0%)

Revenue

Our total revenues have decreased as shown in the following table:

Revenue ($ millions)	Three months ended March 31		Increase(Decrease)	
	2011	**2010**	**$**	**%**
Direct Route Revenue				
Vehicle traffic (volume)	*1,555,687*	*1,588,875*	*(33,188)*	*(2.1%)*
Vehicle tariff	54.4	53.4	1.0	1.9%
Passenger traffic (volume)	*3,744,938*	*3,955,789*	*(210,851)*	*(5.3%)*
Passenger tariff	30.6	30.9	(0.3)	(1.0%)
Social program fees	5.1	4.9	0.2	4.1%
Catering & on-board	13.3	14.6	(1.3)	(8.9%)
Other revenue	2.2	3.7	(1.5)	(40.5%)
Total Direct Route Revenue	105.6	107.5	(1.9)	(1.8%)
Indirect Route Revenue				
Ferry transportation fees	27.1	27.2	(0.1)	(0.4%)
Federal-Provincial subsidy	6.7	6.7	-	-
Total Route Revenue	139.4	141.4	(2.0)	(1.4%)
Other general revenue	1.3	0.9	0.4	44.4%
Total Revenue	140.7	142.3	(1.6)	(1.1%)

Total tariff revenue increased $0.7 million in the last quarter of fiscal 2011 compared to the prior year. The fourth quarter increase in average tariff revenue per vehicle was $1.36 or 4.0% while the increase in average tariff revenue per passenger was $0.36 or 4.6%.
The effect of higher average fares was partially offset by lower vehicle and passenger traffic. A contributing factor to the variation in traffic was the 2010 Winter Olympics in Vancouver. In February 2010, our passenger traffic was up 52,959 or 4.5% while vehicle traffic was down 38,125 or 7.6% compared to February 2009. Vehicle traffic in the fourth quarter of fiscal 2011 compared to the fourth quarter of fiscal 2009, was down 4.5% while passenger traffic was down 3.2%.

Catering and on-board revenues decreased as a result of lower passenger traffic and lower average spending per passenger.

Other revenue reflects a reduction in reservation fees and adjustments to assured loading tickets revenue.

Ferry transportation fees were lower on the Northern Routes, reflecting the reduction in fees as the vessel assets are amortized.

Expenses

Expenses are shown in the following table:

	Three months ended March 31			
			(Increase) Decrease	
($ millions)	**2011**	**2010**	**$**	**%**
Operations	95.9	93.0	(2.9)	(3.1%)
Maintenance	22.4	25.0	2.6	10.4%
Administration	8.9	8.0	(0.9)	(11.3%)
Cost of retail goods sold	5.2	5.8	0.6	10.3%
Amortization	29.3	30.0	0.7	2.3%
Total operating expenses	161.7	161.8	0.1	0.1%
Interest & other	18.0	17.3	(0.7)	(4.0%)
Total expenses	179.7	179.1	(0.6)	(0.3%)

The increase in operations costs reflects wage rate increases averaging about 3%; higher benefit costs due to increased rates in several benefit plans for the new calendar year; partially offset by lower incentive compensation.

The decrease in maintenance costs reflects variations in vessel refit scheduling.

Administration costs increased mainly due to adjustments to incentive compensation in the prior year and higher information technology licence fees and support costs.

Cost of retail goods sold declined as a result of the lower catering and onboard revenues.

Amortization decreased mainly due to $1.5 million lower amortization of our four vessels built in Germany as a result of the receipt of $119.4 million in duty remission and related GST which reduced the capital cost of these vessels; partially offset by higher amortization of terminal assets that have come into service.

Interest expenses increased primarily due to $0.7 million lower funding under the SFF program; $0.6 million additional interest on the capital lease for the new corporate office building; partially offset by $0.5 million lower capitalized interest.

INVESTING IN OUR CAPITAL ASSETS

Assets acquired under Capital Lease

In September, 2010, agreements which constitute a capital lease for space in our new corporate office building in downtown Victoria took effect following the completion of construction of the new building.

The initial term of the lease is 15 years, with four renewal options of five years each. In November, 2010, we advanced $24.2 million to the developer of the property for a term of 15 years, secured by a second mortgage on 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, we were granted an option to purchase up to 50% of the owner's equity interest in the new building at a price of $24.2 million. Final adjustments were made on April 15, 2011, bringing the total amount of the loan and the purchase option to $24.5 million. The purchase option expires at the end of the loan term.

Relocation to this property consolidates our head office functions, allowing for operating efficiencies, by combining all departments under one roof. Assets totalling $49.2 million representing the present value of the future minimum payments under these agreements, including the purchase option, have been added to our capital assets in September 2010.

Capital Expenditures

Capital expenditures in the three and twelve months ended March 31, 2011, totalled $39.5 million and $128.7 million, respectively.

Capital expenditures ($ millions)	**March 31, 2011**	
	3 Months	**12 Months**
Vessel upgrades and modifications	14.9	45.4
Terminal marine structures	13.7	41.6
Terminal and building upgrades and equipment	6.9	24.5
Information technology	4.0	17.2
Total capital expenditures	39.5	128.7

In August 2010, the Government of Canada announced stimulus funding for three projects: an overhead walkway at Horseshoe Bay; a foot passenger walkway at Campbell River; and a waste water facility at Langdale. We expect to receive approximately $2.1 million of the total project costs budgeted at $5.2 million.

On October 1, 2010, the Government of Canada announced that it had granted our request for duty remission on our four vessels built in Germany. Funds totalling $119.4 million (including related GST) were received and have been applied to the capital costs of these four vessels, reducing their net book value.

Our ongoing capital expenditures are expected to be significantly lower than in the previous few years. The next significant vessel renewal program will commence for the Other Routes within the next five years. Planning for this program is currently underway.

Vessel Upgrades and Modifications
Capital expenditures for vessel upgrades and vessel modifications in the three and twelve months ending March 31, 2011, included the following:

Vessel upgrades and modifications ($ millions)	**March 31, 2011** 3 Months	**March 31, 2011** 12 Months
Quadra Queen II life extension	4.6	14.3
Sewage treatment upgrade program	1.5	9.5
Queen of Chilliwack life extension	2.5	3.6
Queen of Nanaimo asset betterment	-	3.6
Queen of Capilano interior upgrades	1.9	2.1
Queen of Cumberland interior upgrades	0.1	1.9
Main engine parts and electrical components for the three Coastal class vessels	0.2	1.2
Mayne Queen interior and safety upgrades	1.0	1.0
Klitsa propulsion and safety upgrades	0.3	0.7
Evacuation chutes for three vessels	0.1	0.9
Electrical & navigational upgrades	0.2	0.8
Quinsam upgrade and betterment	0.3	1.0
Other projects	2.2	4.8
	14.9	45.4

The 41-year-old *Quadra Queen II* returned to service on March 24, 2011, following completion of an 11-month life extension project to prepare the vessel for a further 20 years of service. The $15 million project included new propellers and bow thruster, new generators, new instrumentation and control systems, and new lifesaving systems as well as interior upgrades and hull steel renewal. On April 13, 2010, we received approval for up to $1.8 million of additional interest rate support payments through the SFF program relating to this life extension.

Implementation of a multi-year sewage and waste water treatment program to upgrade 20 vessels and eight terminals for treatment of sewage generated onboard the vessels continues. The program involves major modifications and upgrades to ensure that all vessels comply with *Canada Shipping Act, 2001* sewage regulations, which will apply effective July 1, 2012. Wherever possible, the vessels will convey sewage to a terminal through pump-ashore infrastructure. In all other cases, the vessels will be fitted with compliant marine sanitation devices. Modification of the *Spirit of British Columbia*, *Skeena Queen, Kwuna, Queen of Nanaimo, Queen of Cumberland, Queen of Coquitlam, Queen of New Westminster, Quadra Queen II,* and *Queen of Capilano* are complete.

The project to extend the life of the 33-year-old *Queen of Chilliwack* began in December 2010 with the first phase of a 2-phase project that will allow the vessel to continue in service until it is retired in 2016 or later. The first phase of this $15 million project includes new car deck watertight doors, new propeller seals, new instrumentation and control systems, and new lifesaving systems. The *Queen of Chilliwack* is expected to return to service by the end of the first quarter of fiscal 2012.

The 47-year-old *Queen of Nanaimo* returned to service on December 17, 2010, after completion of a $4 million asset betterment project in the third quarter. The betterment included steel renewal throughout the vessel and a new exhaust system, among other upgrades.

The 20-year-old *Queen of Capilano* returned to service on March 3, 2011, following a $2 million mechanical refit and dry-docking, passenger accommodation upgrade, installation of new car deck deluge piping, and upgrades to the sewage system described above.

While undergoing refit in the third quarter, the interior of the *Queen of Cumberland* was upgraded. The $2 million upgrade included improvements to passenger accommodations and washrooms as well as ergonomic improvements in crew facilities and a change to more efficient surfaces for ease of maintenance. The upgrade to this 19-year-old vessel is the first phase of a planned mid-life upgrade with the balance scheduled for fiscal 2017.

The 29-year-old *Quinsam* returned to service on May 18, 2010, after completion of an extensive $19 million asset betterment project to prepare the vessel for another 17 years of service. The betterment included new lifesaving systems, new electrical switchboard and generators, new right-angle drives, new sewage tank and macerator, as well as engine upgrades, hull steel renewal and various interior improvements. In October 2010, the Government of Canada agreed to provide $1.0 million of interest rate support payments relating to the life extension of the *Quinsam* through the SFF program. Of the $1.0 million, $0.1 million was recorded as a reduction of capitalized interest.

Terminal Marine Structures

Capital expenditures for terminal marine structures in the three and twelve months ending March 31, 2011 included the following:

Terminal marine structures ($ millions)		**March 31, 2011**	
Terminal	**Description**	**3 Months**	**12 Months**
Tsawwassen	Major berth replacement and refurbishment	8.2	27.4
Swartz Bay	Replacement and reconfiguration of two berths	1.4	2.6
Campbell River	Replacement of wingwalls and dolphins	0.3	2.4
Richmond Maintenance Facility	Building four new dolphins, reinforcing three others and modifying ramp	-	1.7
Hornby Island	Replacement of wingwalls, ramps & dolphins	0.8	1.2
Brentwood Bay	Modify the marine structures to accommodate a larger vessel	0.7	0.8
Quathiaski Cove	Replacement of ramp, wingwalls, towers and shelter	-	0.8
Gravelly Bay	Replacement of wingwalls	0.6	0.7
Sturdies Bay	Replacement of floating lead	-	0.7
Various	Other projects	1.7	3.3
		13.7	41.6

The $32 million multi-year project for replacement and refurbishment of berth 4 at Tsawwassen terminal is now complete. The project replaced all 13 dolphins and the port wingwall. The lower ramp was replaced with a new multi-apron ramp with two-lane commercial vehicle capacity and the foundations and ramp supports were upgraded and a new hydraulic lift system installed.

The expenditures at Tsawwassen terminal also include the completion of our project for concrete restoration and full seismic upgrade of the transfer deck between berths 3 and 4. Also included are preliminary costs for deck coating of two berths and replacement of the dolphins, catwalk and sheet pile wall at berth 5.

Terminal and Building Upgrades and Equipment
Capital expenditures for terminal and building upgrades and equipment in the three and twelve months ending March 31, 2011 included the following:

Terminal and building upgrades and equipment ($ millions)	**March 31, 2011**	
	3 Months	**12 Months**
Terminal waste water program	3.6	7.7
Corporate head office	0.3	6.3
Vehicles, machinery & equipment	1.1	3.0
Departure Bay terminal improvements	0.2	1.7
Seismic upgrades	0.3	1.4
Horseshoe Bay terminal improvements	0.4	0.9
Maintenance facility improvements	0.2	0.9
Security upgrades	-	0.6
Other terminal projects	0.8	2.0
	6.9	24.5

As part of the multi-year sewage and waste water treatment program for treatment of sewage generated onboard our vessels, connection of Swartz Bay terminal to the existing municipal infrastructure has been completed, allowing us to transfer sewage from our smaller vessels operating out of this terminal. Construction of a holding tank at the terminal to accommodate sewage from our larger vessels is also complete and is in service. This allows transfer to the municipal infrastructure to occur during off-peak periods. As part of the Federal government's Infrastructure Stimulus Fund program, we received $2.2 million in December 2010 and a further $1.0 million in February 2011 to assist with sewage pump-ashore projects and other major terminal projects. We estimate that we will receive a total of $9.2 million relating to these projects.

At our new corporate office building, we have made capital improvements including security and sound masking systems and an emergency generator. We've also installed movable walls, signage and furniture.

The costs incurred for vehicles, machinery, and equipment include the purchase of a crane truck in the third year of our five-year heavy vehicle replacement program. This new vehicle replaced an 18-year-old crane truck which we donated to Camosun College of Victoria for use in their heavy duty mechanics program. We also continued with the second year of our two-year program supporting our new drop trailer service with the purchase of three additional hostling units. These units will be used to move commercial trailers to and from our holding compounds. In the fourth quarter, we purchased four explosives detection units for use at our four major terminals.

We have completed our multi-year program in accordance with our master plan for improvements at Departure Bay terminal, with the exception of construction of a canopy which is expected to be completed next fiscal year. These improvements have included new retail and ticket buildings, a new waiting room, consolidation of waste management facilities, and reconfiguration and expansion of the holding compound and employee and customer parking lots.

As part of multi-year projects to upgrade our facilities, the office and warehouse buildings at our Nanaimo terminal maintenance facility as well as the pre-boarding building at our Tsawwassen terminal have undergone seismic upgrades.

At nine terminals, mainly serving our Major and Northern Routes, we continued our multi-year project to upgrade 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. We received $3.2 million in the first quarter of fiscal 2011, bringing the total to $9.1 million of federal funding through the Transport Canada Marine Security Contribution Program to help offset our costs of perimeter security, access control measures, and training.

Information Technology

Capital expenditures for information technology in the three and twelve months ending March 31, 2011, included the following:

Information technology ($ millions)	**March 31, 2011** 3 Months	12 Months
Oracle enterprise licence software	-	4.1
Payroll system replacement	0.6	2.7
Customer service program	0.6	1.8
Computer hardware upgrades	0.6	1.7
Website enhancements	0.3	1.0
Communications software	0.3	0.9
Data privacy & archiving	0.2	0.7
Upgrade communication systems	0.1	0.7
ERP foundation upgrades	-	0.6
Other projects	1.3	3.0
	4.0	17.2

As part of our ongoing processes, we have reviewed and updated our enterprise wide Oracle licences.

The payroll system replacement initiative will replace both our payroll and labour distribution systems to provide added reliability and significant processing efficiencies and flexibility.

The customer service program will replace our aged point of sale and reservations systems, and allow us to respond in a more timely fashion to changing business needs and to support marketing, travel services, and pricing initiatives. This program will also include terminal ticketing automation and customer relationship management systems. The multi-year program is in the final planning stage

Computer hardware upgrades continue as we proceed through our programs for replacement of aged computers, servers and printers.

The website initiative is a $4 million project to improve customer service and communications tools, both internally and externally, and to establish a technical platform to enable future web enhancements.

Other projects include automated wireless ticketing and bridge team simulator training. In September 2010, we introduced wireless hand-held point-of-sale units on Denman Island, Quadra Island and Saturna Island where transactions were previously processed manually. This has allowed us to eliminate prepaid paper tickets on these routes and has enabled customers to use credit cards or their BC Ferries Experience Cards to purchase fares.

We have started our bridge team simulator training project that will implement training simulators at three of our major terminals. This will allow us to provide low-risk, affordable, and sustainable simulation training in individual and team skills for bridge personnel.

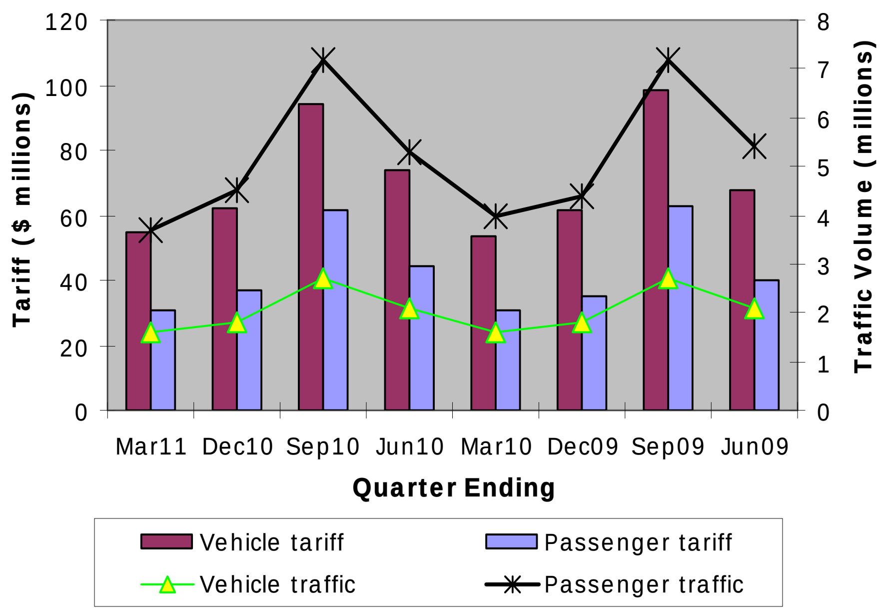
SUMMARY OF QUARTERLY RESULTS

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

	Quarter Ended (unaudited)							
($ millions)	**Mar 11**	**Dec 10**	**Sep 10**	**Jun 10**	**Mar 10**	**Dec 09**	**Sep 09**	**Jun 09**
Total revenue	140.7	162.4	246.0	190.2	142.3	159.9	251.8	178.3
(Loss) earnings from operations	(21.0)	(3.2)	72.4	18.9	(19.5)	(1.9)	81.5	12.2
Net (loss) earnings and comprehensive (loss) income	(39.0)	(12.4)	54.3	0.9	(36.8)	(20.4)	64.2	(3.6)

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 reduction in traffic. We utilize these periods to perform upgrades and major maintenance and refit programs, as well as to undertake mandatory inspections on the majority of our vessels.

The following graph demonstrates the seasonality of our revenue and shows the relationship of traffic volume and tariff revenue over the most recent eight quarters:



OUTLOOK

Traffic Levels

Ferry traffic levels are affected by a number of factors, including the economy, weather, transportation costs, the value of the Canadian dollar, global security, tourism levels, disposable personal income, demographics, and population growth. We are uncertain as to the individual or cumulative impact these items may have on our traffic levels. We are also uncertain as to the cumulative impact that tariff rate increases and the implementation and removal of fuel surcharges or rebates may have.

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 fiscal 2009, the Canadian and world economies experienced turbulence in the financial markets and a recessionary period. British Columbia experienced fewer housing starts, reduced tourism, plant closures in the forest product industry, falling auto sales, dramatically higher vehicle fuel prices during the first part of the fiscal year, rising unemployment, and generally reduced consumer confidence. These and other declining economic conditions all negatively impacted our commercial and discretionary travel markets. The downturn in traffic in fiscal 2009 was at least partly due to these economic conditions.

In fiscal 2010, we experienced a 1.5% increase in both vehicle and passenger traffic levels, as economic conditions began to improve and vehicle fuel prices declined compared to the prior year. The Winter Olympics in Vancouver also had an impact on travel in the latter part of the fiscal year.

In fiscal 2011, our vehicle and passenger traffic declined by 1.6% and 1.4%, respectively, bringing traffic to levels similar to those experienced in fiscal 2009. During fiscal 2011, vehicle fuel prices again climbed while tourism remained lower than in years prior to fiscal 2009.

Vehicle Traffic by fiscal year

(thousands)	**2011**	**2010**	**2009**	**2008**	**2007**
Major routes	3,703.9	3,739.7	3,696.3	3,912.3	3,826.5
Other routes	4,386.2	4,484.6	4,402.4	4,632.6	4,669.6
Northern routes	29.4	31.1	31.7	33.8	25.8
Total	8,119.5	8,255.4	8,130.4	8,578.7	8,521.9
(Decrease) increase	*(1.6%)*	*1.5%*	*(5.2%)*	*0.7%*	*(0.3%)*

Passenger Traffic by fiscal year

(thousands)	**2011**	**2010**	**2009**	**2008**	**2007**
Major routes	10,738.6	10,804.8	10,664.2	11,304.0	11,146.3
Other routes	9,921.6	10,142.6	9,969.3	10,382.7	10,440.5
Northern routes	86.0	88.2	94.0	101.8	78.2
Total	20,746.2	21,035.6	20,727.5	21,788.5	21,665.0
(Decrease) increase	*(1.4%)*	*1.5%*	*(4.9%)*	*0.5%*	*(0.3%)*

Over the near term we expect traffic levels to stabilize at these new levels and over the next few years we anticipate a limited recovery in discretionary traffic levels resulting in no significant increase in overall traffic volume on all our routes.

Market Opportunities

We are constantly looking for innovative ways to serve our customers and actively pursue opportunities for growth.

Our drop trailer service, launched in March 2009, operates on two of our Major Routes. Our commercial customers on these routes can drop their trailers off at one terminal and pick them up at another. This drop trailer service continues to be well received in the commercial market and improves our overall productivity by utilizing otherwise unused capacity. Effective April 1, 2011, this service became subject to minimum allowable average tariff rates pursuant to a ruling by the Commissioner, which is being appealed by our major competitor in this area. However, the Commissioner's ruling has brought some certainty to the market place, enabling us to assure our commercial customers that we can provide them with innovative solutions over the long-term. We expect to see modest growth in commercial traffic over the next few years as general economic conditions continue to improve and we expect to see our overall commercial market share remain relatively stable.

On May 11, 2010, we officially opened our new vacations centre in downtown Vancouver to build and leverage the BC Ferries Vacations' brand, and with marketing programs designed to influence discretionary travel to the communities we serve. Using a 37-foot long interactive media wall display, customers are able to view route maps, vessel schematics, and destination images to help them choose from a variety of travel package options. The 250-square-metre travel centre in the new Fairmont Pacific Rim property is conveniently located in the tourist sector and directly across from the newly expanded Vancouver Convention Centre. Currently we have 50 unique BC coastal vacation packages and more than 100 individual products that include accommodations, activities and adventures available for purchase at the centre, through our website or by telephone.

Approximately 6,550 people have visited the centre since it opened, of which the majority were local Vancouverites and from other parts of Canada, and 40% were tourists from Europe, the United States, Asia, and elsewhere. A total of 3,889 room nights in 28 different communities have been booked through this new offering. As we expand our market reach and increase our profile in the Lower Mainland and within the tourism industry, and as the economy strengthens, we expect to see significant growth in sales of vacation packages, leading to increased traffic volumes as well as incremental non-tariff revenue.

Asset Renewal Program

We have one of the largest fleets in the world. The average age of our assets was among the oldest of major ferry operators worldwide. To address this, we instituted a multi-year major fleet and asset renewal program which involved upgrading and replacing a large share of our fleet and terminal assets. The most significant portion of our asset renewal program was completed during fiscal 2010.

Over a number of years, this program saw seven new vessels being added to our fleet, many other vessels significantly upgraded and numerous improvements to our terminal assets. The entry of the new vessels into service and asset revitalization has reduced the average age of our vessels and assists in maintaining operational reliability.

Our next significant vessel renewal program will be focused on our minor and intermediate sized vessels contemplated for replacement within the next two performance terms. As the identified replacement dates approach, we will undertake a full review of these vessels to determine if any are candidates for life extension rather than replacement. Over the next five years, we expect to replace or life-extend four vessels, one which is expected to be replaced with a cable ferry, assuming regulatory and environmental approvals are obtained.

Cable Ferry

In fiscal 2011, we completed our review of the feasibility of using cable ferry technology on one of our shortest routes. We determined that using a cable ferry is both technically and financially feasible. Cable ferry 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 a reduction in operating costs would also be expected. We are in the process of seeking regulatory and environmental approvals that are required before such a service could be implemented. Safety, reliability and quality of service will continue to be important considerations in the overall assessment of this concept. This initiative is 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.

Alternative Service Providers

In an effort to reduce costs on our regulated routes, from time to time we test the market to determine if another operator, under contract to us, could provide safe, reliable and high quality service that is more cost-effective.

In accordance with the Commissioner's report on the preliminary price cap decision for performance term three, we expect that the Commissioner will issue an order under section 69 of the Act for us to provide a plan to seek alternative service providers with respect to:

- winter service to the mid-coast ports of Bella Bella, Shearwater and Ocean Falls;
- service between Powell River and Comox, and Powell River and Texada Island; and
- service between Buckley Bay and Denman Island if we decide to proceed with the cable ferry option for service on this route.

The Commissioner has indicated his intention to issue this order in conjunction with his final price cap determination, which is due by September 30, 2011.

Financial Outlook

We do not anticipate that economic conditions or our traffic levels will improve in the near term and are continuing our program of cost containment and deferrals, while maintaining safe, reliable service.

We are currently forecasting a net loss estimated to be in the range of $20 million for fiscal 2012, largely driven by significantly lower traffic levels than those included in setting our performance term two price caps. Despite the loss, we have no plans to reduce our refit and maintenance programs, training and safety programs or capital programs. Although lower traffic levels are the major driver, other contributing factors to this loss are such items as the HST, Transport Canada requirements and freedom of information overhead expenses and other costs associated with Bill 20. We expect to return to profitability in fiscal 2013, the first year of performance term three.

We are not intending to apply to the Commissioner for an interim price cap increase as a result of these lower traffic levels. Our strong balance sheet and cash position (aided significantly by the $119.4 million remission of import taxes and related GST on new vessels) will enable us to maintain our current level of operations while continuing to invest in our future.

FINANCIAL RISKS AND FINANCIAL INSTRUMENTS

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

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment. Where the market prices are not available, fair values are estimated using discounted cash flow analysis based on our current borrowing rate for similar borrowing arrangements.

Credit Risk

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

Our credit risk from trade customers is limited by having a large and diversified customer base and is managed through the review of third party credit reports, utilizing pre-authorized payment plans, monitoring of aging of receivables, and collecting deposits and adjusting credit terms for higher risk customers. Amounts due from the Province and the Government of Canada are considered low credit risk. At March 31, 2011, 58% of our accounts receivable was comprised of amounts due from the Province and the Government of Canada.

Liquidity Risk

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

We manage liquidity risk through daily monitoring of cash balances, the use of long-term forecasting models and the maintenance of debt service reserves. Our credit ratings at March 31, 2011, were A (DBRS) with a stable trend and A+ (Standard & Poor's) with a stable outlook.

Market Risk

Interest Rate

Our exposure to interest rate risk is limited to our short-term borrowings and floating rate debt and interest rate movement beyond the term of the maturity of fixed rate short-term investments. To manage this risk, we maintain between 70% and 100% of our debt portfolio in fixed rate debt, in aggregate. A 50 basis point change in interest rates would not have had a significant effect on our fiscal 2011 earnings.

Foreign Currency

We are also exposed to risk from foreign currency prices on financial instruments, such as accounts payable denominated in currencies other than the Canadian dollar. To manage exposure on future purchase commitments, we review our foreign currency denominated commitments and hedge through derivative instruments as necessary. A 10% change in the US dollar or Euro foreign exchange rates would not have had a significant effect on our fiscal 2011 earnings.

Fuel Price

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

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

High levels of fuel pricing could translate into significant fuel surcharges and result in unprecedented total tariff levels. There is uncertainty of the impact on future ferry traffic levels if fuel surcharges and therefore total tariff levels rise significantly. There is a risk of a decline in ferry traffic levels as a result of increasing customer costs resulting from the implementation of fuel surcharges. Throughout much of fiscal 2011, fuel rebates rather than surcharges were in place on many of our routes. All fuel rebates were removed completely on December 1, 2010 due to the increasing cost of fuel. Due to the rising cost of fuel, on May 16, 2011, we announced the implementation of fuel surcharges effective June 1, 2011. These surcharges will be 2.5% on our Major Routes and 5% on many of our other routes.

We also may manage our exposure to fuel price volatility by entering into derivative agreements in order to add a fixed component to the inherent floating nature of fuel prices. Fuel price hedging instruments are used solely for the purpose of reducing fuel price risk, not for generating trading profits. Pursuant to our Financial Risk Management Policy, the term of the contracts is not to extend beyond three years. This policy limits hedging to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period, 90% of anticipated monthly fuel consumption for the 12 month period thereafter, and to 85% of anticipated monthly fuel consumption for the remaining 12 month period. At March 31, 2011, we did not have any outstanding fuel swaps. Gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs.

Derivatives
We hedge our exposure to fluctuations in fuel prices and foreign currency exchange rates through the use of derivative instruments. At March 31, 2011 we held five foreign exchange forward contracts with a carrying and fair value of $23 thousand while there were no commodity derivatives in place. At March 31, 2010, we had no derivative instruments in place.

The fair value of commodity derivatives would reflect only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel. The fair values would reflect the estimated amounts that we would receive or pay should the derivative contracts be terminated at the stated dates. Any gains or losses related to fuel commodity swaps would be charged to our deferred fuel cost accounts.

Non-Derivative Financial Instruments
The carrying and fair values of non-derivative financial instruments at March 31, 2011, and 2010 are as follows:

	2011		**2010**	
($ millions)	**Carrying Value**	**Fair Value**	**Carrying Value**	**Fair Value**
Financial Assets				
Cash and cash equivalents	33.3	33.3	10.6	10.6
Restricted short-term investments	37.0	37.0	37.2	37.2
Other short-term investments	64.1	64.1	7.7	7.7
Accounts receivable	20.6	20.6	18.8	18.8
Loan receivable	24.2	24.2	-	-
	179.2	179.2	74.3	74.3
Financial Liabilities				
Accounts payable and accrued liabilities	51.2	51.2	38.9	38.9
Short-term debt	3.9	3.9	-	-
Interest payable on long-term debt	18.3	18.3	18.3	18.3
Accrued employee costs	48.2	48.2	48.6	48.6
Long-term debt, including current portion	1,349.1	1,464.0	1,357.2	1,458.1
Other long-term liabilities	-	-	0.2	0.2
	1,470.7	1,585.6	1,463.2	1,564.1

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

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

BUSINESS RISK MANAGEMENT

We continue to employ a variety of commonly accepted methodologies to identify, assess and mitigate risks. We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business.

We do not believe that material uncertainties exist in regards to our future. As part of our risk management strategies, 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 ensure a viable, profitable future.

Customer Demand

Many factors affect customer demand, including current economic conditions, levels of tourism, and discretionary travel. The cost of fuel at the pump, the value of the Canadian dollar, disposable personal income, heightened global security and weather may have a negative effect on discretionary travel and levels of tourism.

We are uncertain as to the individual or cumulative impact these items may have on our revenue. We are also uncertain as to the cumulative impact that tariff rate increases and the implementation and removal of fuel surcharges or rebates may have on our traffic levels. No assurance can be given as to the level of traffic on our system and the resulting tariff revenue.

Risk mitigation: We actively manage our capacity in an efficient and effective manner to ensure we can react quickly to changing levels of demand. Vessel planning strategies are in place and we regularly review and update our short and long-term financial and operating plans to ensure appropriate alignment of expenses with revenue.

Security

Deliberate, malicious acts could cause death, injury or property damage. The occurrence of a major incident or mishap could negatively affect the propensity for the public to travel, reducing our ferry traffic levels. It could also lead to a substantial increase in insurance and security costs.

Any resulting reduction in tariff revenues and/or increases in costs could have a material adverse effect on our business prospects, financial condition and results of operations.

Risk mitigation: Security initiatives are in place to counter intentional attacks. Our 24-hour operations and security centre provides enhanced situational awareness and assessments, increased security monitoring, and a coordinated response during any incidents.

We are committed to our multi-year project to upgrade security at our terminals. 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.

We also have a sound conventional insurance program designed to mitigate the financial impact of a major incident. However, there can be no guarantee that the insurance coverage will be sufficient to cover all such accidents or disasters.

Safety
The safety of the public and our employees is our highest priority. However, there is a risk to passenger and employee safety and/or property damage as a result of the ineffectiveness of policy and procedures, equipment, maintenance, training, supervision, facility design and security measures.

We also have significant food and beverage sales, both on our vessels and at our terminals, and there is a risk of a foodborne illness contracted from contaminated products purchased from our food services.

A significant damage, injury or illness event could have an adverse effect on the lives of our employees and customers, our ability to meet operational service requirements, the environment, staff morale, our reputation and our financial position and results of operations.

Risk mitigation: In fiscal 2007, we commissioned former B.C. Auditor General, George L. Morfitt to conduct an independent review of our operational safety policies, procedures and practices. We have made significant progress in the implementation of all of the recommendations contained within his report. We have also engaged Morfitt to conduct a review on the status of the recommendations contained within his original report, completion of which is expected in fiscal 2012.

Our safety program, SailSafe, which was launched in fiscal 2008 and involves all employees, has begun to change our culture of safety awareness. Through SailSafe, safety is kept as the primary concern in the minds of our employees each and every day. As part of the SailSafe program, we are currently upgrading our safety management system including the introduction of an operational risk assessment and management process.

Our food storage, handling, preparation and cooking procedures are aligned with the hazard analysis critical control point (HACCP) methodology which is a preventive approach to food safety. HACCP is an industry-wide effort approved by the scientific community, as well as by regulatory and industry practitioners.

We also adhere to a program of internal and external safety audits designed to verify our compliance with our safety management system.

Performance Risk
The occurrence of a major incident or mishap could result in default under the Coastal Ferry Services Contract unless such accident or mishap qualified as an event of force majeure.

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

Risk mitigation: We have an asset renewal program for our vessels and terminals, a major portion of which has already been completed. This program will revitalize our fleet and upgrade our terminals to support our ongoing operations and maintain service reliability.

We regularly update our vessel maintenance schedules to ensure that we provide the core service levels required under the Coastal Ferry Services Contract.

We continuously monitor our operations from our 24-hour operations and security centre. This provides enhanced situational awareness and assessments to identify and prevent potential incidents and provides a coordinated response to any incident that may occur.

Regulations - Environmental
Our operations are subject to Federal, Provincial and local environmental laws and regulations dealing with various operations, including solid and liquid waste management, air quality and oil spill response.

The provincial government has made a commitment to reduce greenhouse gas emissions (GHG) by 33% by the year 2020, based on emissions in 2007. While the reduction targets have not yet been set, the transportation industry has been identified as a sector that will have emission limits.

If we were to be involved in an environmental accident or be found in material violation of applicable law and regulations, we could be responsible for material clean-up costs, repair of property damage, and fines or other penalties.

Risk mitigation: We will continue to comply with environmental laws and regulations and actively search for ways to improve our environmental performance to help us become an industry leader in environmental management.

We have a fuel reduction strategy that is designed to reduce fuel consumption and emissions on our vessels. We continue to use a lower sulphur diesel with a 5% biodiesel component on all of our vessels where the product is available. We have implemented a wide variety of fuel saving measures ranging from operating our vessels more efficiently to installing new, more fuel-efficient engines on some of our vessels and fuel monitoring systems on others and designing and building our new vessels to meet or exceed current environmental standards.

We have programs in place to protect the environment and reduce GHG. Besides using biodegradable hydraulic oils, we recycle beverage containers, cardboard, newsprint, plastics, wood, metal, spent fluorescent tubes, batteries, aerosol spray cans, and used cooking oil. We continue to replace chemical products with more environmentally friendly solutions and have replaced gasoline powered terminal vehicles with electric vehicles and gasoline powered baggage vans with propane powered tugger units. We also reduce GHG levels by transferring vessels to shore-power while berthed overnight, promoting anti-idling and increasing waste diversion.

We are also introducing new initiatives to further mitigate our environmental impact. A multi-year sewage and waste water treatment program to upgrade 20 vessels and eight terminals for treatment of sewage generated by the vessels is underway. Wherever possible, the vessels will convey sewage to a terminal through pump-ashore infrastructure. Where terminal facilities are not available, small vessels will be fitted with holding tanks, with truck pump-off. In all other cases, the vessels will be fitted with federally compliant marine sanitation devices. (See "Investing in our Capital Assets" above for more detail).

We believe that we maintain adequate environmental insurance; however, there can be no guarantee that the insurance coverage will be sufficient to cover all such losses.

Economic Regulatory Environment

We cannot predict what changes the Province may make to the Act or to other legislation, nor can we predict how the Commissioner's interpretation and administration of the Act may change over time. Such changes may impact our profitability. (See "Corporate Structure – Amendments to the *Coastal Ferry Act*" and "Corporate Structure – Economic Regulatory Environment" above for more detail).

The appointment term of the previous Commissioner expired on April 30, 2011, and a new Commissioner has been appointed. The previous Commissioner released preliminary price caps for the third performance term on March 31, 2011, and we submitted our response on May 2, 2011. Under the Act, the Commissioner is required to make the final decision on price caps by September 30, 2011. However, the Province has indicated it may extend this deadline by one year and establish price caps for the first year of performance term three by legislation. There is a risk that the price caps, which may be established by the Province, will be insufficient to re-establish profitability. There is also uncertainty inherent with the review of the Act to be undertaken by the Commissioner, as well as his future price cap rulings.

Risk mitigation: We strive to maintain regular and open communications and positive relationships, with the Province, the Commissioner, the Deputy Commissioner and local Ferry Advisory Committees that represent the interests of the communities we serve.

Regulations - Other

Our operations are subject to a wide variety of national and local laws and regulations, all of which may change at any time.

There is the potential that the introduction of new safety or other regulations, including new taxes, or the interpretation of existing regulations, may impose a new, unexpected and significant cost burden and/or result in major disruptions to our operations.

Risk mitigation: We foster positive relationships with local officials and treat recommendations and advisories with respect and due consideration. Appeals are made to higher authorities as required.

We strive to lead the way in adopting new regulations. We were one of the first to adopt, prior to the mandatory compliance date, the provincial *Public Health Act* regulation which restricts trans-fat in all food service establishments.

We continue to seek reasonable and cost effective solutions for compliance with new regulations through our planning processes and asset renewal initiatives. (See "Financial and Operational Overview" above for discussion on compliance with regulations of the *Canada Shipping Act, 2001*).

We have the opportunity to apply to the Commissioner under Section 42 of the Act for an extraordinary price cap increase if the introduction of new safety or other regulations impose a new, unexpected and significant cost burden.

Access to Capital Markets

Our ability to arrange sufficient, cost-effective and timely debt financing could be materially adversely affected by numerous factors; our economic regulatory environment, our results of operations and financial position, market conditions, our credit ratings and general economic conditions.

Any failure or inability to borrow on satisfactory terms when required could impair our ability to repay maturing debt, fund necessary capital expenditures and meet other obligations and requirements and, as a result, could have a material adverse effect on our ongoing operations.

Risk mitigation: We strive to communicate to our stakeholders the importance of our financial viability within our economic regulatory framework and our commitment to maintaining financial strength, in order to access these important markets.

Vessel Repair Facilities

We have a vessel repair facility in Richmond where we perform maintenance and refit work on our vessels; however, our facility does not have a dry-dock. There are only two shipyards with dry-docks in British Columbia that can accommodate large vessels. One of these shipyards dominates the vessel repair market, especially for large vessels.

Our vessel repair requirements are also changing. We expect to have fewer but larger refit projects over time, with most requiring dry-dock space. This strategy is expected to reduce mobilization and vessel re-deployment costs. At the same time, the overall demand for ship repair and ship building facilities is expected to increase with the federal ship procurement strategy. As a result, we expect docking facilities may become over-subscribed and demand for ship repair capacity will outstrip supply, especially for large vessels.

The inability to acquire timely and cost effective ship repair services may cause operational disruption and may have an adverse effect on results of operations, cash flow and financial results.

Risk mitigation: We plan our vessel maintenance to minimize the amount of dry-dock time required and to maximize the maintenance performed while vessels are afloat. When regulations permit, in-water surveys are performed on newer vessels, potentially eliminating the requirement for dry-docking. Also, alternatives to using local facilities are being researched.

We have also allocated $20 million of the $119.4 million received in remission of import taxes and related GST on the four vessels built in Germany to upgrade key assets in the ship repair and maintenance business in British Columbia.

Labour Relations – Collective Agreement

The majority of our employees are members of the Union. On March 8, 2007, a final award was released by arbitrator Vince Ready, building on the October 2004 interim award. This is expected to continue to provide us with labour stability until the end of the term on October 31, 2012. We have begun discussions with the Union on wage reopeners for the remainder of the current term.

The inability to maintain or to renew the collective agreement on acceptable terms could result in increased labour costs or service interruptions arising from labour disputes that are not provided for in approved rates and that could have an adverse effect on the results of operations, cash flow and financial results.

Risk mitigation: We work diligently to build productive relationships with our employees and the Union. The award has a mechanism in place that allows for the orderly transition to the next collective agreement without the ability to strike and provides a unique and innovative dispute resolution process to facilitate future collective bargaining.

Labour Relations – Application for Exclusions
Our application to Mr. Ready for the exclusion of approximately 155 positions of authority onboard our vessels was approved. There is a risk that we are unable to implement in accordance with our desired timetable. Also, as we implement these changes, there is a risk of operational disruption which may have an adverse effect on results of operations, cash flow and financial results.

Risk mitigation: A comprehensive transition adjustment plan, beginning with the most senior positions, has been developed and discussed with the Union. It provides for a gradual, phased implementation of the newly excluded positions over a two to five year timeframe to ensure the optimum retention of current staff and the orderly placement and orientation of staff into the new positions. This plan includes the assignment of leaders, employee mentors and an ombudsperson. The initial response from the senior positions is encouraging.

Taxes
We received an advance income tax ruling from Canada Revenue Agency (CRA) that, provided the facts and other statements set out therein are accurate, we are a “Tax Exempt Corporation” described in paragraph 149(1)(d.1) of the *Income Tax Act*. This ruling was subject to a proposed amendment to subsection 149(1.3) of the *Income Tax Act* announced by the Department of Finance on December 20, 2002. The essential elements of this amendment were included in Bill C-10, which was cancelled when Parliament was dissolved before the 2008 federal election and then subsequently included in the July 16, 2010 draft Income Tax Amendments Act, 2010, which had not been introduced into Parliament prior to Parliament being dissolved before the 2011 federal election. There is no reason to believe that the proposed amendment to subsection 149(1.3) will not be reintroduced. We have received a non-binding opinion from CRA that subsection 149(1.3), if amended as proposed on December 20, 2002, will not cause us to cease to be a Tax Exempt Corporation. There can be no assurance that subsection 149 (1.3) of the *Income Tax Act* will be amended as proposed, or that we are and will continue to be a Tax Exempt Corporation.

The 12% HST came into effect on July 1, 2010. As a result, we incurred a significant increase in our tax cost as a number of items we previously purchased exempt from the Provincial Sales Tax became subject to this new tax. We estimate the annual increase in our operating costs to be approximately $5 to $6 million. The HST also caused the selling price of our catering and certain other on-board services to increase. The additional cost to our customers may negatively impact their level of spending and, in turn, our revenue.

As the vast majority of ferry fares charged to our customers will be exempt from HST, we have limited opportunity to recover HST paid through input tax credits. The total effect of the HST could have an adverse effect on the results of operations, cash flow and financial results.

Risk mitigation: We have reviewed and updated our financial and operating plans in consideration of the increased costs resulting from the HST and have included the impact of this tax in our submission in respect of our third performance term price caps.

We have the opportunity to apply to the Commissioner under Section 42 of the Act for an extraordinary price cap increase if the introduction of new safety or other regulations imposes a new, unexpected and significant cost burden.

Treaty Negotiations: Aboriginal Rights and Title

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

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

Risk mitigation: Under the master agreement, the Province retains its liability, to the extent any exists, for the acts and omissions of the Province that occurred prior to our possession of the ferry terminal properties leased under the Terminal Leases and will reimburse us for any damages we suffer as a result. The Province will reimburse us for damages suffered if there is a final court decision or a treaty settlement that recognizes or confers upon an aboriginal group a proprietary or other interest in the ferry terminal properties should that right or interest interfere with our quiet enjoyment of the ferry terminal properties as set out in the Terminal Leases.

ACCOUNTING PRACTICES

Critical Accounting Policies and Estimates

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

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

We believe the following are the most critical accounting policies and estimates that we have used in the preparation of our financial statements:

Workers' Compensation Claims Liability

Our financial statements include an estimate of residual liability for workers' compensation claims arising from the Workers' Compensation Board (WCB) deposit class coverage system, in which our predecessor entity participated on or prior to March 31, 2003.

An actuarial valuation of the unfinalized claims remaining to be paid at March 31, 2006 that relate to incidents on or prior to March 31, 2003 was received in fiscal 2007 and the accrued benefit obligation estimated at $4.7 million. This residual liability is drawn down as claims are paid. The remaining balance at March 31, 2011 and March 31, 2010 of $1.7 million is included in accrued employee future benefits in our financial statements.

Public Service Pension Plan

Our employees are members of the Public Service Pension Plan (the Plan), a defined benefit and multiemployer pension plan. The Plan is exempt from the requirements under the provincial *Pension Benefits Standards Act* to use the "solvency" method in conjunction with the "going concern" method for valuation purposes. As such, the Plan is currently valued solely by the going concern method. The most recent valuation of the total Plan, as at March 31, 2008, indicated a surplus of $487 million.

Effective April 1, 2009, the Public Service Pension Board of Trustees increased contribution rates to the basic account for plan members and employers from 7.63% to 7.78% of pensionable earnings each, primarily due to the change in the investment return and salary increase assumptions. The contribution rates to the inflation adjustment account remain unchanged for members and employers at 1.5% and 2.5% respectively.

Retirement Bonus Liability

We sponsor a plan that provides a post-retirement benefit for eligible long service employees. The valuation of this plan is estimated based on complex actuarial calculations using several assumptions. These assumptions are determined by management with significant input from our actuary. The valuation of the obligation depends on such assumptions as discount rate, projected salary increases, retirement age and termination rates. An actuarial valuation of the plan at March 31, 2010, was obtained and the accrued benefit obligation estimated at $13.4 million. The liability included in accrued employee future benefits in our financial statements at March 31, 2011, was $10.2 million ($10.0 million at March 31, 2010).

We have adopted the corridor method of recognizing actuarial gains and losses. Any gains and losses in excess of 10% of the obligation balance will be amortized over the average remaining service period of employees expected to receive benefits under this plan.

Rate Regulation
We follow generally accepted accounting principles which, as we are a rate-regulated entity, may differ from those otherwise expected in non-rate-regulated businesses. These differences occur when the regulator issues orders and generally involve the timing of revenue and expense recognition. The principles we follow ensure that the actions of the regulator, which create assets and liabilities, have been reflected in the financial statements.

The accounting for these items is based on an expectation of the future actions of the regulator. As of March 31, 2011, we have three regulatory assets or liabilities:

- Deferred fuel costs: the difference between amounts allowed by the regulator in operating expense and those actually incurred with settlement expected through future tariffs, surcharges or rebates;
- Performance term submission costs: costs for incremental contracted services relating to our second and third performance term submissions. Our regulator has approved recovery of the second performance term submission costs over the second performance term ending March 31, 2012 and recovery of the third performance term submission costs over the third performance term ending March 31, 2016.
- Tariffs in excess of price caps: the amount by which average annual tariffs collected at a specific date exceed established price caps set under the terms of the Act. The excess amounts collected will be returned to customers through future tariffs.

If the regulator's future actions are different from our expectations, the timing and amount of the settlement of regulatory assets and liabilities could be substantially different from that reflected in our financial statements.

Amortization Expense
Our capital assets, including assets under capital leases, are amortized on a straight-line basis at varying rates. Amortization rates require the use of estimates of the useful lives of the assets and of salvage value to be realized upon asset retirement.

We periodically review asset lives in conjunction with our longer term asset deployment, replacement and upgrade strategies. When we determine that asset lives do not reflect the expected remaining period of benefit, we make prospective changes to the remaining period over which they are amortized. There are a number of uncertainties inherent in estimating our asset lives and changes in these assumptions could result in material adjustments to our financial statements.

As disclosed in note 1 to our financial statements, we review and evaluate our long-lived assets for impairment when events or changes in circumstances indicate that the related amounts may not be recoverable.

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

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

Asset Retirement Obligations

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

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

No amount has been recorded for asset retirement obligations relating to these assets as it is not possible to make a reasonable estimate of the fair value of any such liability due to the indeterminate magnitude, likelihood or financial impact, if any, of this issue. In addition, as our operations are regulated, there is a reasonable expectation that any significant asset retirement costs would be recoverable through future tariffs.

Adoption of New Accounting Standards

No new accounting standards have been adopted for fiscal 2011.

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 IFRS over an expected five year transitional period.

  Our changeover date for the conversion to IFRS was originally April 1, 2011. However, the 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 IFRS to disclose that fact.

  The Canadian Securities Administrators' regulations have also been amended to incorporate the AcSB's one-year deferral.

  We have elected this option which defers our changeover date for conversion to IFRS to April 1, 2012.

  Transition to IFRS will require the restatement for comparative purposes of amounts reported by us for the year prior to changeover date. 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 AcSB 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, we are unable to fully determine the impact of IFRS on the future financial position and results of operations.

  We commenced our IFRS transition 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 transition project consists of three phases:

1. Scoping and diagnostic phase, which has been completed, involved project planning and resourcing, high level impact assessment of differences between current Canadian GAAP and IFRS, and priority setting;
2. Analysis and development phase which involves detailed analysis and evaluation of options and alternative methodologies available under IFRS, and the financial impact of these options; and
3. Implementation and review phase which involves implementing and approving changes to accounting policies, information systems, business processes and training, and developing IFRS-compliant financial statements.

We are currently in either the analysis and development stage or the implementation and review stage, depending on the specific area.

The following table includes elements of our IFRS transition plan and an assessment of progress towards achieving the key milestones which have been amended to reflect our election to defer our changeover to IFRS by one year, to April 1, 2012. 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.

Financial statement preparation
Key activities • Identify differences in Canadian GAAP/IFRS accounting policies • Select ongoing IFRS policies • Develop financial statement format • Select IFRS 1 exemptions for transition • Quantify effects of change at April 1, 2011 (for fiscal 2012 comparative financial statements)
Milestones • Senior management review of policy decisions and illustrative IFRS financial statements and disclosures by June 30, 2011 • Audit & Finance Committee approval of policy decisions and IFRS financial statement format, in principle, by September 30, 2011 • IFRS 1 exemptions finalized and quantified by September 30, 2011 • Policies and procedures in place by March 31, 2012
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; review prioritized; and in-depth analysis complete • Accounting policy alternatives have been analyzed and recommendations made for key accounting policy decisions • IFRS 1 exemptions reviewed and analyzed • Preparation of illustrative financial statements and note disclosures complete • Drafting of policies and procedures in progress

Information technology infrastructure
Key activities • Confirm system upgrades required for IFRS reporting • Review/revise data gathering processes • Review/revise budgeting and forecasting processes
Milestones • System configuration changes complete by March 31, 2010 • System reporting changes required to accommodate both current Canadian GAAP and IFRS complete by August 31, 2010 • Changes to budgeting and forecasting processes complete by June 30, 2011
Status • Detailed reporting requirements to accommodate the transition to IFRS identified and documented • Overall system approach selected • System configuration to accommodate both current Canadian GAAP and IFRS complete • System changes to accommodate reporting requirements complete • Review to determine effects on the project of one-year deferral of changeover and absence of standard on rate-regulation complete • Changes to budgeting and forecasting processes in progress

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 • Provide department specific training on revised policies and procedures • Provide timely communication to both internal and external stakeholders on impacts of the transition to IFRS
Milestones • Topic-specific training for IFRS working committee complete prior to March 31, 2010 • Department-specific training completed by March 31, 2012 • Impacts of transition to IFRS communicated to external stakeholders by March 31, 2012
Status • Core IFRS project team members completed topic-specific training, and successfully completed the "IFRS Award Program, Certificate Level" through the Institute of Chartered Accountants in England and Wales • Interdepartmental workshops provided on specific topics, including property, plant and equipment; IFRS 1; and the IFRS Framework • Training requirements identified and training plan developed for stakeholders • Ongoing communications with key stakeholders, including direct communication with the Commissioner, our Agent Bank, rating agencies, our Board of Directors, and with investors indirectly through our website • Interdepartmental training on specific topics underway

Control environment
Key activities • Accounting policy determination, documentation and implementation • MD&A ongoing communications
Milestones • All internal control process descriptions updated by March 31, 2012 • Publish quantitative effects of conversion on April 1, 2011 opening balance sheet in December 31, 2011 MD&A
Status • Analysis of control issues in progress as part of the detailed implementation plan • Review and update of process descriptions in progress • Documentation of policies and procedures nearing completion

Business policy assessment
Key activities • Financial covenants assessment • Compensation arrangements assessment • Customer and supplier contract evaluation
Milestones • Potential impact on compensation arrangements determined by December 31, 2011 • Impact on customer/supplier contracts determined by December 31, 2011 • Impact on financial covenants quantified by March 31, 2012
Status • All relevant GAAP-dependent covenants and contracts have been identified • Analysis to determine effects of IFRS on existing covenants and contracts in progress

A summary of progress in the review of areas identified to have the highest potential to impact us is as follows:

- Rate-regulated operations: IFRS does not currently provide specific guidance with respect to accounting for rate-regulated activities. In December 2008, the International Accounting Standards Board (IASB) initiated a project on accounting for rate-regulated activities that had an objective to develop a standard on rate-regulated activities that would clarify whether regulated entities could or should recognize assets or liabilities as a result of rate-regulation imposed by a regulatory body.

  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.

  This project on rate-regulated activities has been closed. There are no further discussions planned for this project. The IASB 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.

It is our expectation that issues regarding rate-regulated activities will remain unresolved for some time and that we will not be reporting our regulatory assets or liabilities on the IFRS Statement of Financial Position. Accordingly, our regulatory assets or liabilities will be derecognized on our transition date of April 1, 2011. As future balances of our regulatory accounts are uncertain, we cannot reasonably estimate and conclude the impact on our future financial position and results of operations with respect to accounting for rate-regulated activities.

- Property, plant and equipment:
  - *Inspections and major overhauls:* The capitalization of inspections and major overhauls of our vessels is a significant change affecting us. A process to track these items has been finalized and necessary system configuration changes have been completed. We have defined and identified inspection and major overhaul items for each class of vessel and are in the process of quantifying them for reclassification at transition date. We are also currently working on internal reporting solutions. As the quantification is in progress, the effect on our consolidated financial statements of the adoption of this guidance cannot be quantified at this time.
  - *Valuation subsequent to transition:* We have a choice under IFRS to value our property, plant and equipment using either a historical cost model or a revaluation model. We have decided to use a historical cost model for all property, plant and equipment with the exception of land. We will use a revaluation model for our land.

- IFRS 1 *First-Time Adoption of IFRS*: All elections and exemptions under IFRS 1 have been reviewed. The elections and exemptions that apply to us upon adoption are summarized as follows:
  - *Employee Benefits:* There is a choice to either recognize all cumulative actuarial gains and losses of defined benefit plans through opening retained earnings or recalculate the actuarial gains and losses under IFRS from the inception of the defined benefit plans. We have elected to recognize all cumulative actuarial gains and losses through opening retained earnings at April 1, 2011.
  - *Property, plant and equipment and Intangible assets:* There is a choice of valuation of property, plant and equipment and intangible assets at April 1, 2011, either to:
    - retrospectively apply IFRS to the valuation of the assets; or
    - to revalue items, on an asset by asset basis, at fair value and use that fair value as deemed cost; or
    - use previous GAAP carrying amounts at transition as the deemed cost for assets used in rate-regulated operations as detailed in the amendment to IFRS 1 published May 6, 2010.

    We have elected to use previous GAAP carrying amounts at transition as the deemed cost for all intangible assets and the majority of our property, plant and equipment with the exception of land. We have elected to revalue land at fair value at April 1, 2011. This revaluation will result in an increase in land value of $12.2 million.

  As actuarial valuations of our defined benefit plans at April 1, 2011 are yet to be completed, the full effect on our consolidated financial statements of the elections adopted under IFRS 1 cannot be quantified at this time.

- Intangible assets: There is substantially no change in IFRS from Section 3064, *Goodwill and Intangible Assets,* which we adopted April 1, 2009. The adoption of this guidance is not expected to have any significant effect on our consolidated financial statements.

- Asset impairment: Policies and processes regarding asset impairment and potential subsequent reversals have been completed. The adoption of this guidance is not expected to have any significant effect on our consolidated financial statements.

CORPORATE STRUCTURE AND GOVERNANCE

National Instrument 58-101 *Disclosure of Corporate Governance Practices* (the "Instrument") and a related National Policy 58-201 *Corporate Governance Guidelines* (the "Guidelines") issued by the Canadian Securities Administrators require reporting issuers to disclose annually their approach to corporate governance with reference to specific matters. See Schedule A for the disclosure in accordance with this Instrument.

FORWARD LOOKING STATEMENTS

This management's discussion and analysis contains certain "forward looking statements". These statements relate to future events or future performance and reflect management's expectations regarding our growth, results of operations, performance, business prospects and opportunities and industry performance and trends. They reflect management's current internal projections, expectations or beliefs and are based on information currently available to management. Some of the market conditions and factors that have been considered in formulating the assumptions upon which forward looking statements are based include traffic, the Canadian Dollar relative to the US Dollar, fuel costs, construction costs, the state of the local economy, fluctuating financial markets, demographics, tax changes, and the requirements of the Coastal Ferry Services Contract.

Forward looking statements included in this document include statements with respect to our: short-term and long-range business plans, and asset renewal programs for vessels and terminals; expectations regarding traffic levels, vacation package sales, and our lack of need to access capital markets for at least the next two years; expectations of a net loss in fiscal 2012, a return to profitability in 2013 and the impacts of the HST, certain Transport Canada requirements, and costs associated with Bill 20; estimates of funding under the Infrastructure Stimulus Fund program; and expectations regarding the impacts of IFRS. 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, limitations of vessel repair facilities, 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 except as may be required by applicable law.

SCHEDULE A
Corporate Structure and Governance
Board of Directors

British Columbia Ferry Services Inc. (BCFS or the Company) is subject to the *Business Corporations Act – British Columbia* and the *Coastal Ferry Act – British Columbia* (CFA). The Board of Directors (the Board) of BCFS is appointed by the Company's sole voting shareholder, B.C. Ferry Authority (BCFA or the Authority).

The directors are stewards of BCFS and set the strategic direction of the Company. The Board exercises its stewardship responsibilities by overseeing the conduct of the business, supervising management, which is responsible for the day-to-day conduct of the business, and endeavouring to ensure that all major issues affecting the business and affairs of the Company are given proper consideration.

The Board Governance Manual articulates the governance framework under which the Board fulfills its stewardship responsibilities. The manual assembles in one document the essential elements for providing an appropriate level of governance for the organization. It includes, among other things, terms of reference for the Board, Chair, directors, Committees, and Committee Chairs, and serves as a practical guide for the Board and management in fulfilling their respective duties and responsibilities. The Governance Manual is a product and responsibility of the Board.

In the fiscal year ended March 31, 2011, the Province of British Columbia enacted legislation, the *Miscellaneous Statutes Amendment Act (No.3), 2010* (Bill 20), which amended several statutes, including the CFA. The amendments to the CFA responded to the Comptroller General's Report on Review of Transportation Governance Models, released November 6, 2009, and included provisions that changed the governance framework within which BCFA and BCFS operate.

Among other things, Bill 20 required that effective September 30, 2010, the directors of BCFS be replaced and further stipulated that an officer of the Company, including the President & Chief Executive Officer, cannot be a director of BCFA or BCFS, and an individual cannot serve simultaneously as a director of BCFA and BCFS.

For the period April 1, 2010 to September 30, 2010, the Board was comprised of the following directors:

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

In accordance with the provisions of Bill 20, the Authority replaced all of the directors of the Company on September 30, 2010. Effective that date, the Board was comprised of the following directors:

Chair:	Donald P. Hayes
Members:	Elizabeth J. Harrison (Vice Chair), Holly A. Haston-Grant, Brian G. Kenning, Maureen V. Macarenko, P. Geoffrey Plant, Wayne H. Stoilen and Graham M. Wilson

Gordon R. Larkin was appointed a director of the Company effective November 26, 2010.

The Board is committed to the principles of independence and accountability. The Board has adopted policies and practices that ensure it has the capacity, independent of management, to fulfill the Board's responsibilities, make objective assessments of management, and assess the merits of management initiatives. The Governance & Nominating Committee has an ongoing responsibility to ensure that the governance structures and processes continue to enable the Board to function independently.

The Board and management recognize that there is a regular need for the Board to meet without management in attendance. It is general practice to conduct a portion of every Board meeting with only independent directors present.

The Board and its Committees each have the authority to retain any outside advisor, at the Company's expense, that it determines to be necessary to permit it to carry out its duties.

The recruitment of directors is undertaken with the objective of ensuring the Board is composed of a majority of strong, qualified, independent directors. The Board supports the concept that the Board Chair should be an independent director.

The Board has adopted a definition of an independent director for members of the Audit & Finance Committee consistent with the definition of independence in Multilateral Instrument 52-110. This definition, with some modification that is consistent with Multilateral Instrument 52-110, also applies to determining the independence of other members of the Board.

The Board is responsible for determining whether directors are independent pursuant to the definition of independence adopted by the Board. To do this, the Board requires members to disclose their relationships with the Company and its subsidiaries. These disclosures are reviewed by the Corporate Secretary, the Chair of the Governance & Nominating Committee, and the Chair of the Board. Any director who is deemed independent, and whose circumstances change such that he or she might be considered to no longer be an independent director, is required to promptly advise the Board of the change in circumstances. Directors are required annually to attest to their independence in writing.

David L. Hahn, President & CEO, served as a director of the Company from April 1, 2010 to September 30, 2010. By virtue of his being a member of management, Mr. Hahn was not independent. The other directors of the Company during the fiscal year were determined by the Board to be independent pursuant to the definition of independence adopted by the Board.

Directorships

The following were directors of a reporting issuer (or the equivalent) in Canada or a foreign jurisdiction, other than BCFS:

Donald P. Hayes:	*Director, Prima Colombia Hardwood Inc.*
Brian G. Kenning:	*Director, MacDonald Dettwiler & Associates Inc.*
	Director, Royal Oak Ventures
Jane L. Peverett[1]:	*Director, Canadian Imperial Bank of Commerce*
	Director, EnCana Corporation
	Director, Northwest Natural Gas Company
P. Geoffrey Plant:	*Director, Catalyst Paper Corporation*
Graham M. Wilson:	*Director, ITRON Inc.*
	Director, Naikun Wind Energy Group Inc.
	Director, Daylight Energy Inc.
	Trustee, Hardwoods Distribution Income Trust

Note 1: Jane L. Peverett ceased to be a Director of BCFS on September 30, 2010.

Orientation and Continuing Education
The Company has a variety of orientation and education programs in place for directors. These programs are aimed at increasing the directors' familiarity with the operation of the Company and its governance practices.

All new directors are provided with the opportunity to participate in an orientation program. The orientation program is tailored to the individual director's needs and areas of interest. The program generally involves a half to full day session, usually held prior to a new director attending his/her first BCFS Board meeting, during which the new director is briefed by members of senior management, and receives written information about the business and operations of BCFS and Board governance practices, including the duties and obligations of directors. A copy of the Board Governance Manual is made available to all directors. This manual provides a comprehensive overview of the roles and responsibilities of the Board, its committees, and the contributions expected by each director.

The Board recognizes the importance of ongoing director education and the need for each director to take personal responsibility for this process. To facilitate ongoing education, presentations are made to directors from time to time on matters of particular importance or emerging significance to the Company. As well, attendance by directors at seminars, courses or conferences of relevance to their position as directors of the Company may be arranged. Visits by directors to BCFS facilities and operations are also encouraged and serve to further enhance the directors' ongoing knowledge and understanding of the Company.

Responsibility for ensuring that orientation and ongoing education are provided to directors rests with the Chair of the Board. The Governance & Nominating Committee has responsibility for reviewing the orientation and education programs to ensure they are effective and meet the needs of directors.

Ethical Business Conduct
The Board approved and adopted a Code of Business Conduct and Ethics (Code) in November 2004; the Code was subsequently reviewed and amended by the Board in November 2009. Notice of adoption, and subsequent amendment of the Code as Company policy, was communicated to the Company's personnel by intra-Company information bulletin and BCFS' newsletter for personnel. In addition, the Code has been posted on the Company's intranet website for Company personnel, and on the Company's internet site. The Code was filed on SEDAR on March 1, 2006; the amended Code was filed on November 24, 2009. The Board has also adopted a Corporate Disclosure and Securities Trading Policy, which is also posted on the Company's intranet and internet sites.

As part of the Company's disclosure controls process, in conjunction with quarter-end financial reporting, appropriate managers are required to make representations regarding compliance with the Code and the Corporate Disclosure and Securities Trading Policy.

As part of the communication process for the reporting of questionable accounting and auditing matters, a secure telephone line and a secure e-mail address, each monitored by the Executive Director of Internal Audit, as well as a secure e-mail address monitored by the Chair of the Audit & Finance Committee of the Board, have been established and this has been communicated to Company personnel by intra-Company information bulletin and BCFS' newsletter for personnel. The contact particulars are also posted with the Code on the Company's intranet site.

The Board, through the Audit & Finance Committee, monitors compliance with the Code through review of compliance reports received quarterly from management, the external auditors, and the internal auditors.

Directors and officers review the Code, and acknowledge their support and understanding of the policy by signing an annual disclosure statement.

The Code requires that directors and officers disclose potential conflicts of interest at the time of their appointment and immediately upon a situation of a conflict of interest or potential conflict of interest arising. Such disclosures are communicated to and reviewed by the Corporate Secretary, the Chair of the Governance & Nominating Committee, and the Chair of the Board.

Nomination of Directors

The CFA, as amended by Bill 20, requires that when electing directors to the Board of BCFS, BCFA must select individuals in such a way as to ensure that, as a group, the directors of BCFS are qualified candidates, who hold all of the skills and all of the experience needed to oversee the operation of BCFS in an efficient and cost effective manner. On the recommendation of the BCFS Board, the Board of BCFA approves a profile setting out the skills, experience and expertise that should be represented on the BCFS Board (the Skills Profile). The Board of BCFS nominates qualified candidates for election as directors and recommends to BCFA the size of the BCFS Board.

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

The skills, experience, and expertise of the incumbents and any retiring directors of BCFS are reviewed by the Governance & Nominating Committee in the context of the Skills Profile approved by the BCFA Board and the ongoing governance needs of BCFS. Any gaps are identified. Potential conflicts of interest and other extenuating circumstances are also identified.

The Governance & Nominating Committee makes recommendations to the BCFS Board on suitable candidates for appointment to the BCFS Board. These recommendations take into account the talents of the existing BCFS Board, and the talents of all nominees, taking the Skills Profile established for the BCFS Board, including knowledge of or presence in the communities served by BCFS, into account.

The BCFS Board makes its decision on prospective directors and forwards its recommendations to the BCFA Board. The BCFA Board then determines the directors of BCFS and causes BCFA, as the sole holder of the single voting share of BCFS, to elect such individuals to the Board of BCFS.

Executive Compensation

Future:

The Bill 20 amendments to the CFA changed the mandate of the Authority to include responsibility for approving an executive compensation plan for BCFS' future President & CEO and Executive Vice Presidents, the remuneration provided under such plan, not to be greater than the remuneration that provincial public sector employers in British Columbia provide to individuals who, in those organizations, perform similar services or hold similar positions to that BCFS executive. Once an executive compensation plan is approved or amended by the Authority, the Company must set and provide remuneration in accordance with that plan.

The Bill 20 amendments to the CFA respecting the remuneration for BCFS' President & CEO and Executive Vice Presidents exclude the current incumbents in those positions for so long as that individual remains in his current position.

In the fiscal year ended March 31, 2011, as there were no individuals to whom an executive compensation plan established pursuant to the CFA would apply, there was no legal requirement for the Authority to establish such a plan and, as at March 31, 2011, no such plan was in effect.

Current:
As described above, the compensation program for the current President & CEO and Executive Vice Presidents falls outside the provisions for executive compensation set forth in the CFA as amended by Bill 20, and is the responsibility of the BCFS Board.

Each year, the Human Resources & Compensation Committee reviews the compensation of the President & CEO and Executive Vice Presidents. The Committee engages an independent third-party compensation expert to research and provide independent advice on the level and types of compensation for the President & CEO and Executive Vice Presidents. In making its recommendations to the Board, the Committee takes into account the types of compensation and the amounts paid by other comparable companies.

Director Compensation

April 1, 2010 – September 30, 2010:
The Governance & Nominating Committee is responsible for reviewing and making recommendations to the BCFS Board on director compensation. The process followed by the Committee to set the framework for director compensation in effect for the period April 1, 2010 to September 30, 2010, was informed by analyzing market comparable data and by engaging an independent third-party compensation expert to assist in the process.

Effective October 1, 2010:
The Bill 20 amendments to the CFA changed the mandate of the Authority to include responsibility for the compensation plan for the directors of BCFS, the remuneration provided under such plan to be consistent with the remuneration that organizations in Canada that are of a similar size and scope to BCFS provide to their Directors, and not to be greater than the remuneration that provincial public sector organizations in British Columbia provide to their Directors. Once the Authority approves or amends a BCFS directors' compensation plan it must, in accordance with that plan, determine the remuneration for the directors of BCFS and the terms on which it is to be paid.

Bill 20 required that the Authority establish a BCFS directors' compensation plan by September 30, 2010. On September 15, 2010, the Authority approved and established a compensation plan for the directors of the Company consistent with the requirements of Bill 20. Remuneration for directors of BCFS was amended and set by the Authority effective October 1, 2010, in accordance with the approved BCFS directors' compensation plan.

Protocol Agreement
The Authority and BCFS have entered into a Protocol Agreement which clarifies and confirms their respective roles and responsibilities in relation to the authority of BCFA as shareholder of BCFS and the matters set forth in the CFA respecting the appointment and remuneration of BCFS' directors and the remuneration of future senior executives of BCFS.

Board Committees
The Board has developed guidelines for the establishment and operation of Committees of the Board. Each Committee operates according to a specific mandate approved by the Board. The Committee structure is set out below. The Board Chair is an ex-officio (non-voting) member of each of the Committees.

Audit & Finance Committee:

Members April 1, 2010 to September 30, 2010:
Chair: Brian G. Kenning
Members: Christopher C. Gardner, Elizabeth J. Harrison and Graham M. Wilson

Members effective September 30, 2010:
Chair: Brian G. Kenning
Members: Elizabeth J. Harrison, P. Geoffrey Plant and Graham M. Wilson

The Audit & Finance Committee is appointed by the Board to assist the Board in fulfilling its oversight responsibilities. The Committee has the mandate to:

- review the financial reports and other financial information provided by the Company to its security holders;
- review the annual operating and capital budgets, modifications thereto, and details of any proposed financing;
- monitor the integrity of the financial reporting process and the system of internal controls that the Board and the Company's management have established;
- monitor the management of the principal risks that could impact the financial reporting of the Company, and the Company's compliance with legal and regulatory requirements as they relate to the Company's financial statements;
- review and approve the audit plan, process, results, and performance of the Company's external auditors and the internal audit department (the internal auditor) while providing an open avenue of communication between the Board, management, external auditors, and the internal auditor; and
- assess the qualifications and independence of the external auditors, and recommend to the Board the nominations of the external auditors and the compensation to be paid to the external auditors.

The Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the external auditors as well as anyone in the organization. The Committee has the authority to retain special legal, accounting, and other advisors or experts it deems necessary in the performance of its duties.

Each of the members of the Committee has been determined by the Board to be independent, that is, without any direct or indirect relationship with the Company that could reasonably interfere with the exercise of the member's independent judgment.

All members of the Committee are financially literate within the meaning of Multilateral Instrument 52-110, that is, each has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the Company's financial statements.

Since April 2, 2003, all recommendations of the Committee to nominate or compensate an external auditor have been adopted by the Board.

The aggregate fees billed by the Company's external auditor in each of the last two fiscal years were:

External Auditor billings ($ thousands)	Year ended March 31 2011	2010
Audit and audit related	196.3	151.3
Tax services	2.6	4.5
All other fees		
Advisory services (IFRS and environmental pre-assessment)	8.7	44.1
	207.6	199.9

Pursuant to its terms of reference, the Committee must pre-approve retaining the external auditors for any non-audit service to be provided to the Company or its subsidiaries, provided that no approval shall be provided for any service that is prohibited under the rules of the Canadian Public Accountability Board or the Public Company Accounting Oversight Board, or the Independence Standards of the Canadian Institute of Chartered Accountants.

Before retaining the external auditors for any non-audit service, the Committee must consider the compatibility of the service with the external auditors' independence. The Committee may pre-approve retaining of the external auditors for the engagement of any non-audit services by establishing policies and procedures to be followed prior to the appointment of the external auditors for the provision of such services. To date, no such policies and procedures have been established. In addition, the Committee may delegate to one or more members the authority to pre-approve retaining of the external auditors for any non-audit services to the extent permitted by applicable law.

***Safety, Health, Environment & Security Committee*:**
Members April 1, 2010 to September 30, 2010:
Chair: Wayne H. Stoilen
Members: Holly A. Haston-Grant, Gordon R. Larkin and Stephen E. Smith

Members effective September 30, 2010:
Chair: Wayne H. Stoilen
Members: Holly A. Haston-Grant and Maureen V. Macarenko

Gordon R. Larkin became a voting member of the Committee effective November 26, 2010.

The Safety, Health, Environment & Security Committee is appointed by the Board to assist the Board in fulfilling its oversight responsibilities. The Committee has the mandate to:

- exercise due diligence over the safety, health, environmental, and security operations of the Company;
- develop, review, and make recommendations, as required, on matters related to the Company's safety, health, environmental, and security policies and practices; and
- monitor compliance with Government regulations and with the Company's commitment to excellence on these issues.

Governance & Nominating Committee:
Members April 1, 2010 to September 30, 2010:
Chair: A. Daniel Miller
Members: Christopher C. Gardner, Elizabeth J. Harrison, Holly A. Haston-Grant, Brian G. Kenning and Jane L. Peverett

Members effective September 30, 2010:
Chair: Elizabeth J. Harrison
Members: P. Geoffrey Plant and Wayne H. Stoilen

Gordon R. Larkin became a member of the Committee effective November 26, 2010.

The Governance & Nominating Committee is appointed by the Board to assist the Board in fulfilling its oversight responsibilities with respect to ensuring that the corporate governance system of BCFS is effective. The Committee has the mandate to:

- review, assess, and make recommendations regarding the effectiveness of the policies and practices of the Board;
- ensure the Board's continuing ability to fulfill its legislative mandate;
- implement effective due diligence over the operations of the Company;
- make recommendations on the skills, experience and expertise that Board members collectively and individually should have in order to oversee the operation of BCFS in an efficient and cost effective manner;
- establish and implement effective processes for identifying and recommending suitable candidates for appointment as directors of BCFS; and
- make recommendations on the remuneration of directors of BCFS.

Human Resources & Compensation Committee:

Members April 1, 2010 to September 30, 2010:

Chair:	Jane L. Peverett
Members:	Brian G. Kenning, Gordon R. Larkin, A. Daniel Miller, Stephen E. Smith and Graham M. Wilson

Members effective September 30, 2010:

Chair:	Graham M. Wilson
Members:	Holly A. Haston-Grant, Brian G. Kenning and Maureen V. Macarenko

The Human Resources & Compensation Committee is appointed by the Board to assist the Board in fulfilling its oversight responsibilities regarding the human resources and compensation strategies and policies of BCFS. The Committee has the mandate to:

- regularly review, at a strategic level, the approach taken to manage the Company's human resources, including the recruitment, retention, motivation, and engagement of employees in the interests and success of the Company;
- regularly review the succession and development plans for the President & CEO and executive management; and
- review and recommend to the Board a total compensation philosophy for the President & CEO and executive management that, subject to the CFA, attracts and retains executives, links total compensation to financial performance, and the attainment of strategic, operational, and financial performance, provides competitive total compensation opportunities at a reasonable cost, while enhancing the ability to fulfill the Company's overall strategies and objectives.

Assessments

As part of its dedication to best governance practices, the Board is committed to regular assessments of the effectiveness of the Board, the Board Chair, Committees, Committee Chairs, and individual directors.

The Governance & Nominating Committee annually reviews and makes recommendations to the Board on the method and content for annual evaluations. The Board has in the past engaged an independent governance consultant to coordinate the evaluation. The Board also regularly assesses the performance of individual directors. This occurs through discussions between the individual directors and the Board Chair.

The evaluation of the Board's performance in the fiscal year ended March 31, 2011, was led by the Board Chair. It involved the completion by directors of a written questionnaire and individual discussions between each director and the Board Chair on matters related to Board effectiveness. The process also included a self assessment by directors of their skills and experience in relation to the Skills Profile established for the Board. The Board will implement the recommendations arising from the assessment in the upcoming year.