Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Six months ended September 30, 2011 and 2010

(unaudited)

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Balance Sheets
(expressed in thousands)

	September 30, 2011 (unaudited)	March 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$ 21,374	$ 33,335
Restricted short-term investments (note 2(c))	35,745	37,040
Other short-term investments	59,110	64,074
Accounts receivable	20,833	20,619
Prepaid expenses	8,204	5,648
Inventories	20,946	19,957
Derivative assets	14	-
Regulatory assets (note 3)	2,387	3,703
	168,613	184,376
Property, plant and equipment (note 4)	1,579,178	1,581,007
Intangible assets (note 5)	36,336	34,929
Long-term loan receivable	24,515	24,247
Long-term land lease	32,750	32,979
	$ 1,841,392	$ 1,857,538
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 38,559	$ 51,249
Short-term debt (note 2(b))	-	3,949
Interest payable on long-term debt	18,287	18,261
Accrued employee costs	49,492	48,194
Deferred revenue	14,408	15,596
Derivative liabilities	-	23
Current portion of long-term debt (note 2)	9,000	22,125
Current portion of accrued employee future benefits	1,200	1,200
Current portion of obligations under capital lease	991	1,040
	131,937	161,637
Accrued employee future benefits	11,388	10,907
Regulatory liabilities (note 3)	858	1,558
Long-term debt (note 2)	1,289,247	1,327,014
Obligations under capital lease	47,499	47,723
	1,480,929	1,548,839
Shareholders' equity:		
Share capital	75,478	75,478
Retained earnings	284,985	233,221
	360,463	308,699
Commitments (note 4)		
	$ 1,841,392	$ 1,857,538

See accompanying notes to consolidated financial statements.

On behalf of the Board:

"Donald P. Hayes"	*"Brian G. Kenning"*
Director	Director

BRITISH COLUMBIA FERRY SERVICES INC.

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

	Three months ended September 30		Six months ended September 30	
	2011	2010	2011	2010
Revenue:				
Tariffs	$ 161,985	$ 155,709	$ 277,458	$ 273,921
Ferry service fees	48,456	46,408	87,867	84,939
Federal-Provincial Subsidy Agreement	6,872	6,731	13,743	13,462
Retail	27,035	28,052	46,434	48,142
Other income	7,697	9,115	13,228	15,790
	252,045	246,015	438,730	436,254
Expenses:				
Operations	114,553	114,908	219,590	218,524
Maintenance	14,183	12,623	39,210	36,475
Administration	8,449	7,317	15,806	14,834
Cost of retail goods sold	9,967	10,277	17,430	17,957
Amortization	29,530	28,441	58,924	57,129
	176,682	173,566	350,960	344,919
Earnings from operations	75,363	72,449	87,770	91,335
Gain on foreign exchange	155	31	176	106
Interest expense	(18,254)	(17,959)	(36,220)	(35,987)
Gain (loss) on disposal of capital assets	9	(239)	38	(253)
Net earnings	57,273	54,282	51,764	55,201
Other comprehensive income (note 1 (d))	-	-	-	-
Net earnings and comprehensive income	57,273	54,282	51,764	55,201
Retained earnings, beginning of period	227,712	236,397	233,221	235,478
Retained earnings, end of period	$ 284,985	$ 290,679	$ 284,985	$ 290,679

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

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

	Three months ended September 30 2011	Three months ended September 30 2010	Six months ended September 30 2011	Six months ended September 30 2010
Cash provided by (used in):				
Operations:				
Net earnings	$ 57,273	$ 54,282	$ 51,764	$ 55,201
Items not involving cash:				
Amortization	29,530	28,441	58,924	57,129
Other non-cash charges	864	1,401	1,848	1,790
Long-term regulatory costs deferred	(159)	(2,927)	(700)	(5,276)
Change in non-cash operating working capital (note 9)	286	2,957	(18,298)	(8,345)
	87,794	84,154	93,538	100,499
Financing:				
Repayment of long-term debt	(49,500)	(4,500)	(51,375)	(4,500)
Repayment of short-term loans	-	-	(3,949)	-
Repayment of capital lease obligations	(263)	(286)	(539)	(397)
	(49,763)	(4,786)	(55,863)	(4,897)
Investing:				
Proceeds from disposal of property, plant and equipment	55	52	84	78
Purchase of property, plant and equipment and intangible assets	(27,868)	(23,137)	(55,711)	(43,776)
Reduction of debt service reserves	1,295	200	1,295	200
Advancement of long-term loan	-	-	(268)	-
(Purchase of) proceeds from short-term investments	(36)	(57)	4,964	(219)
	(26,554)	(22,942)	(49,636)	(43,717)
Increase (decrease) in cash and cash equivalents	11,477	56,426	(11,961)	51,885
Cash and cash equivalents, beginning of period	9,897	6,067	33,335	10,608
Cash and cash equivalents, end of period	$ 21,374	$ 62,493	$ 21,374	$ 62,493

Supplemental cash flow information (note 9)

See accompanying notes to consolidated financial statements.

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

The interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the fiscal year ended March 31, 2011 except as disclosed below. The disclosures provided below are incremental to those included with the annual consolidated financial statements. The interim consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto for the year ended March 31, 2011.

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

1. Significant accounting policies:

(a) Basis of presentation:
These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All inter-company balances and transactions have been eliminated on consolidation.

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

(c) Embedded derivatives:
As at September 30, 2011, the Company has no embedded derivatives that meet the requirements of Section 3855 which would require that they be separated from host contracts and valued separately at fair value.

(d) Comprehensive income:
The Company has not recognized any adjustments through other comprehensive income for the six months ended September 30, 2011.

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

1. Significant accounting policies (continued):

(f) Future accounting changes:

International Financial Reporting Standards ("IFRS"):

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

- Qualifying entities with rate-regulated activities to adopt IFRSs for the first time no later than annual periods beginning on or after January 1, 2012; and
- Entities electing to defer the first-time adoption of IFRSs to disclose the fact.

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

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

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

The IASB published an amendment to IFRS 1 on May 6, 2010 which provides an exemption for property, plant and equipment and intangible assets used in operations subject to rate regulation. A first-time adopter may elect to use, on an item by item basis, the previous GAAP carrying amount of such items as deemed cost at the date of transition to IFRS. The Company has assessed the impact of the options available as a result of this IFRS 1 amendment and has decided to adopt the exemption for all its intangible assets and the majority of its items of property, plant and equipment. The Company has chosen the revaluation method for its land assets, which will result in a $12.2 million increase in the value of these assets at its transition date of April 1, 2011.

IFRS 1 First-Time Adoption of IFRS allows 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. The Company has 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 $3.6 million.

1. Significant accounting policies (continued):

(f) Future accounting changes (continued):

International Financial Reporting Standards ("IFRS") (continued):

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

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

The IASB closed its project on rate-regulated activities. However, the IASB has commenced consulting constituents to seek input on their strategic direction and preparation in setting work plans over the next three years. It has also provided constituents with suggestions for items to add to their agenda, including rate-regulated activities. The Company has provided a response in support of reinstating a project on rate-regulated activities.

The Company expects that issues regarding rate-regulated activities will remain unresolved for some time and that regulatory assets or liabilities will not be reported on the IFRS Statement of Financial Position. Accordingly, current regulatory assets of $3.7 million and long-term regulatory liabilities of $1.6 million will be derecognized on the Company's transition date of April 1, 2011 with a net reduction in retained earnings of $2.1 million. As future balances of its regulatory accounts are unknown, the Company cannot reasonably estimate and conclude the impact on future financial position and results of operations with respect to accounting for rate-regulated activities.

(columnar dollars expressed in thousands)

2. Loans:

Long-term debt:		September 30 2011		March 31 2011
5.74% Senior Secured Bonds, Series 04-1, due May 2014 (effective interest rate 5.92%)	$	250,000	$	250,000
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (effective interest rate 6.41%)		250,000		250,000
5.02% Senior Secured Bonds, Series 07-1, due March 2037 (effective interest rate 5.06%)		250,000		250,000
5.58% Senior Secured Bonds, Series 08-1, due January 2038 (effective interest rate 5.62%)		200,000		200,000
6.21% Senior Secured Bonds, Series 08-2, due December 2013 (effective interest rate 6.33%)		140,000		140,000
12 Year Loan, maturing March 2020 (a)				
Tranche A (effective interest rate 5.17%)		63,750		67,500
Tranche B (floating interest rate of 1.47% at September 30, 2011)		1,875		22,500
12 Year Loan, maturing June 2020 (a)				
Tranche A (effective interest rate 5.18%)		65,625		69,375
Tranche B (floating interest rate of 1.48% at September 30, 2011)		1,875		20,625
2.95% Loan, maturing January 2021 (effective interest rate 3.08%)		85,500		90,000
		1,308,625		1,360,000
Less: Deferred financing costs and unamortized bond discounts		(10,378)		(10,861)
Current portion		(9,000)		(22,125)
	$	1,289,247	$	1,327,014

(a) 12 Year Loans:

During the quarter ended September 30, 2011, the Company entered into amendments to the two loan agreements. These amendments allowed for the continuance of Tranche B for three years provided that the outstanding balance of Tranche B was fully prepaid. The Company fully prepaid the outstanding Tranche B balances of both loans ($22.5 million each); consequently, the Tranche A principal payments will be transferred to Tranche B for the next three years. Tranche B payments are interest only, paid in periods ranging from one to six months at the option of the Company, with the principal balance due when the loan matures. The interest rates on Tranche B are reset at floating rates of CAD LIBOR plus 30 bps, which will vary depending on the interest payment period.

(columnar dollars expressed in thousands)

2. Loans (continued):

(b) Credit facility:

There were no draws on the $155 million credit facility as at September 30, 2011 and draws on this facility totalled $3.9 million as at March 31, 2011. Interest expensed during the quarter ended September 30, 2011 was $nil (September 30, 2010: $nil). Interest expensed during the six months ended September 30, 2011 was $0.1 million (September 30, 2010: $0.1 million). Letters of credit outstanding against this facility at September 30, 2011 totalled $0.1 million (March 31, 2011: $0.2 million).

(c) Debt service reserves:

The Company is required to maintain debt service reserves for the Series 04-1, 04-4, 07-1, 08-1 and 08-2 bonds equal to not less than six months forecasted debt service, to be increased under certain conditions. Further debt service reserves are required to be maintained for the 12 year loans and the 2.95% loans equal to not less than six months forecasted debt service, to be increased under certain conditions.

As at September 30, 2011, debt service reserves of $35.7 million (March 31, 2011: $37.0 million) were held in short-term investments and have been classified as restricted short-term investments on the balance sheet.

3. Financial statement effect of rate regulation:

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

Regulatory accounts		September 30 2011		March 31 2011
First performance term accounts:				
Balance at March 31, 2008:				
Deferred fuel costs	$	18,501	$	18,501
Performance term submission costs		600		600
		19,101		19,101
Accumulated amortization		(16,714)		(14,326)
Total of first performance term accounts		**2,387**		**4,775**
Second performance term accounts:				
Deferred fuel costs				
Balance – beginning of period		(1,790)		(9,185)
Fuel costs deferred (including realized hedge gains and losses)		8,681		849
(Surcharges) rebates granted		(5,515)		8,593
Fuel price risk recoveries from the Province		(1,001)		(196)
Other payments from the Province		(1,503)		(1,556)
Interest payable		(56)		(295)
Balance – end of period		(1,184)		(1,790)
Tariffs in excess of price cap (b)		-		(1,072)
Performance term submission costs		326		232
Total of second performance term accounts		**(858)**		**(2,630)**
Total regulatory assets		**1,529**		**2,145**
Current regulatory assets		**2,387**		**3,703**
Total long-term regulatory (liabilities)	**$**	**(858)**	**$**	**(1,558)**

(columnar dollars expressed in thousands)

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

(a) Amortization expense:

During the quarter ended September 30, 2011 the Company recognized $1.2 million in amortization expense for first performance term accounts (September 30, 2010: $1.2 million). Amortization expense for first performance term accounts for the six months ended September 30, 2011 totalled $2.4 million (September 30, 2010: $2.4 million).

(b) Tariffs in excess of price cap:

The *Coastal Ferry Act* (the "Act") contains provisions which ensure that if tariffs charged by the Company exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. At September 30, 2011 tariffs charged to customers on all route groups were below established price caps and at March 31, 2011, tariffs charged to customers on the Major Route Group exceeded the price cap by $1.1 million.

If the Company was not a rate-regulated entity and did not record regulatory assets and liabilities, net earnings for the six months ended September 30, 2011, would have been $0.6 million higher (2010: $3.7 million higher) as detailed below:

Impact of regulatory accounts on net earnings	Three months ended September 30, 2011	Three months ended September 30, 2010	Six months ended September 30, 2011	Six months ended September 30, 2010
First performance term accounts:				
Deferred fuel costs	$ (1,157)	$ (1,157)	$ (2,313)	$ (2,313)
Performance term submission costs	(37)	(37)	(75)	(75)
Second performance term accounts:				
Deferred fuel costs	128	2,882	606	5,238
Performance term submission costs	31	45	94	38
Unrealized fuel hedge gains and losses	-	-	-	-
Tariffs in excess of price cap	-	(6,674)	1,072	(6,674)
Total (decrease) in net earnings resulting from regulatory accounts	$ (1,035)	$ (4,941)	$ (616)	$ (3,786)
Unamortized training costs (note 5)	36	109	(10)	70
Total (decrease) in net earnings	$ (999)	$ (4,832)	$ (626)	$ (3,716)

(columnar dollars expressed in thousands)

4. Property, plant and equipment:

September 30, 2011	Cost	Accumulated amortization	Net book value
Vessels	$ 1,712,186	$ 657,007	$ 1,055,179
Berths, buildings and equipment	91,864	52,798	39,066
Berths, buildings and equipment under capital lease	699,045	268,162	430,883
Land	1,385	-	1,385
Land under capital lease	5,177	-	5,177
Construction-in-progress	47,488	-	47,488
	$ 2,557,145	$ 977,967	$ 1,579,178

March 31, 2011	Cost	Accumulated amortization	Net book value
Vessels	$ 1,698,151	$ 620,758	$ 1,077,393
Berths, buildings and equipment	91,932	49,260	42,672
Berths, buildings and equipment under capital lease	686,128	259,789	426,339
Land	914	-	914
Land under capital lease	5,177	-	5,177
Construction-in-progress	28,512	-	28,512
	$ 2,510,814	$ 929,807	$ 1,581,007

Capitalized financing costs during construction for property, plant and equipment for the six months ended September 30, 2011 totalled $0.8 million (September 30, 2010: $1.0 million).

Amortization expense for assets under capital lease for the quarter ended September 30, 2011 totalled $5.7 million (September 30, 2010: $4.8 million) and the six months ended September 30, 2011 totalled $11.2 million (September 30, 2010: $9.4 million).

In addition to the construction-in-progress referenced above, the contractual commitments at September 30, 2011 for capital assets to be constructed, totalled $23.4 million (March 31, 2011: $48.7 million).

Rental income earned from buildings held for leasing purposes for the quarter ended September 30, 2011, totalled $0.2 million (September 30, 2010: $0.2 million) and six months ended September 30, 2011, totalled $0.4 million (September 30, 2010: $0.4 million). These buildings have a cost and accumulated amortization of $13.5 million and $1.9 million respectively, as at September 30, 2011.

(columnar dollars expressed in thousands)

5. Intangible assets:

September 30, 2011		Cost		Accumulated amortization		Net book value
Acquired software, licenses and rights	$	28,858	$	13,075	$	15,783
Internally developed software and websites		23,684		14,138		9,546
Work-in-progress		11,007		-		11,007
	$	63,549	$	27,213	$	36,336

March 31, 2011		Cost		Accumulated amortization		Net book value
Acquired software, licenses and rights	$	36,476	$	19,767	$	16,709
Internally developed software and websites		23,920		15,652		8,268
Work-in-progress		9,952		-		9,952
	$	70,348	$	35,419	$	34,929

There was no impairment of intangible assets during the six months ended September 30, 2011 or the year ended March 31, 2011.

Capitalized financing costs during construction for intangible assets for the six months ended September 30, 2011 totalled $0.2 million (September 30, 2010: $0.2 million).

Included in the cost of intangible assets as at September 30, 2011 is $0.8 million of unamortized training costs (March 31, 2011: $0.8 million). If the Company was not a regulated entity, these training costs would be expensed in the period incurred.

During the six months ended September 30, 2011 intangible assets totaling $4.1 million (September 30, 2010: $7.5 million) were acquired and $0.4 million (September 30, 2010: $1.2 million) were internally developed. Amortization expense for the six months ended September 30, 2011 totalled $3.1 million (September 30, 2010: $2.4 million).

6. Accrued employee future benefits:

During the quarter ended September 30, 2011 the Company recognized total defined benefit costs of $0.4 million (September 30, 2010: $0.4 million) and during the six months ended September 30, 2011 the Company recognized total defined benefit costs of $1.7 million (September 30, 2010: $0.7 million).The amount recognized in the three months ended June 30, 2011 includes a cost of $1.0 million to reflect the actuarial valuation of the residual liability at March 31, 2011 for workers' compensation claims arising from the Workers' Compensation Board deposit class coverage system in which our predecessor entity participated prior to April 1, 2003. This actuarial valuation report was received June 15, 2011.

(columnar dollars expressed in thousands)

7. Interest rate support:

During the quarter ended June 30, 2011 the Government of Canada agreed to provide $1.3 million in the form of interest rate support to the Company for the major refurbishment of one vessel (during the year ended March 31, 2011: $1.0 million for the major refurbishment of one vessel). During the quarter ended September 30, 2011 interest rate support received and recorded as a reduction of interest expense totalled $0.4 million (September 30, 2010: $0.1 million) and $nil (September 30, 2010: $0.1 million) was recorded as a reduction of capitalized interest. During the six months ended September 30, 2011 interest rate support received and recorded as a reduction of interest expense totalled $0.9 million (September 30, 2010: $0.2 million) and a further $0.2 million (September 30, 2010: $0.1 million) was recorded as a reduction of capitalized interest.

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

8. Related party transactions:

In accordance with the Act, the Company is responsible for paying any expenses that are incurred by its parent, B.C. Ferry Authority (the "Authority") without charge. During the six months ended September 30, 2011, the Company paid $98,656 (September 30, 2010: $4,028) of such expenses.

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

9. Supplemental cash flow information:

	Three months ended September 30		Six months ended September 30	
(a) Changes in non-cash operating working capital:	2011	2010	2011	2010
Change in working capital				
Accounts receivable	$ 2,420	$ (123,274)	$ (214)	$ (123,258)
Prepaid expenses	7,689	4,913	(2,556)	(1,070)
Inventories	(93)	(599)	(989)	(744)
Regulatory assets	-	-	(1,072)	-
Accounts payable and accrued liabilities	(4,934)	2,150	(12,690)	4,350
Interest payable on long-term debt	3,172	3,130	26	54
Accrued employee costs	328	(1,875)	1,298	(2,968)
Deferred revenue	(4,687)	(5,053)	(1,188)	(2,957)
Regulatory liabilities	-	6,674	-	6,674
Change in non-cash working capital	3,895	(113,934)	(17,385)	(119,919)
Change attributable to capital asset acquisitions	(3,609)	116,891	(913)	111,574
Change in non-cash operating working capital	$ 286	$ 2,957	$ (18,298)	$ (8,345)
(b) Cash paid during the period for interest	$ 15,671	$ 15,249	$ 37,532	$ 36,617
(c) Non-cash transactions:				
Capital assets acquired under capital lease	$ -	$ 49,247	$ -	$ 49,247