

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

**For the three months ended June 30, 2011
Dated August 2, 2011**



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**Management's Discussion & Analysis
of Financial Condition and Results of Operations
For the three months ended June 30, 2011
Dated August 2, 2011**

The following is our discussion and analysis of the financial condition and results of operations for British Columbia Ferry Services Inc. as of August 2, 2011. This should be read in conjunction with our unaudited interim consolidated financial statements and related notes for the three month periods ended June 30, 2011 and 2010, and our audited consolidated financial statements and related notes for the years ended March 31, 2011 (fiscal 2011) and March 31, 2010 (fiscal 2010), together with our fiscal 2011 Management's Discussion & Analysis. These documents are available on SEDAR at www.sedar.com and on our Investor webpage at <http://www.bcferries.com/about/investors/index.html>.

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

BUSINESS OVERVIEW

British Columbia Ferry Services Inc. is an independent company providing ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world, providing frequent year-round transportation service on 25 routes, supported by 35 vessels and 47 terminals. We also manage ferry transportation service on other remote routes through contracts with independent operators.

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

We are a versatile company, providing a wide range of ferry services for our customers. During the three months ended June 30, 2011 (the first quarter of fiscal 2012), we provided 45,800 sailings, carrying 5.2 million passengers and 2.0 million vehicles.

In the first quarter of fiscal 2012, we experienced a decline of 3.3% in vehicle traffic and 2.9% in passenger traffic as compared to the same period in the prior year. This is the largest first quarter year-over-year traffic decline we've experienced in recent years, and is the lowest vehicle traffic we've experienced in 11 years and the lowest passenger traffic we've experienced in 20 years. The decline in vehicle and passenger traffic was experienced across the Major, Northern and Other routes. (See discussion under "Financial and Operational Review" below).

Significant events during or subsequent to our first quarter of fiscal 2012:

- 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.
- On May 19, 2011, the Province and the British Columbia Ferries Commissioner (the Commissioner) announced a review of the *Coastal Ferry Act* (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 in the timeline established for this purpose. We will provide full cooperation with the Commissioner and we are in favour of any opportunity to look at ways to ensure the provision of affordable ferry fares, while still protecting the long term financial viability of our company.

- On June 1, 2011, fuel surcharges were implemented due to the rising cost of fuel. These surcharges were 2.5% of tariffs on average on our Major Routes and 5% of tariffs on average on many of our other routes. There are no surcharges in place on our Northern Routes.
- On June 2 through June 26, 2011, our "CoastSaver" program was in place on our three Major Routes. This promotional fare incentive program provided price discounts of more than 30% on passenger and passenger vehicle fares from Thursday through Sunday each week through the duration of the program. Despite this incentive program, traffic on these routes declined.
- On June 14, 2011, the 33-year-old *Queen of Chilliwack* returned to service after completion of the first phase of a 2-phase project that will allow the vessel to continue in service until it is retired in 2017 or later. (See "Investing in our Capital Assets" below for more detail).
- On June 23, 2011, we released the results of our 2010 Customer Satisfaction Tracking surveys which indicated that 89% of customers surveyed reported being satisfied with their overall trip experience. A copy of the full report is available on our website.
- On June 27, 2011, the Province announced a \$550,000 investment to develop training strategies for workers within a new industry-led marine training facility in Victoria. We are one of the industry partners, committing approximately \$200,000 to the project. Training programs include skills development training for individuals new to marine trades, an upgrading program and a supervisory training program for experienced workers. We plan on sending approximately 200 employees over the next several years to these programs for training in shipbuilding and ship repairs. Also, of the \$119.4 million granted in fiscal 2011 for remission of import taxes and related GST on the four vessels built in Germany, we have allocated \$20 million to upgrade key assets in the ship repair and maintenance business in British Columbia.
- On July 26, 2011, we announced a 90-day, one-time only refund to customers who purchased assured loading tickets between 1984 and July 25, 2011 and no longer want the tickets. This decision was made prior to completion of fiscal 2011 and was reflected in the fiscal 2011 financial statements.

FINANCIAL AND OPERATIONAL OVERVIEW

This section provides an overview of our financial and operational performance for the three months ended June 30, 2011 and 2010.

(\$millions)	Three months ended June 30			
	2011	2010	Variance	
Total revenue	186.7	190.2	(3.5)	(1.8%)
Operating expenses	(174.3)	(171.3)	(3.0)	(1.8%)
Earnings from operations	12.4	18.9	(6.5)	(34.4%)
Interest and other	(17.9)	(18.0)	0.1	0.6%
Net (loss) earnings and comprehensive income	(5.5)	0.9	(6.4)	(711.1%)

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

Our commercial and discretionary travel markets continue to be negatively impacted by economic conditions including high vehicle fuel prices, a high Canadian dollar and generally reduced consumer confidence. In the first quarter ending June 30, 2011, our vehicle traffic levels were the lowest they've been in 11 years and our passenger traffic levels were the lowest they've been in 20 years. We do not anticipate that economic conditions or our traffic levels will improve in the near term. We do expect vehicle and passenger traffic this fiscal year to be lower than that of the prior year.

We had planned for a net loss estimated to be in the range of \$20 million for this fiscal year, largely driven by significantly lower traffic levels than those included in setting our performance term two price caps. Although lower traffic levels are the major driver, other contributing factors to this loss are such items as the harmonized sales tax, Transport Canada requirements and Freedom of Information overhead expenses and other costs associated with the October 1, 2010 amendments to the Act resulting from the *Miscellaneous Statutes Amendment Act (No. 3), 2010*. As the traffic levels in the first quarter were even lower than anticipated, we believe that the net loss for this fiscal year will be larger than originally estimated. In response to the reduced traffic levels and larger than expected loss, we have initiated a thorough review of all expenditures.

In March 2011, the Commissioner set preliminary price cap increases for each of the four years of performance term three of 4.15% on the Major Routes and 8.23% on all other routes, effective April 1, 2012. In making these determinations, the Commissioner excluded certain of our forecast costs and incorporated a productivity challenge effectively further reducing our allowed costs. Financial conditions have significantly changed from those existing when the submission was made in September 2010.

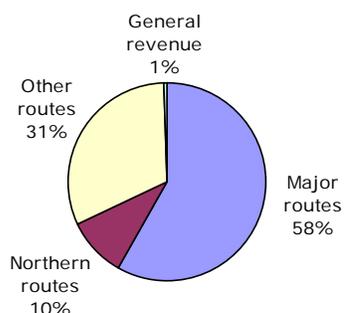
Effective April 1, 2012, for the first year of performance term three, Bill 14 established a price cap increase for each route group of 4.15% from the weighted average of the tariffs in place at March 31, 2012. Bill 14 also prevents us from obtaining price cap increases as a result of unanticipated and extraordinary changes in traffic levels. We had expected to return to profitability in fiscal 2013, however, the constraints of Bill 14 and traffic levels much lower than anticipated in the performance term three submission will negatively impact our future financial performance.

There is uncertainty related to the outcome of the Commissioner's review of the Act. The Commissioner's recommendations are due to the B.C. Minister of Transportation and Infrastructure by January 24, 2012, as to how the Act could be amended to allow the Commissioner to balance the interests of ferry users with the financial sustainability of our company. Future financial performance is dependent on the results of this review.

Our earnings from operations in the three months ended June 30, 2011, were \$6.4 million lower than the same period in the prior year. We incurred a net loss of \$5.5 million in the first quarter of fiscal 2012 compared to net earnings of \$0.9 million in the first quarter of fiscal 2011.

Revenue

Our total revenue in the three months ended June 30, 2011 decreased from the same period in the previous year as shown in the table below.



In the three months ended June 30, 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)	Three months ended June 30			
	2011	2010	Increase (Decrease)	
Direct Route Revenue				
<i>Vehicle traffic (volume)</i>	2,029,329	2,099,035	(69,706)	(3.3%)
Vehicle tariff	72.3	73.9	(1.6)	(2.2%)
<i>Passenger traffic (volume)</i>	5,172,459	5,327,594	(155,135)	(2.9%)
Passenger tariff	43.2	44.3	(1.1)	(2.5%)
Social program fees	7.2	6.6	0.6	9.1%
Catering & on-board	19.0	19.8	(0.8)	(4.0%)
Other revenue	4.9	6.3	(1.4)	(22.2%)
Total Direct Route Revenue	146.6	150.9	(4.3)	(2.8%)
Indirect Route Revenue				
Ferry transportation fees	32.2	31.9	0.3	0.9%
Federal-Provincial subsidy	6.9	6.7	0.2	3.0%
Total Route Revenue	185.7	189.5	(3.8)	(2.0%)
Other general revenue	1.0	0.7	0.3	42.9%
Total Revenue	186.7	190.2	(3.5)	(1.8%)

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 Consumer Price Index (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, 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 \$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.

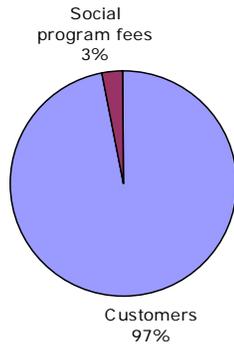
A fuel surcharge of 2.5% of tariffs on average on our Major Routes and 5% of tariffs on average on many of our other routes was implemented June 1, 2011 due to the rising cost of fuel. No fuel surcharges or rebates were in place on our Northern Routes.

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

Major Routes

Direct Route Revenue (\$ thousands)	Three months ended June 30			
	2011	2010	Increase (Decrease)	
<i>Vehicle traffic (volume)</i>	922,264	953,382	(31,118)	(3.3%)
Vehicle tariff	53,333	54,855	(1,522)	(2.8%)
<i>Passenger traffic (volume)</i>	2,674,810	2,747,339	(72,529)	(2.6%)
Passenger tariff	31,252	32,139	(887)	(2.8%)
Social program fees	3,424	3,167	257	8.1%
Catering & on-board	15,617	16,229	(612)	(3.8%)
Reservation fees	2,615	2,848	(233)	(8.2%)
Parking	915	722	193	26.7%
Assured loading	476	1,811	(1,335)	(73.7%)
Other revenue	517	439	78	17.8%
Total Direct Route Revenue	108,149	112,210	(4,061)	(3.6%)
Indirect Route Revenue				
Ferry transportation fees	-	-	-	-
Federal-Provincial subsidy	-	-	-	-
Total Route Revenue	108,149	112,210	(4,061)	(3.6%)

Our Major Routes consist of three regulated routes connecting Greater Vancouver with mid and southern Vancouver Island. Both vehicle and passenger traffic decreased in the three months ended June 30, 2011, compared to the same period in the previous year. Annual traffic levels on these routes are anticipated to be lower than the prior fiscal year.



In the three months ended June 30, 2011, revenue from our Major Routes consisted of 97% from customers and 3% from social program fees.

On June 2 through June 26, 2011, our "CoastSaver" program was in place, providing price discounts of more than 30% on passenger and passenger vehicle fares from Thursday through Sunday each week through the duration of the program. Despite this incentive program, traffic on these routes declined. This further reinforced our view that other external factors are largely responsible for declining traffic levels.

Average tariff revenue per vehicle increased \$0.29 or 0.5% in the quarter compared to the first quarter in the prior year, mainly as a result of higher tariffs offset by promotional fare discounts. The reduction in traffic more than offset the higher average fares, resulting in a decrease of \$1.5 million in vehicle tariff revenue. Average tariff revenue per passenger remained at the same level as the first quarter in the prior year with promotional fare discounts offsetting the increase in average fares. The decrease in passenger traffic resulted in \$0.9 million lower passenger tariff revenue.

On June 1, 2011 fuel surcharges of 2.5% of tariffs on average were put in place on the Major Routes due to the increasing cost of fuel.

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 passenger traffic. In our gift shops, sales of quality apparel remain strong with an increase of more than 10% over the same period of the prior year.

The increase in parking revenue reflects greater use of parking facilities as a result of a change in travel patterns at least partly due to improvements in transit services both on Vancouver Island and on the mainland.

The decrease in assured loading revenue reflects a gain of \$1.2 million recognized in the same quarter of the prior year relating to expired tickets. The gain was reversed in the fourth quarter of fiscal 2011 upon the decision to restore the value of these expired tickets. The annual assured loading revenue in fiscal 2012 is expected to be slightly lower than the prior year.

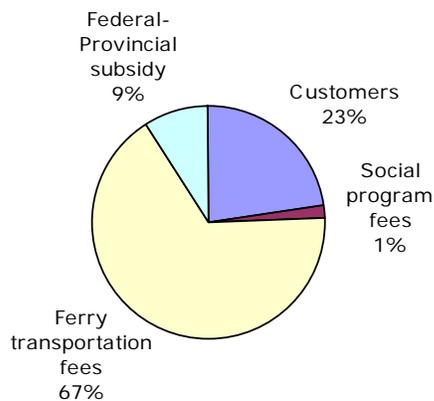
Other revenue increased mainly as a result an increase in hostling¹ fees from our drop-trailer service for commercial customers.

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

Northern Routes

Direct Route Revenue (\$ thousands)	Three months ended June 30			
	2011	2010	Increase (Decrease)	
<i>Vehicle traffic (volume)</i>	6,548	7,159	(611)	(8.5%)
Vehicle tariff	1,928	1,949	(21)	(1.1%)
<i>Passenger traffic (volume)</i>	17,843	19,696	(1,853)	(9.4%)
Passenger tariff	1,595	1,729	(134)	(7.8%)
Social program fees	287	304	(17)	(5.6%)
Catering & on-board	470	529	(59)	(11.2%)
Stateroom rental	253	277	(24)	(8.7%)
Hostling & other	40	53	(13)	(24.5%)
Total Direct Route Revenue	4,573	4,841	(268)	(5.5%)
Indirect Route Revenue				
Ferry transportation fees	12,511	12,236	275	2.2%
Federal-Provincial subsidy	1,700	1,665	35	2.1%
Total Route Revenue	18,784	18,742	42	0.2%

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



In the three months ended June 30, 2011, revenue from our Northern Routes consisted of 23% from customers and 77% from the Province (1% social program fees, 67% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

Northern Routes, cont'd

Both vehicle traffic and passenger traffic decreased in the three months ended June 30, 2011, compared to the same period in the previous year. Annual traffic levels on these routes are also anticipated to be lower than the prior fiscal year.

The average tariff revenue per vehicle increased \$22.20 or 8.2% while the average tariff revenue per passenger increased \$1.61 or 1.8%. The reduction in traffic more than offset the increase in average rates, resulting in a total tariff revenue decrease for the quarter of \$0.2 million.

Reimbursements from the Province for social program fees decreased marginally as a result of lower usage, partially offset by higher average fares.

Revenue from catering, on-board services, stateroom rental, hostling and other decreased as a result of lower traffic levels.

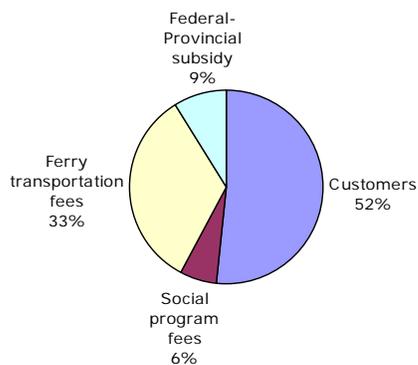
We receive ferry transportation fees for these routes under the Coastal Ferry Services Contract. These fees are higher in the quarter, reflecting an increase in funding this fiscal related to the *Queen of Chilliwack* life extension, partially offset by the impact of lower net book value of the vessels used on these routes. The transportation fees decrease as these vessel assets are amortized. The total annual transportation fees are expected to be \$1.4 million higher than the prior fiscal year.

The Federal-Provincial subsidy has increased by the change in the annual CPI (Vancouver).

Other Routes

Direct Route Revenue (\$ thousands)	Three months ended June 30			
	2011	2010	Increase (Decrease)	
<i>Vehicle traffic (volume)</i>	1,100,517	1,138,494	(37,977)	(3.3%)
Vehicle tariff	17,016	17,140	(124)	(0.7%)
 <i>Passenger traffic (volume)</i>	 2,479,806	 2,560,559	 (80,753)	 (3.2%)
Passenger tariff	10,350	10,400	(50)	(0.5%)
Social program fees	3,480	3,111	369	11.9%
Catering & on-board	2,640	2,713	(73)	(2.7%)
Reservation fees	298	328	(30)	(9.1%)
Parking & other	87	112	(25)	(22.3%)
Total Direct Route Revenue	33,871	33,804	67	0.2%
 Indirect Route Revenue				
Ferry transportation fees	19,710	19,713	(3)	-
Federal-Provincial subsidy	5,172	5,066	106	2.1%
 Total Route Revenue	58,753	58,583	170	0.3%

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



In the three months ended June 30, 2011, revenue from our Other Routes consisted of 52% from customers and 48% from the Province (6% social program fees, 33% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

Other Routes, cont'd

Both vehicle traffic and passenger traffic decreased in the three months ended June 30, 2011, compared to the same period in the previous year. Annual traffic levels on these routes are also anticipated to be lower than the prior fiscal year.

The average tariff revenue per vehicle increased \$0.41 or 2.7% while the average tariff revenue per passenger increased \$0.11 or 2.8%. The reduction in traffic more than offset the increase in average fares, resulting in lower total tariff revenue for the quarter of \$0.2 million.

On June 1, 2011 fuel surcharges of 5% of tariffs on average were put in place on the majority of these routes due to the increasing cost of fuel.

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

Revenue from catering and on-board services decreased mainly as a result of lower traffic levels, partially offset by an increase in revenue from the services provided on the *Queen of Burnaby*. In the same quarter of the prior year, the cafeteria and retail areas on the *Queen of Burnaby* were closed for approximately one month as some asbestos abatement work was being done in these areas.

Fees for reservations decreased primarily as a result of lower traffic levels on routes where those services are offered.

Parking revenue decreased due to reduced traffic levels and other revenue decreased reflecting lower charter revenue.

Total annual ferry transportation fees are expected to equal that of the prior fiscal year.

The Federal-Provincial subsidy has increased by the change in the annual CPI (Vancouver).

Expenses

Expenses for the three months ended June 30, 2011 and 2010 are summarized in the tables below:

Operating expenses (\$ millions)	Three months ended June 30			
	2011	2010	Increase (Decrease)	
Operations	105.0	103.6	1.4	1.4%
Maintenance	25.0	23.8	1.2	5.0%
Administration	7.4	7.5	(0.1)	(1.3%)
Total operations, maintenance & administration	137.4	134.9	2.5	1.8%
Cost of retail goods sold	7.5	7.7	(0.2)	(2.6%)
Amortization	29.4	28.7	0.7	2.4%
Total operating expenses	174.3	171.3	3.0	1.8%

The \$1.4 million increase in operations expenses consists mainly of:

- \$1.4 million or 6.1% increase in fuel expense as a result of higher approved fuel prices, partially offset by a 0.3% reduction in fuel consumption; and
- \$0.9 million increase in benefit costs resulting from a revised actuarial valuation of our residual liability for unfinalized claims for compensation benefits arising from claims prior to March 31, 2003. These claims are administered by the Workers Compensation Board; partially offset by:
 - \$0.4 million decrease in water taxi and barge service costs that were required in the prior year on a northern route while the *Nimpkish* was undergoing a refit;
 - \$0.3 million reduction in salaries and wages; and
 - \$0.2 million decrease in several other operational areas.

The \$1.2 million increase in maintenance costs reflects an increase in vessel maintenance as a result of variations in vessel refit scheduling, partially offset by lower terminal maintenance.

The \$0.1 million decrease in administration expenses is mainly as a result of a \$0.2 million reduction in salaries and wages, partially offset by an increase in benefit costs.

Amortization increased a total of \$0.7 million, reflecting the following assets that have come into service:

- \$0.4 million increase due to new information technology assets;
- \$0.4 million increase due to a major berth replacement and refurbishment at Tsawwassen; and
- \$0.4 million increase due to leasehold improvements at our new corporate office; partially offset by:
 - \$0.5 million lower vessel amortization mainly as a result of the reduction in capital costs of our foreign-built vessels arising from the \$119.4 million remission of import taxes and related GST granted in the third quarter of fiscal 2011.

Interest and other (\$ millions)	Three months ended June 30		
	2011	2010	Increase (Decrease)
Interest expense			
Bond interest	15.8	15.8	-
KfW loans	2.5	2.7	(0.2)
Interest on capital lease	0.6	-	0.6
Interest on deferred accounts	-	0.1	(0.1)
Structured Financing Facility Program	(0.5)	-	(0.5)
Capitalized interest	(0.5)	(0.6)	0.1
Total interest and other	17.9	18.0	(0.1)

Interest expenses decreased \$0.1 million primarily due to:

- \$0.6 million interest on the capital lease of our new corporate office building, more than offset by:
- \$0.5 million interest rate support received through the Structured Financing Facility Program offered by the Government of Canada, reflecting amounts relating to the life extension of the *Quadra Queen II*; and
- \$0.2 million lower interest on the 12-year amortizing KfW loans.

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.

Our ongoing capital expenditures are expected to be significantly lower than in the previous few years. Over the next five years, we expect our operational cash requirements will be met through operating cash flows and by accessing our credit facility from time to time. At June 30, 2011, our unrestricted cash and cash equivalents totalled \$10 million and short-term investments totalled \$59 million.

Over the next few years, we have two bond issues totalling \$390 million that will mature. We anticipate that at least one of these issues will be refinanced. We also monitor the current market for opportunities to ensure that our debt structure continues to be efficient.

We target maintaining a strong investment-grade credit rating to allow capital market access at reasonable interest rates. Our credit ratings at June 30, 2011, were A (DBRS) with a stable trend and A+ (Standard & Poor's) with a stable outlook.

Sources and 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 the three months ended June 30, 2011 and 2010 are summarized in the table below:

(\$ millions)	Three months ended June 30	
	2011	2010
Net (loss) earnings	(5.5)	0.9
Items not involving cash:		
Amortization	29.4	28.7
Other non-cash charges	1.0	0.4
Regulatory costs deferred	(0.6)	(2.3)
Change in non-cash operating working capital	(18.6)	(11.3)
Cash provided by operating activities	5.7	16.4
Cash used in financing activities	(6.1)	(0.1)
Cash used in investing activities	(23.1)	(20.8)
Total decrease in cash and cash equivalents	(23.5)	(4.5)

In the three months ended June 30, 2011, cash provided by operating activities included \$0.6 million of cash used to reduce regulatory liabilities as follows:

- \$3.6 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;
- \$1.2 million in fuel surcharges; and
- \$0.4 million receivable from the Province relating to the Northern Routes.

Cash provided by operating activities also included an increase in non-cash operating working capital of \$18.6 million. This increase in non-cash operating working capital was due to:

- \$10.2 million increase in prepaid expenses primarily due to \$4.4 million in fuel, \$2.5 million in property taxes, \$1.8 million in service contracts, and \$1.3 million in insurance;
- \$5.5 million increase in accounts receivable, mainly due to \$3.0 million increase in commercial travel cards receivable and \$1.5 million in social program fees receivable reflecting the seasonality of the business;
- \$3.1 million decrease in interest payable reflecting timing of interest and principal payments;
- \$2.9 million decrease in payables and accrued liabilities relating to refit and maintenance and other operating activities;
- \$1.1 million decrease in current regulatory liabilities reflecting the return to customers through discount fare promotions of tariff revenues collected in excess of price caps at March 31, 2011; and
- \$0.3 million increase in inventory mainly due to an increase in fuel reflecting both a higher volume and higher price of fuel on the vessels.

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

- \$3.5 million increase in deferred revenue mainly due to \$2.6 million increase in reservations, \$0.4 million increase in stored value cards, and \$0.3 million increase in vacation packages, all reflecting the seasonality of the business; and
- \$1.0 million increase in accrued employee costs.

Cash used in financing activities reflects the \$3.9 million repayment of short-term loans; \$1.9 million principal repayment on the 12-year loan, maturing March 2020; and \$0.3 million payment of capital lease obligations.

Cash used in investing activities consisted of:

- \$27.8 million used to purchase capital assets (See "Investing in Our Capital Assets" below for detail of significant purchases); and
- \$0.3 million used for finalization of long-term loan to the developer of our corporate office leased property;

partially offset by:

- \$5.0 million in proceeds from short-term investments.

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.

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. 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 cost adjustments were made on April 15, 2011, bringing the total amount of the loan and the purchase option to \$24.5 million.

The value of our capital assets was increased by \$0.3 million in the three months ended June 30, 2011 to reflect the final cost adjustments.

Capital Expenditures

Capital expenditures in the three months ended June 30, 2011, totalled \$25.7 million, as follows:

	(\$ millions)
Vessel upgrades and modifications	10.7
Terminal marine structures	6.9
Terminal and building upgrades and equipment	4.1
Information technology	4.0
Total capital expenditures	<u>25.7</u>

Vessel Upgrades and Modifications

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

	(\$ millions)
<i>Queen of Chilliwack</i> life extension	4.2
Sewage treatment upgrade program	2.8
<i>Klitsa</i> asset betterment	2.0
Vessel electrical & navigation program	0.5
Other projects	1.2
	<u>10.7</u>

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 2017 or later. The vessel returned to service on June 14, 2011, following completion of the first phase of this \$15 million project which included new car deck watertight doors, new propeller seals, new instrumentation and control systems, and new lifesaving systems.

Implementation of a multi-year sewage and waste water treatment program to upgrade 28 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. All vessels will be modified as part of this project or as part of their scheduled upgrade. 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, Queen of Chilliwack, Queen of Capilano, North Island Princess, and Queen of Surrey* are complete.

The 39-year-old *Klitsa* returned to service on June 1, 2011, after completion of a \$2.7 million asset betterment project. The betterment included new lifesaving systems, new right-angle drives, and new sewage pump-ashore system.

Terminal Marine Structures

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

Terminal	Description	(\$ millions)
Swartz Bay	Berth 4 and 5 replacement and refurbishment	3.2
Brentwood Bay	Modifications to accommodate the <i>Klitsa</i>	1.0
Tsawwassen	Major berth 4 replacement and refurbishment	0.7
Tsawwassen	Refurbishment of decks and berth 5 upgrades	0.7
Hornby Island	Replacement of ramp, wingwalls, towers and shelter	0.4
Various	Other projects	0.9
		6.9

The \$19 million project at Swartz Bay for the upgrade of berths 4 and 5 includes replacement of ramps, ramp abutments, aprons, towers, wingwalls, dolphins and floating leads. Dredging at berth 5, ship-to-shore electrical upgrades, and a new waiting shelter are also included. Completion of both berths is expected before the end of the fiscal year.

At Brentwood Bay, modifications to marine structures were required to accommodate the *Klitsa* which replaced the 55-year-old *Mill Bay* sold in May 2011. This \$1.9 million project included replacement of trestle, apron, port and starboard wingwalls, floating leads, two mooring dolphins, and construction of a small building for ticket collection and passenger shelter. Work began at the terminal on May 2, 2011 and service on this route resumed June 1, 2011.

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.

Also at Tsawwassen terminal, concrete restoration and a full seismic upgrade of the transfer deck between berths 3 and 4 was completed and preliminary work for deck coating of two berths and replacement of the dolphins, catwalk and sheet pile wall at berth 5 is underway.

At Shingle Spit on Hornby Island, a major marine structure replacement program is underway. The \$11 million multi-year project includes replacement of the wingwalls, ramp, ramp abutment, apron, trestle, tower, and five dolphins. The project is expected to be complete in October 2011.

Terminal and Building Upgrades and Equipment

Capital expenditures for terminal and building upgrades and equipment in the quarter included the following:

	(\$ millions)
Terminal waste water program	2.0
Horseshoe Bay overhead walkway	0.5
Swartz Bay roadway reconstruction	0.4
Vehicles, machinery and equipment	0.2
Departure Bay waiting room and restrooms	0.2
Other terminal projects	0.8
	<u>4.1</u>

As part of the multi-year sewage and waste water treatment program for treatment of sewage generated onboard our vessels, installation of pump ashore infrastructure at Bear Cove terminal is now complete and in service and work at Langdale has begun. As part of the Federal government's Infrastructure Stimulus Fund program, we received \$3.2 million in fiscal 2011 and estimate that we will receive a total of \$9.2 million relating to sewage pump-ashore projects and other major terminal projects.

At Horseshoe Bay terminal, a \$1.5 million project to improve safety with the installation of a new overhead walkway was completed.

At Swartz Bay terminal, a \$0.5 million project for reconstruction of the roadway at the vehicle entrance to the pick-up and drop-off areas was completed.

The costs incurred for vehicles, machinery, and equipment are primarily for sub-metering at five of our terminals to take advantage of potential energy reduction and conservation opportunities.

At Departure Bay terminal construction has begun on a new waiting room that is expected to be complete this summer.

Information Technology

Capital expenditures on information technology in the quarter included the following:

	(\$ millions)
Customer service system replacement	1.3
Computer hardware upgrades	0.6
Operational document management system	0.4
Payroll system replacement	0.3
Other projects	1.4
	<u>4.0</u>

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.

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

An electronic document management system for the control, revision and publication of operations manuals is underway. This will enable employees access to current policy and procedure documents even when onboard a vessel.

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

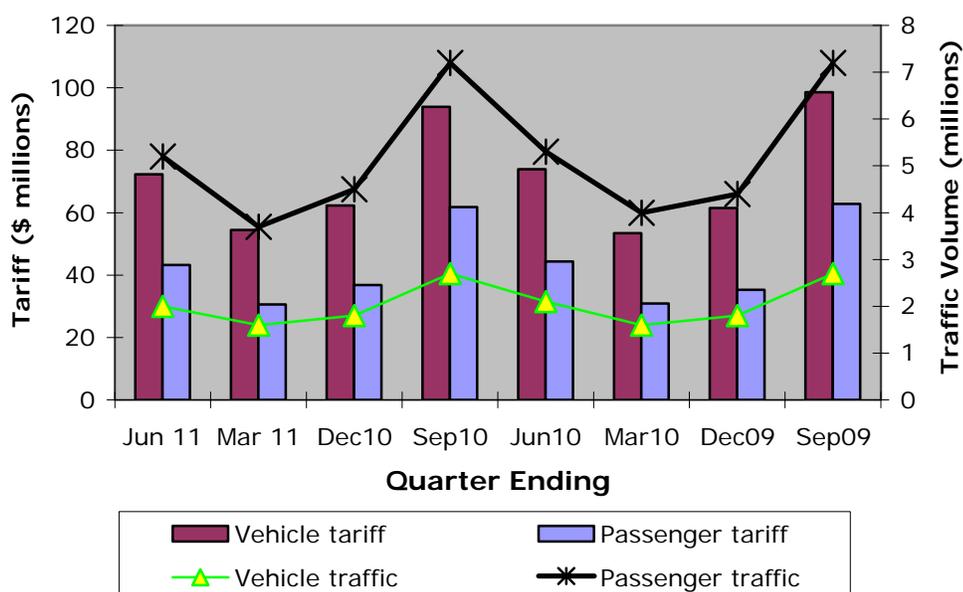
SUMMARY OF QUARTERLY RESULTS

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

(\$ millions)	Quarter Ended (unaudited)							
	Jun 11	Mar 11	Dec 10	Sep 10	Jun 10	Mar 10	Dec 09	Sep 09
Total revenue	186.7	140.7	162.4	246.0	190.2	142.3	159.9	251.8
Earnings (loss) from operations	12.4	(21.0)	(3.2)	72.4	18.9	(19.5)	(1.9)	81.5
Net (loss) earnings and comprehensive income	(5.5)	(39.0)	(12.4)	54.3	0.9	(36.8)	(20.4)	64.2

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:



FINANCIAL RISKS AND FINANCIAL INSTRUMENTS

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

A discussion of financial risks can be found on pages 36 through 38 of our fiscal 2011 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2011.

BUSINESS RISK MANAGEMENT

Understanding and managing operational risk is an important part of our business. We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business. A discussion of enterprise wide risk management can be found on pages 39 through 45 of our fiscal 2011 Management's Discussion & Analysis. Our risk profile is substantially unchanged during the three months ended June 30, 2011. An update on the risk relating to customer demand is included below.

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

Our vehicle and passenger traffic levels in the first quarter of fiscal 2012, as compared to the same period in the prior year, declined 3.3% and 2.9%, respectively. The decline in traffic was experienced across the Major, Northern and Other routes.

Impacting our traffic levels is the increased value of the Canadian dollar. More Canadians are travelling to the United States and fewer Americans are travelling to Canada. Many other factors affect customer demand, including current economic conditions, levels of tourism, and discretionary travel. The cost of transportation, including the price of fuel at the pump and ferry fares (including the implementation and removal of fuel surcharges or rebates), 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 revenues. No assurance can be given as to the level of traffic on our system and the resulting revenues.

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. However, we are constrained by the Coastal Ferry Services Contract which stipulates, among other things, the number of round trips that must be provided for each regulated ferry route.

ACCOUNTING PRACTICES

Critical Accounting Policies and Estimates

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

Our significant accounting policies are contained in note 1 to our March 31, 2011 and June 30, 2011 consolidated financial statements. Certain of these policies involve critical accounting estimates because they require us to make particularly subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts could be reported under different conditions or using different assumptions. These estimates and assumptions are subject to change as new events occur, as more experience is acquired, as additional information is obtained and as the general operating environment changes.

Discussion of the most critical accounting policies and estimates that we have used in the preparation of our consolidated financial statements can be found on pages 46 through 48 of our fiscal 2011 Management's Discussion & Analysis. The following describes the changes to critical accounting policies we have used in the preparation of our consolidated financial statements for the three months ended June 30, 2011, or expect to use in the future.

Adoption of New Accounting Standards

No new accounting standards have been adopted for fiscal 2012.

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 1, 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 future balances of our regulatory accounts are uncertain and analysis of future major overhauls and inspections is still underway, we cannot reasonably estimate and conclude the impact of IFRS on our 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
<p><i>Key activities</i></p> <ul style="list-style-type: none"> • 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)
<p><i>Milestones</i></p> <ul style="list-style-type: none"> • 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
<p><i>Status</i></p> <ul style="list-style-type: none"> • 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 analyzed and recommendations made for key accounting policy decisions • IFRS 1 exemptions reviewed and analyzed • Senior management review of policy decisions complete • Preparation of illustrative financial statements and note disclosures complete • Senior management review of illustrative financial statements complete • Drafting of policies and procedures nearing completion

Information technology infrastructure
<p>Key activities</p> <ul style="list-style-type: none"> • Confirm system upgrades required for IFRS reporting • Review/revise data gathering processes • Review/revise budgeting and forecasting processes
<p>Milestones</p> <ul style="list-style-type: none"> • 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
<p>Status</p> <ul style="list-style-type: none"> • 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 required to budgeting and forecasting processes complete

Training, Education & Communication
<p>Key activities</p> <ul style="list-style-type: none"> • 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
<p>Milestones</p> <ul style="list-style-type: none"> • 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
<p>Status</p> <ul style="list-style-type: none"> • 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
<p>Key activities</p> <ul style="list-style-type: none"> • Accounting policy determination, documentation and implementation • MD&A ongoing communications
<p>Milestones</p> <ul style="list-style-type: none"> • 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
<p>Status</p> <ul style="list-style-type: none"> • 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
<p>Key activities</p> <ul style="list-style-type: none"> • Financial covenants assessment • Compensation arrangements assessment • Customer and supplier contract evaluation
<p>Milestones</p> <ul style="list-style-type: none"> • 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
<p>Status</p> <ul style="list-style-type: none"> • 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. On July 26, 2011, the IASB launched a public consultation to seek input on their strategic direction and prioritization in setting work plans over the next three years. Responses are required by November 30, 2011. We intend to provide a response in support of reinstating a project for rate-regulated activities.

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, balances at March 31, 2011 of \$3.7 million of current regulatory assets and \$1.6 million of long-term regulatory liabilities will be derecognized on our transition date of April 1, 2011 with a net reduction in retained earnings of \$2.1 million.

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, identified, and quantified inspection and major overhaul items for each class of vessel for reclassification at transition date and internal reporting solutions are nearing completion. This change has the potential to cause significant fluctuations in earnings over the reporting periods due to the level of inspections and major overhauls in any one period and the number of periods over which each will be amortized.
 - *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 and the choices we have made will result in a net increase of \$8.9 million in retained earnings on transition. 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. The actuarial loss to be recognized in opening retained earnings is \$3.3 million.
 - *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.
- 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.

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: traffic levels; a net loss in fiscal 2012 larger than \$20 million; our future financial performance; the anticipated rolling over of at least one of the two bond issues maturing over the next few years; our short-term and long-range business plans and asset renewal programs for vessels and terminals; our expectations of ferry transportation fee amounts; our estimates of funding under the Infrastructure Stimulus Fund program; our expectations regarding how our operational cash requirements will be met; and our expectations regarding the impacts of Bill 14 and 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.