

# Building a better BC Ferries



ANNUAL REPORTS 2004/05

British Columbia Ferry Services Inc. & B.C. Ferry Authority

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This report contains historical information and may contain certain forward-looking statements which relate to future events or future performance. These forward-looking statements are based upon management's current expectations and assumptions as to a number of factors, including, the risks, uncertainties and other factors as described in BC Ferries' Management's Discussion and Analysis herein and certain of the other BC Ferries' documents available at [www.sedar.com](http://www.sedar.com). These forward-looking statements are made as of today's date and are based upon information currently available to management and BC Ferries assumes no obligation to update or revise them to reflect new events or circumstances. If management's expectations and assumptions prove to be incorrect, or factors change, then actual results could differ materially from the forward-looking information contained in this report.







Life on the Coast



## A Message from the Chair

**“We are making substantial progress in  
renewing and revitalizing our ferry system.”**

WITH OUR FIRST bond offerings successfully completed, BC Ferries has established itself as a commercial company able to raise capital funding in the Canadian bond markets.

In 2004/05 we built upon the foundation of the new business model that was established in the previous year. As a result, we are making substantial progress in renewing and revitalizing our ferry system. All of our profits are being invested in the purchase of new ships and infrastructure.

The results of this hard work are evident in significant improvements to our services, our ships and our terminals. On behalf of the Boards of the B.C. Ferry Authority and British Columbia Ferry Services Inc., I would like to extend our gratitude to all of our employees and management.

I would also like to acknowledge the Directors for their ongoing commitment, and thank outgoing board member, Marilyn Baker, for her service this past year. I join the

B.C. Ferry Authority Board in welcoming returning and new members Sandy Fulton, John R. Henderson and Doreen Hewitt.

I would also like to welcome to the British Columbia Ferry Services Inc. Board three new members: Peter Armstrong, Robert McCaskill and David L. Hahn. Together they bring additional transportation, tourism, legal and corporate governance expertise to the existing board.

We look forward to the year ahead, as we further our pursuit of customer-service excellence and commercial success.

A handwritten signature in black ink, appearing to read 'Elizabeth J. Harrison'.

Elizabeth J. Harrison, QC

*Chair*

*August 1, 2005*







## A Message from the President and CEO

**“We look to the future with confidence in our people, and our strategy, as we work to build a better BC Ferries.”**

THIS PAST YEAR we made significant strides towards achieving our goal of becoming a world-class transportation system that is financially viable and customer-focused.

First and foremost, I would like to acknowledge the dedication of all of our employees for their sustained efforts in delivering safe, customer-oriented service this past year. With our marine links extending from Victoria to the Queen Charlotte Islands and serving more than 58,000 customers a day, the women and men of BC Ferries are fundamental to our success.

Our strategy is translating into solid operating performance and financial results. Overall, 88 per cent of our customers reported satisfaction with our service this year, up from 82 per cent the year before. This is a substantial improvement from previous years and a clear indication that we are making progress in areas that are of value to our customers.

BC Ferries continues to contribute significantly to the provincial economy. This year BC Ferries employed over 4,500 individuals, representing a total payroll and benefits in excess of \$250 million. In addition, we spent \$173 million in other operating expenditures, \$127 million in capital programs, and \$26 million in the cost of goods sold in our catering and retail operations, for a total of approximately \$580 million during the fiscal year 2005. The majority of this was spent in British Columbia.

Vehicle and passenger traffic rose by more than three per cent, and our net earnings increased to \$39.8 million from \$28 million the previous year. Vessel and terminal enhancements, along with

our commitment to increasing product quality and choice, stimulated greater customer spending.

Financial accomplishments this past year included the achievement of a commercial credit rating of A- from two prominent rating companies; two successful public bond offerings totalling \$500 million; and the repayment of a \$428-million debt to the Province of British Columbia. Going forward, we recognize that we have financial challenges, including higher fuel prices and construction costs. We remain committed to finding new ways to improve our revenues and control our operating costs.

We also successfully launched an extensive program to revitalize our fleet and upgrade our terminals.

Our goal is the transformation of the BC Ferries fleet into the finest ferry fleet in the world, and the renewal of our fleet is well underway. We completed major renovations to the *Queen of Cowichan*, which operates on the Horseshoe Bay–Departure Bay route and is the second of five C-class vessels to undergo this work. We also began a six-month upgrade on the third C-class vessel, the *Queen of Oak Bay*, which returned to service in June 2005.

In March 2005 the *Spirit of British Columbia* returned to service after a refit and passenger-service upgrade. Our other flagship vessel, the *Spirit of Vancouver Island*, is scheduled for a major refurbishment next year. We also expect to complete the evaluation of proposals and award a contract for the construction of a new intermediate-size ferry early this fall.

Over the next 10 years our investment in new vessel and terminal construction is expected to be at least \$1.9 billion. It is therefore essential

that we achieve the best terms possible for each vessel and terminal project. This past year, after a competitive bidding process, we placed orders for three new Super C-class vessels from Flensburger Schiffbau-Gesellschaft (Flensburger Shipyard) of Germany. These contracts substantially reduce our risk in terms of design, construction and delivery, while guaranteeing a quality product for our customers.

Among the most notable improvements are the renewals of our Tsawwassen and Swartz Bay terminals, representing a \$25-million investment this past year. In the summer of 2005 the new Tsawwassen Quay Market was completed, which will bring further improvements.

Our operations philosophy is for our front-line managers and employees to be better able to meet the needs of our customers.

Throughout the company, employees have shown commendable initiative in their response to customer needs and creating solutions to enhance the travel experience of our passengers.

We are excited about the successes we have achieved this year in offering greater choice and improved customer service. We look to the future with confidence in our people, and our strategy, as we work to build a better BC Ferries for everyone in British Columbia.

David L. Hahn  
President and Chief Executive Officer  
August 1, 2005





## Corporate profile

BC FERRIES is an independent marine transportation company operating a complex coastal ferry system that provides vehicle and passenger transportation and related services in British Columbia's coastal waters.

We are one of the largest ferry operators in the world, based on passengers transported annually and transportation infrastructure.

We provide frequent year-round services on 25 routes, supported by 35 vessels and 47 terminals. (In addition, BC Ferries owns two other vessels, which we charter to other operators.)

Our company is governed by an independent Board of Directors appointed by the B.C. Ferry Authority, which owns the single voting common share of BC Ferries. The Province of British Columbia owns cumulative preferred shares of BC Ferries, but has no voting interest in either the B.C. Ferry Authority or BC Ferries.

To learn more about BC Ferries, please visit our website at [www.bcferries.com](http://www.bcferries.com).





## Our Vision

To become a world-class marine transportation system that is customer-focused and financially viable.

## Our Mission

To provide a safe, reliable and efficient ferry service which consistently exceeds the expectations of our customers and communities, and creates value for the shareholder.

## Our Values

**Safety.** Ensure that the safety and security of our customers and staff is a primary concern in all aspects of doing business.

**Quality.** Be motivated by customer expectations in providing quality facilities and services.

**Integrity.** Be accountable for all our actions and ensure we demonstrate integrity in our business relations, utilization of resources, treatment of our customers and staff, and in the general conduct of our business.

**Partnerships.** Work openly and constructively with our various business and community stakeholders to exceed the expectations of our customers and advance each other's interests.

**Environment.** Ensure that environmental standards are maintained.



## 2004/05 Key accomplishments

### Improving our customers' travel experience...

- Completed our comprehensive annual customer satisfaction survey in April 2005. The results showed that 88 per cent of our customers are satisfied with our service, up from 82 per cent last year. In a 2003 study, 72 per cent of those surveyed had a favourable impression of BC Ferries.
- Carried over 22 million passengers and eight million vehicles, an increase of over three per cent compared to last year.
- Upgraded website and telephone reservation systems to ensure vital and timely information, including current conditions on sailings and terminal status. This included the addition of web-based commercial vehicle reservations.
- Refined our website, [www.bcferrries.com](http://www.bcferrries.com), to make travel planning easier for our customers.
- Expanded our innovative travel programs, such as SailPass, to provide customers with convenient and affordable ways to enjoy coastal destinations.
- Improved customer amenities on board, in our gift shops and at terminals.

### Revitalizing our vessels and terminals...

- Completed substantial renovations to passenger areas at Swartz Bay and Tsawwassen terminals.
- Reconfigured our Horseshoe Bay terminal and successfully alleviated traffic congestion on the Upper Levels Highway.
- Initiated construction of a 16,000-square-foot retail facility at Tsawwassen and signed a 10-year agreement with Lonsdale Quay Market Corp. to manage the retail operations at the terminal.
- Awarded a contract for the construction of three Super C-class vessels that will serve on our Horseshoe Bay–Departure Bay and Tsawwassen–Swartz Bay routes.
- Issued a request for proposal for the construction of a new intermediate-size ferry to replace the 45-year-old *Queen of Tsawwassen*.
- Completed upgrades to the *Queen of Cowichan* and *Spirit of British Columbia*, and initiated upgrades to the *Queen of Oak Bay*.
- Completed 20-year Terminal Master Plans for Swartz Bay, Westview, Alert Bay and Quathiaski Cove.

### Building a better BC Ferries...

- Achieved a seven-year collective agreement with our union that offers stability and certainty for our employees and customers.
- Secured our capital markets financing platform. Completed our first public bond offering in May 2004, raising \$250 million, and our second in October 2004, raising a further \$250 million.
- Transferred many people-management responsibilities to field locations, offering our employees more independence and accountability, and our customers better front-line service.
- Continued consultation with First Nations to address potential environmental and archeological impacts as we move ahead with our terminal master planning process.
- Began an intensive public consultation process with nine northern communities to assist us in planning for future service requirements.





# Operating highlights

(Years ended March 31)	2005	2004
<b>Operating information</b>		
Number of vessels <sup>(1)</sup>	37	37
Mean age of vessels	33 years	32 years
Passengers carried	22.0 million	21.4 million
Vehicles carried	8.6 million	8.3 million
On-time performance	84%	84%
Full-time equivalent employees <sup>(2)</sup>	3,153	3,261
<b>Financial results</b> (\$ in millions)		
Total revenue	\$564.5	\$533.7
Earnings from operations	\$65.0	\$52.0
Net earnings	\$39.8	\$28.0
<b>Financial position</b> (\$ in millions)		
Total assets	\$763.4	\$629.8
Long-term debt	\$499.6	\$427.7
Shareholders' equity	\$131.2	\$97.4
<b>Financial ratios</b>		
Return on assets	5.2%	4.4%

<sup>(1)</sup> Number of vessels for both 2005 and 2004 includes two owned vessels that are chartered to other operators.

<sup>(2)</sup> Full-time equivalent employees are calculated by dividing actual labour hours worked by the standard hours in a work year (1,827).





## Our business model

The guide for BC Ferries' transformation is our long-term strategic plan, which sets six strategic objectives as the framework:

- 01 | Ensure a safe, secure and environmentally responsible marine transportation system
- 02 | Establish a company-wide commitment to customer service
- 03 | Foster a highly motivated, committed and flexible workforce
- 04 | Establish proactive and constructive relationships with communities and governments
- 05 | Respond to and develop market demand to increase revenue
- 06 | Maximize shareholder value

Our business model provides a long-term ferry service guarantee to B.C.'s coastal communities, as well as operational certainty and the freedom to grow our business and improve our financial position.





# 01 | Ensure a safe, secure and environmentally responsible marine transportation system

“We have long been recognized for our safety record, and our commitment to safety is uncompromising.”

At BC Ferries safety always comes first. We have long been recognized for our safety record, and our commitment to safety is uncompromising. In the past year we added new measures to ensure our compliance with maritime and environmental regulations and to improve workplace safety and our ability to respond to onboard emergencies.

## Anticipating and complying with regulatory changes

Transport Canada regulates safety on board our vessels. The new *Canada Shipping Act* is expected to be introduced in 2006, specifying new and updated regulations. In anticipation of these changes, we regularly meet with Transport Canada officials to ensure we are fully informed of all upcoming regulatory issues.

We comply with the requirements of the International Maritime Organization (IMO), a United Nations body concerned with the safety of shipping and cleaner oceans. We also voluntarily comply with the International Safety Management (ISM) Code, a world-recognized quality assurance system for shipping companies.

Our internal ISM auditors conduct annual audits of all our vessels, terminals and operational management. In addition, Lloyd's Register carries out external audits of operational management annually and audits our vessels every two and one-half years to ensure that we are complying with the ISM Code.

## Improved emergency-response capability

BC Ferries' crews must be prepared for a wide range of emergencies. This year our highly skilled crews assisted with 23 marine rescues and 342 marine medical emergencies.

To prepare for these situations our employees

regularly train to respond to emergencies. Each crew member participates in hands-on fire and boat drills twice a month. Man-overboard drills are conducted monthly, and training for specific scenarios, such as oil spills, is conducted quarterly and semi-annually.

This year 14 passengers suffered heart attacks on board our vessels. To help us better respond to these emergencies, we equipped 17 of our major vessels with automatic external defibrillators and trained 140 crew members in their use. We subsequently expanded the program to include 18 more ships and seven terminals and are training additional staff to use this life-saving equipment.

## A safer workplace

BC Ferries representatives and the BC Ferry and Marine Workers' Union participate in a joint committee to address safety issues on an ongoing and proactive basis.

This year the number of employee workdays lost due to injury declined by 15 per cent compared to the previous year. Our employees deserve much recognition for their collaborative efforts to make our company a safe place to work.

## Focus on security

We continue to meet or exceed all legislative requirements respecting the security of our vessels and terminals. We also consult regularly with the RCMP, Transport Canada Marine Security and other intelligence agencies, and participate in a provincial critical infrastructure security intelligence and information network.

Membership in this group includes law enforcement agencies, E-Comm (911), security and emergency planners for Ports Canada, regional districts, and other transportation and emergency-response organizations. We also

remain in contact with security and emergency planners of other northwest coast ferry operators regarding the exchange of security information.

## Our commitment to the environment

We are committed to the highest levels of environmental stewardship, and we are developing improved environmental standards and procedures.

We tested new cleaning products and sewage treatment plant enhancers, and a sewage effluent UV sterilization system on the *Skeena Queen*. Periodic sampling revealed significant improvement in sewage treatment plant performance. Follow-up trials will be conducted in the future.

We conducted a year-long test of continuous water injection technology on the main engine of the *Queen of New Westminster*. This trial demonstrated a substantial reduction in emissions and an increase in fuel efficiency. The trial is now being evaluated by a third party marine engineering company as an option for other vessels.

## Environmental regulations

Future environmental regulations are expected to have an impact on our operations. At the federal level, Canada has pledged to uphold its commitments under the Kyoto Protocol to reduce greenhouse gas emissions to six per cent below 1990 levels by the year 2012. The IMO has set out new requirements specifying that all marine engines, either new or substantially rebuilt and installed after 2000, must meet specific limits with respect to the emission of nitrogen and sulphur oxides.

As part of this larger initiative to improve environmental conditions, we are committed to developing and improving operational practices that reduce fuel consumption and greenhouse gas (GHG) emissions.





## 02 | Establish a company-wide commitment to customer service

“We continued to enhance the operation of our terminals, and we added more amenities for our customers this year.”

BC FERRIES is committed to enhancing the customer's travel experience. We are dedicated to improving our reliability, and our choice of food and amenities, as well as the overall appearance and comfort of our vessels and terminals. An independent research firm has told us that customers are pleased with the courtesy of our employees and the renovations we have been making to our vessels and terminals.

### Improving our terminals

We continued to enhance the operation of our terminals, and we added more amenities for our customers this year.

We began construction of a 16,000-square-foot retail facility at our Tsawwassen terminal and signed a 10-year agreement with Lonsdale Quay Market Corp. to manage the retail operations at the terminal. Customers are now offered a wide range of local and specialized products, such as fresh fruit and vegetables, specialty coffees, baked goods, deli products, clothing, local crafts and gifts. This improvement provides an exciting new experience for our customers.

We also undertook substantial renovations to passenger areas at our Swartz Bay and Tsawwassen terminals, introducing a west coast design theme consistent with our vessel renovations. Freshly painted buildings, new landscaping and service improvements help us provide a more comfortable travel experience to our customers.

### New vessel orders

Revitalizing our fleet to world-class standards is vital to the achievement of our customer-service goals. Several new construction projects are

underway as part of our 10-year, approximately \$1.9-billion capital expenditure program.

We awarded our first Newbuild program contract to Flensburger Shipyard for the construction of three Super C-class vessels. The new ships will serve on our busy Horseshoe Bay–Departure Bay and Tsawwassen–Swartz Bay routes, and will allow us to replace three vessels that are more than 40 years old. The new 160-metre vessels, which are slightly larger than our existing C-class ships, will accommodate 370 vehicles and 1,650 passengers. The first vessel is scheduled to arrive in December 2007, with the second scheduled to arrive in March 2008 and the third in June 2008.

We also issued a request for proposal for the construction of a new intermediate-size ferry to replace the 45-year-old *Queen of Tsawwassen*. We expect to make a decision on this contract during the 2005 calendar year.

### A better travel experience on our vessels

In terms of ongoing vessel renewal, we spend more than \$100 million annually on refits, upgrades and maintenance.

We invested more than \$34 million on a mid-life upgrade to the *Queen of Cowichan*, the second of five C-class vessels to undergo this work. The work included safety upgrades and major maintenance work, such as steel replacement, piping and cable renewal, hull sandblasting and extensive painting. The vessel was also outfitted with four state-of-the-art marine evacuation systems. Significant machinery overhaul work was completed to clutches, gear boxes, tailshafts and controllable pitch propellers, with refurbishment of couplings, valves, rudders and other components. In addition, we expanded

the gift shop, added new food service facilities, redesigned passenger lounges and the children's play area, and added study carrels. We also began a similar extensive, six-month upgrade on a third C-class vessel, the *Queen of Oak Bay*, which returned to service in June 2005.

Our two Spirit-class vessels are the largest vessels in our fleet. They operate on our busy Tsawwassen–Swartz Bay route and each carries approximately 2.3 million passengers a year. In March 2005 the *Spirit of British Columbia* returned to service after a \$14-million refit and passenger-service upgrade. Upgrades included improved lifesaving equipment, renovated washrooms, an expanded gift shop, renewed children's play areas, upgraded buffet and cafeterias, a new tourist and customer information area, and a new Seawest Lounge, ideally suited for quiet work or relaxation.

This was one of several projects carried out at our wholly owned subsidiary, Deas Pacific Marine Inc. Our other flagship vessel, the *Spirit of Vancouver Island*, had its gift shop remodelled in the winter of 2004 and is scheduled for a major refurbishment to be completed at Deas Pacific Marine Inc. next year.

Our Peak Performance Plan was introduced to improve our customers' overall travel experience from travel planning through to their experience at our terminals and on board our vessels. Particular focus was given to peak periods where customers may experience delays in service delivery due to high traffic volume. In the busy summer period we also introduced onboard customer-service teams to support our front-line staff in responding to customer needs.





“Without question, the women and men who work at BC Ferries are our greatest asset.”

EVERY DAY our employees demonstrate their skill and dedication to the safety and comfort of our customers. Without question, the women and men who work at BC Ferries are our greatest asset.

This year we concentrated on building an energized, people-focused culture that encourages us to work together to earn the respect of our customers. Our progress is increasingly evident, with the establishment of new corporate values, much-improved internal communication and a renewed relationship with our employees.

#### A long-term collective agreement

In October 2004 we achieved a seven-year collective agreement with the BC Ferry and Marine Workers' Union. In effect until October 31, 2010, this agreement offers stability and certainty for our employees and customers. It also provides us with a foundation on which to build a stronger relationship with our workforce.

#### A new corporate culture

We have initiated an extensive and fundamental shift in how we work with our employees to ensure we are providing world-class customer service and an exciting environment to develop a long-term career.

As we continue to implement our new operations business model, we have moved many of the people-management responsibilities to field locations and have offered employees more independence and accountability. We have also restructured reporting relationships so that front-line decision makers are in the best position to respond to the needs of their staff.

We are implementing a new Crewing, Human Resources and Time System (CHaRTS). This system allows us to produce long-term, predictable work schedules for our employees, gives us access to real-time shift information and automatically generates timesheets.

#### Developing our employees

To ensure our long-term success, we are making every effort to develop and retain our existing workforce, as well as attract skilled and highly qualified new employees.

As a company, we've also been developing new employee-centric corporate values that more accurately reflect our philosophy towards our employees. It is crucial to consider our employees as investments in the future of our company and ensure they meet their full potential. To do so, we are developing world-class management and employee development practices through career planning and training, and identifying improvements to structures and processes that enhance accountability, increase spans of control and reduce layers of bureaucracy.





## 04 | Establish proactive and constructive relationships with communities and governments

“This year we continued to consult widely with individuals and associations throughout coastal British Columbia on issues ranging from local service needs to terminal and vessel improvements.”

FOSTERING POSITIVE relationships with our stakeholders, including local governments, First Nations, chambers of commerce, and tourism and customer interest groups, is a key priority for us.

### Consulting as we plan

This year we continued to consult widely with individuals and associations throughout coastal British Columbia on issues ranging from local service needs to terminal and vessel improvements.

In April 2004 we began an intensive public consultation process with nine communities from Port Hardy to the Queen Charlotte Islands. The purpose of these meetings was to assist us with decisions related to the long-term provision of ferry service to northern communities.

All three of our northern vessels must be replaced by new, modern vessels by 2012. Community input will guide the process forward as we work to improve service and generate revenue growth over the long term.

In January 2005 we met with the communities of Powell River, Texada Island, Westview and Sliammon First Nation to begin the development of a long-term plan for the improvement of marine transportation links to Powell River. In March we met with local government and community leaders from the Comox Valley for the same purpose. Also in March we met with communities on the Sunshine Coast to discuss ongoing service issues and improvements.

These consultation initiatives are in addition to ongoing Ferry Advisory Committee meetings on 12 routes to ensure that our service meets the needs of the communities and the customers we

serve. As well, discussions with local government representatives were held at the annual meetings of the Union of British Columbia Municipalities and the Association of Vancouver Island Coastal Communities this past year.

Our Terminal Master Plans will help us efficiently manage and schedule much-needed upgrades to our terminals and vessels over the next 20 years. Input from local communities will be integral to these plans. This year we sought public feedback on our terminals at Tsawwassen, Swartz Bay, Quathiaski Cove, Alert Bay, Crofton and Snug Cove. As we develop master plans for other terminals, we will continue to consult with the affected communities.

### Inaugural annual meetings

In September 2004, at the annual general meeting of the B.C. Ferry Authority and the annual public meeting of British Columbia Ferry Services Inc., we welcomed guests and thanked customers and coastal communities for their ongoing feedback.

### Fostering good community relations

As part of our ongoing effort to establish more contact with local community leaders, our President and CEO, as well as senior executives, made nearly three dozen presentations this year. In communities served by BC Ferries, our senior management team described our plans, answered questions and discussed concerns.

These events included presentations to elected councils in Nanaimo, Courtenay,

Parksville and the Cowichan Valley, and to the chambers of commerce in ferry-dependent communities, including Salt Spring Island, Powell River and Prince Rupert. Our executives also accepted several invitations to speak with business leaders in Victoria and Vancouver.

### Sport BC

In February 2005 we signed a three-year partnership agreement with Sport BC. Sport BC's 80 member organizations and their member clubs will be eligible for travel assistance through a new joint program, Sporting Life on the Coast. Through promotional offers, BC Ferries will also raise funds for Sport BC's KidSport™, a program for children that helps remove financial barriers to participation in organized sport.

### Strengthening aboriginal relations

Our relationships with aboriginal communities in coastal British Columbia are important to us. We have established a new program targeted at building and renewing these relationships. We want to integrate local indigenous cultures with our service and enhance our communications with coastal First Nations.

Consultation with several of these groups has been instrumental in addressing potential environmental and archeological impacts as we proceed with our terminal master planning process. At Swartz Bay, for example, we are working with five First Nations communities to effectively map our plans for current and future terminal development.





## 05 | Respond to and develop market demand to increase revenue

“Responding to customers is helping us to grow revenues in areas such as reservations, food, beverage and retail services.”

THIS YEAR we carried over 22 million passengers and 8 million vehicles—the most vehicles ever carried by BC Ferries in a single year and the third highest passenger total. Responding to customers is helping us to grow revenues in areas such as reservations, food, beverage and retail services. We are also stimulating travel through pricing promotions.

### Pricing our services to encourage and shift time of travel

Throughout the year we continued to test a number of pricing initiatives to help us better manage periods of peak demand, including the Christmas and Easter holidays, and to encourage more travel during less busy sailings. Although these pricing incentives had modest success in shifting traffic away from the busiest periods, they did demonstrate an ability to stimulate non-peak travel.

In April we offered a nearly 50 per cent savings for reserved under-height vehicles on select major route sailings as incentive to travel during non-peak times over the Easter long weekend. In September, as part of a special promotion to follow the busy summer season, we offered a two-for-one, midday weekday fall special for customers travelling to Vancouver Island, the mainland and the Sunshine Coast with a car reservation.

Other promotions were offered during late November and early December on our Horseshoe Bay–Langdale route, and on our major Mainland–Vancouver Island routes before spring break.

We also used special promotions to create attractive travel opportunities. We continued our popular SailPass program for a second season.

With this promotion customers were offered four- or seven-day seasonal passes on up to 20 of our southern routes. In conjunction with the British Columbia Automobile Association, we also introduced the SummerSail Vacation Pass to further encourage vacation travel.

Commercial trucking represents an important market for us. For a week starting in late February we offered commercial customers on our three Mainland–Vancouver Island routes a 50 per cent discount in recognition of their valued business.

### Reservations and travel planning

In June 2004 we introduced web-based commercial vehicle reservations for our Mainland–Vancouver Island routes, offering instant confirmation and enabling commercial customers to check space availability in advance. We also expanded commercial vehicle reservations for our Horseshoe Bay–Langdale route in response to customer input.

We introduced variable rate reservations with a \$17.50 price for bookings inside of seven days and \$15 for bookings outside of seven days.

We implemented extensive improvements to our telephone reservations system to assist customers in organizing their travel plans in time for the busy summer season. The system is now upgraded and simplified, with one toll-free number, 1-888-BCFERRY (1-888-223-3779), through which customers can access numerous services. Rogers and Telus Mobility cell phone customers are also offered quick dial \*BCF (\*223) capability.

We continued to refine our website over the past year. In response, visits to [www.bcferries.com](http://www.bcferries.com) averaged increases of 20 per cent a month, and

individual page views on our site averaged increases of 11 per cent a month. This growth in usage confirms that many of our customers increasingly value self-service options for travel planning.

We made substantial signage improvements to the approaches to key terminals. We added a new electronic sign that provides current sailing conditions on the highway approaching Swartz Bay terminal and intend to install a similar electronic sign leading up to Tsawwassen terminal. At several terminals we installed new web-cams that feed real-time data onto the current conditions page of our website and show the actual load on each sailing.

In addition, we partnered with Expedia.ca to provide web-based car rental and hotel booking capabilities in order to give our customers quick access to other travel options.

### Food and retail

With a number of vessel and terminal renovations in place we were able to create a better environment for our food and retail customers.

Revenues from food and retail operations increased 7.3 per cent to \$67.8 million. The growth was attributable to a number of new initiatives, including ongoing upgrades to major route vessels, expansion of retail shops and improved customer flow on board.

Partnerships with Salt Spring Coffee Company, Starbucks and Bread Garden were expanded and new products were introduced, such as meal-size salads, soy beverages and a low-carb breakfast. These and other changes contributed substantially to growth in our catering and retail revenues.





“The profits we generate are reinvested in much-needed capital improvements to vessels, terminals and equipment.”

THE PROFITS we generate are reinvested in much-needed capital improvements to vessels, terminals and equipment.

## Sound financial platform

In May 2004 we successfully completed our first bond offering and raised \$250 million from the sale of secured bonds. These funds, together with a \$200-million bank credit facility, allowed us to repay \$428 million of indebtedness to the Province of B.C. We also established revolving bank credit facilities totalling \$155 million, which to date have been undrawn.

In October 2004 we completed a further issue of \$250 million in secured bonds. We used \$200 million of this issue to repay the bank credit facility, and we allocated the remainder to fund future capital expenditures.

## Meeting Commissioner requirements

The Commissioner serves as an independent regulator responsible for ensuring the public interest is protected under our operating model.

As required by the *Coastal Ferry Act*, in the spring of 2004 we submitted a plan to determine if additional or alternative service providers can provide safe, reliable service more cost effectively than BC Ferries.

In May 2004 we submitted an application to the BC Ferry Commissioner under Section 55 of the *Coastal Ferry Act* for a declaration regarding the purchase of the three Super C-class vessels. In his response, the Commissioner indicated satisfaction that we had structured the procurement process to be “credible and create competition among high quality international bidders.” He also declared that “acquisition of up to three vessels for deployment on the major route group is reasonably required.”

This year we began enhancing our internal controls and audit processes with new reporting procedures based on industry best practices. This will help ensure that our financial reporting fulfills the new requirements of our lenders and securities regulators.

## Fuel oil pricing and recovery strategy

Fuel is our second largest operating expense. In the fall of 2004 BC Ferries received approval from the BC Ferry Commissioner to establish a fuel deferral account to address what appeared to be a short-term spike in fuel prices. However, with energy prices remaining extremely high, BC Ferries anticipates it will incur approximately \$25 million in incremental fuel costs by the end of fiscal year 2006.

While we have been prudent and proactive

in our fuel purchasing strategy in order to keep costs down, by the end of the 2006 fiscal year, BC Ferries’ annual cost of fuel is projected to be 45 per cent higher than it was two years earlier. Like other major transportation companies, such as airlines and freight carriers, we can no longer absorb the additional cost of fuel.

As a result, BC Ferries applied to the BC Ferry Commissioner for extraordinary price cap increases that would allow BC Ferries to implement fuel surcharges to recover increasingly high fuel costs. On July 24, 2005, we received a final ruling from the BC Ferry Commissioner that provides for a fuel surcharge of, on average, four per cent for major routes connecting Vancouver Island to the mainland and six per cent on other routes.

## Captive insurance subsidiary

Last year we established BCF Captive Insurance Company Ltd., a wholly owned subsidiary of BC Ferries. The company is designed to serve as a strategic risk financing mechanism that will improve our access to insurance wholesalers and allow us to implement a “cost of risk” approach to allocating insurance and other costs more accurately. This in turn will improve our route and route group reporting, as required by the *Coastal Ferry Act*.





# BC Ferries fleet

## MAJOR VESSELS

Average Vessel Age 29.6 years

PASSENGERS • 450-2,052  
CREW • 21-48  
AUTOMOBILE EQUIVALENTS • 286-470



Spirit of British Columbia • 1993



Spirit of Vancouver Island • 1994



Queen of Alberni • 1976



Queen of Coquitlam • 1976



Queen of Cowichan • 1976



Queen of Esquimalt • 1963



Queen of New Westminster • 1964



Queen of Oak Bay • 1981



Queen of Saanich • 1963



Queen of Surrey • 1981



Queen of Vancouver • 1962

## INTERMEDIATE AND SMALL VESSELS

Average Vessel Age 33.8 years

PASSENGERS • 133-1,129  
CREW • 4-35  
AUTOMOBILE EQUIVALENTS • 16-192



Queen of Burnaby • 1965



Queen of Nanaimo • 1964



Queen of Tsawwassen • 1960



Skeena Queen • 1996



Queen of Cumberland • 1992



Queen of Capilano • 1991



Mayne Queen • 1965



Bowen Queen • 1965



Powell River Queen • 1965



Quinsam • 1982



Quinitsa • 1977



Klitsa • 1972



Kahloke • 1973



Kwuna • 1975



Howe Sound Queen  
1964



Tachek • 1969



North Island Princess  
1958



Quadra Queen II  
1969



Tenaka • 1964



Nimpkish • 1973



Mill Bay • 1956

## NORTHERN VESSELS

Average Vessel Age 34.0 years

PASSENGERS • 374-650  
CREW • 26-50  
AUTOMOBILE EQUIVALENTS • 80-120



Queen of the North • 1969



Queen of Prince Rupert • 1966



Queen of Chilliwack • 1978





## BC Ferries routes



“BC Ferries operates 25 regulated routes between 47 terminals. This year we carried over 22 million passengers and eight million vehicles.”



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

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

The following is our discussion and analysis of the financial condition and results of operations for British Columbia Ferry Services Inc. as of June 9, 2005. This should be read in conjunction with the consolidated financial statements for the year ended March 31, 2005 (fiscal year 2005).

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

The certifying officers of British Columbia Ferry Services Inc. have concluded that the disclosure controls and procedures as of March 31, 2005 are effective.

## 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, with 35 vessels operating on 25 routes. We are a versatile company, providing a wide range of ferry services for our customers. In fiscal year 2005, we provided over 183,000 sailings, carrying over 22 million passengers and 8 million vehicles. Passenger and vehicle traffic was 3.1% higher than the previous fiscal year.

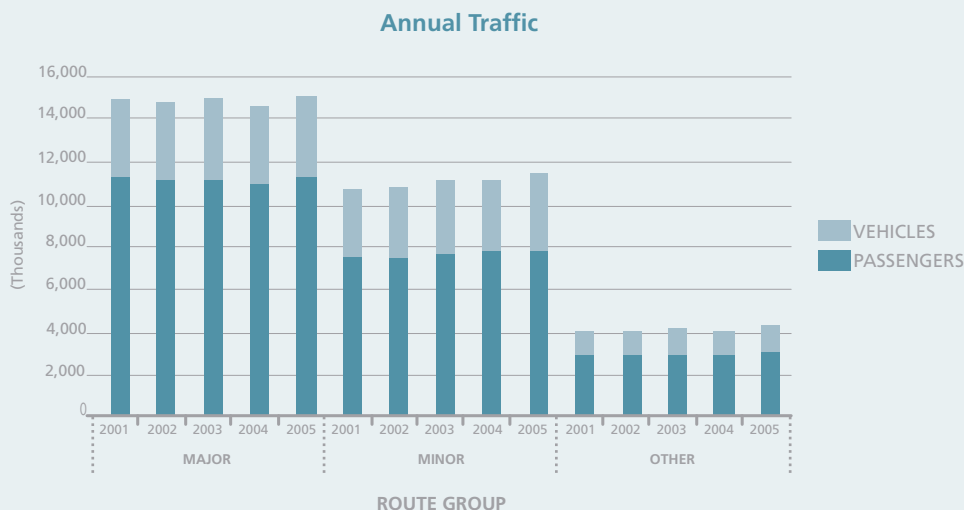
Our customers travel on our ferries for business purposes and for leisure. Our traffic volumes are affected by a number of external factors, including population growth, economic trends and the tourism industry.

Tourism is on the rebound in British Columbia.<sup>1</sup> We witnessed an increase in bus tours in fiscal year 2005, reflecting a renewed growth in tourism after a period of reduced volume on our major routes due to the 9/11 terrorist attacks in the United States in 2001, and the SARS outbreak the following year. With the announcement of Vancouver as the host city for the 2010 Olympics, the impact on tourism and our business is expected to remain strong and grow.

We placed increased emphasis on travel demand management techniques by offering differential pricing for peak and off-peak travel. We also expanded our service offering by providing more scheduled service. This allowed an increase in the number of reservations year over year, while also increasing availability on sailings for those electing to travel without reservations.

The demand for coastal ferry services has increased, with 4.1% growth from 2001 to 2005, or approximately 1% per year. Based upon the above traffic drivers and our use of demand management techniques, this growth is expected to continue.

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 downturn 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.



<sup>1</sup>Chief Economist, The Conference Board of Canada



## Corporate Structure and Governance

### Coastal Ferry Services Contract

We operate ferry services under a regulatory regime as defined by the *Coastal Ferry Act*, and under the terms set out in the Coastal Ferry Services Contract. This 60-year services contract with the Province of British Columbia (the "Province"), that commenced April 1, 2003, stipulates the minimum number of round trips that must be provided for each regulated ferry service route in exchange for specified fees. These fees are fixed over the first performance term of the contract, which ends March 31, 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 this 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 Vancouver Consumer Price Index.

### Economic Regulatory Environment

The office of the British Columbia Ferry Commissioner (the "Commissioner") was created under the *Coastal Ferry Act*, enacted by the Province on April 1, 2003. The Commissioner regulates price caps for designated ferry route groups which, to the end of the first performance term, are specified in the *Coastal Ferry Act*. The Commissioner is also responsible for regulating the reduction of service, discontinuance of routes and certain other matters. The *Coastal Ferry 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.

## 2005 Financial Overview

This section provides an overview of our financial performance over the past 3 fiscal years.

Our consolidated net earnings in fiscal year 2005 grew \$11.8 million or 42.3% from the previous fiscal year. Our earnings in fiscal year 2004, before loss on disposal of high-speed ferries grew \$3.6 million or 14.8% from the fiscal year 2003.

(\$millions)	Year ended March 31		
	2005	2004	2003
Total revenue	564.5	533.7	489.9
% Growth	5.8%	8.9%	3.6%
Expenses	(499.5)	(481.7)	(463.9)
Earnings from operations	65.0	52.0	26.0
Financing & loss on disposal	(25.2)	(24.0)	(1.6)
Earnings before the following	39.8	28.0	24.4
Loss on disposal of high-speed ferries			(53.1)
Net Earnings (Loss)	39.8	28.0	(28.7)
	As at March 31		
	2005	2004	2003
Total assets	763.4	629.8	636.8
Total long-term financial liabilities	516.6	443.3	18.6

## Revenue

Our total revenues have increased steadily over the past three years, as shown in the table below. Year to year changes for the past two fiscal years are discussed separately.

Revenue	Year ended March 31		
	2005	2004	2003
Tariff	345.9	323.0	315.6
Ferry services fees	107.0	105.8	0.0
Federal-Provincial subsidy	24.3	24.0	23.4
Retail	67.8	63.2	61.8
Other income	19.5	17.7	14.9
Motor fuel tax subsidy	0.0	0.0	74.2
Total Revenue	564.5	533.7	489.9

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

## Year to Year Comparison of Revenues - Fiscal 2005 vs. Fiscal 2004

The improvement in our tariff revenue is a result of higher traffic volumes, together with annual average rate increases of 2.8% on our three major routes connecting Vancouver Island to the mainland and 4.4% on the remaining routes. These tariff increases are as permitted by the *Coastal Ferry Act*.

Ferry service fees are higher due to an increase of \$1.1 million (8.9%) in social program fees received from the Provincial Government. These programs include discount fares for B.C. seniors, students travelling to and from school, and persons travelling under the Medical Travel Assistance Program. Ferry service fees, other than social program fees, are linked to the number of scheduled sailings which, except for emergency events, are essentially the same each year. Social program fees are based on usage.

The Federal-Provincial subsidy is adjusted each year in accordance with changes in the Vancouver Consumer Price Index.

Retail revenue includes food and other retail merchandise sales. Revenue from food sales grew 2.6% over the previous fiscal year, the majority of the increase reflecting a January 7, 2004 price increase of 3%. Other retail spending increased 13.4%. This increase was mainly attributable to positive customer response to our gift shop expansions on the *Queen of Coquitlam*, *Queen of Cowichan*, and the *Spirit of Vancouver Island*.

The increase in other income reflects increased usage of our reservation system. Reservation fees were \$2.3 million higher than the previous fiscal year, with \$1.9 million more revenue from reservations on our major routes and the balance from the Horseshoe Bay-Langdale route. This increase is partially offset by reductions in foreign exchange and advertising revenues.

## Year to Year Comparison of Revenues - Fiscal 2004 vs. Fiscal 2003

Tariff revenue increases in fiscal year 2004, compared to the previous fiscal year, were due mainly to the annual tariff increase. Traffic volume on the major routes lagged behind prior fiscal year results, reflecting the impact of the war in Iraq and the outbreak of SARS on the B.C. tourism sector. We experienced reductions in travel on these routes of 1.2% for vehicles and 2.5% for passengers. These reductions were not as severe as the impact on the B.C. tourism sector as a whole. Traffic volume on our minor and other routes was not significantly affected.

Fiscal year 2004 was the first year of ferry services fees and the first year without the motor fuel tax subsidy, as a result of the Coastal Ferry Services Contract coming into effect April 1, 2003.

Average per passenger spending increased by 3.5% while gross profit per passenger on food and other retail merchandise increased by 1.6% over the previous fiscal year. This resulted in an increase in our retail revenues of \$1.4 million.

Other income was \$2.8 million higher. This change was largely driven by increases in reservation usage on major routes and on the Horseshoe Bay-Langdale route. Reservations first became available on the Horseshoe Bay-Langdale route in July 2003.

## Expenses

Expenses for the past three years are summarized in the table below.

Expenses (\$millions)	Year ended March 31		
	2005	2004	2003
Operations	294.0	286.0	
Maintenance	86.8	86.1	
Administration	44.5	38.9	
Total operations, maintenance & administration	425.3	411.0	397.8
% Increase	3.5%	3.3%	3.4%
Cost of retail goods sold	26.5	23.3	22.0
Amortization	47.7	47.4	44.1
	499.5	481.7	463.9
% Increase	3.7%	3.8%	2.3%
Loss (Gain) on foreign exchange	0.1	(0.2)	(0.2)
Interest expense	24.5	22.7	1.4
Loss on disposal of capital assets	0.6	1.6	0.4
	25.2	24.1	1.6



In December, 2003, we changed our income statement format to disclose operations, maintenance and administration expenses. We restated our March 31, 2004 year-end expenses and the expense variance of fiscal year 2005 to fiscal year 2004 will be explained following this classification.

#### **Fuel Deferral**

Because of the implementation of an Order from our regulator, the British Columbia Ferry Commissioner, our expenses and reported earnings were not impacted by the high prices of fuel oil in fiscal year 2005. This order authorized us to maintain deferral accounts to mitigate the effect on our earnings of unpredictable and uncontrollable price volatility in world fuel oil markets. This is consistent with regulatory practice in other regulated industries.

In his Order, the Commissioner established set prices for fuel oil for each of the years until March 31, 2008. Differences between the set prices and the actual prices of fuel oil are held in these deferral accounts. These accounts will be maintained until March 31, 2008, at which time the Commissioner will decide on their continuation. Any balance in the deferral accounts as at March 31, 2008 will be taken into account by the Commissioner in setting future tariffs charged to our customers. It is expected that all such deferred fuel oil costs will be recovered through tariffs as approved by the Commissioner. The balance in the deferral accounts at March 31, 2005 is \$8 million.

The Order recognizes that the existence of the fuel deferral account does not remove our ability to make application under Section 42 of the *Coastal Ferry Act* for an extraordinary price cap increase because of an increase in the price of fuel oil. If such application is made, and approved by the Commissioner, proceeds from the extraordinary price cap increase will be credited against the balance in the deferral accounts. Because of the persisting high price of fuel, we will be filing such an application.

#### **Year to Year Comparison of Expenses - Fiscal 2005 vs. Fiscal 2004**

The total increase in operations expenses was \$8.0 million. The most significant item was an increase of \$5.8 million in property taxes due to 2005 being the first complete calendar year of the change from paying grants in lieu of taxes to property taxes based on assessed value. Another \$1.6 million was due to increased wage and training costs.

Maintenance expenses which include expenditures for vessel refit and maintenance as well as terminal maintenance activities were \$0.7 million higher mainly due to changes in scope and scheduling of vessel refits and maintenance.

Administration expenses increased \$5.6 million. The most significant increase was the cost of corporate information technology support of \$4.3 million. We have had many new initiatives and upgrades in our computer systems which require increased support.

The increased cost of retail goods sold reflects the higher level of retail sales. The expansion of our vessel gift shops with increased lines of merchandise has been very successful.

Amortization increased a total of \$0.3 million. This change was a combination of revisions to the estimates of vessel salvage value and increases from additional assets coming into service offset by the *Queen of Chilliwack* which was fully amortized at the end of March 2004.

Interest expenses increased a total of \$1.8 million reflecting the overall increase in our level of debt and the effect of interest rates payable on the debt instruments issued and in place as described in the "Liquidity and Capital Resources" section below.

#### **Year to Year Comparison of Expenses - Fiscal 2004 vs. Fiscal 2003**

The total increase in expenses in fiscal year 2004 was \$13.2 million. In April 2003, we converted from a Crown corporation to an independent company. Because of this, we started paying GST on our direct purchases. Ferry service is an exempt transportation service, therefore, input tax credits cannot be claimed on purchases related to the exempt service. This caused an increase in expenses of \$8.5 million in fiscal year 2004.

We also experienced a \$4.7 million increase in unexpected repairs and maintenance in fiscal year 2004, the most significant of which was as a result of a fire on the *Queen of Surrey* with repairs totalling \$2.9 million.

The \$1.3 million increase in cost of retail goods sold was caused by the higher volume of sales than the previous fiscal year, and the \$3.3 million increase in amortization was driven by the reduction in the useful lives of assets to be replaced by expected vessel and terminal improvement projects.

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

## Quarterly Results and Review of Fourth-Quarter Performance

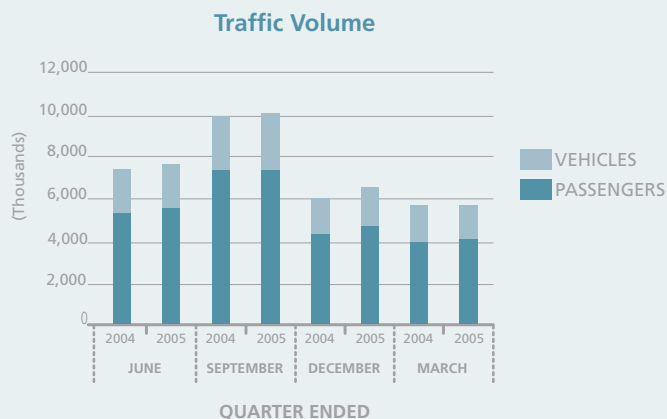
The table below compares earnings by quarter for the fiscal year ended March 31, 2005 and the previous fiscal year.

(\$millions)	Quarter ended (Unaudited)				Fiscal 2005
	30-Jun	30-Sep	31-Dec	31-Mar	
Total revenue	140.4	194.4	122.7	107.0	564.5
Earnings (loss) from operations	17.3	67.9	3.6	(23.8)	65.0
Net earnings (loss)	12.3	63.0	(4.2)	(31.3)	39.8

(\$millions)	Quarter ended (Unaudited)				Fiscal 2004
	30-Jun	30-Sep	31-Dec	31-Mar	
Total revenue	133.7	186.7	110.2	103.1	533.7
Earnings (loss) from operations	17.9	65.2	(0.8)	(30.3)	52.0
Net earnings (loss)	12.3	60.3	(8.2)	(36.4)	28.0

Our net earnings in each quarter of fiscal year 2005 were equal to or greater than the previous fiscal year. The most significant contributing factor to the trend was higher tariff revenue as a result of increases in both traffic and tariffs. As mentioned above, we increased tariff rates an average of 2.8% on the three major routes and 4.4% on the remaining routes. In addition, traffic increased over the previous year in every quarter, ranging from 0.4% in the second quarter to 8.6% in the third quarter, with an average annual increase of 3.1%.

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.



Highlights of our fiscal year 2005 fourth quarter include:

- Increase in vehicle traffic of 26,700, (1.6%) and in passenger traffic of 69,700 (1.7%) over last fiscal year's fourth quarter.
- One of our flagships, the *Spirit of British Columbia*, returned to service following a major two-and-a-half month refit and passenger-service upgrade. The passenger-service improvements are part of a major initiative to revitalize our fleet, and when combined with the refit expenditures totalled an investment of \$15.2 million. In addition to the numerous customer-service improvements, upgrades have also been made to the vessel's lifesaving equipment.
- Continuation of the *Queen of Oak Bay* mid life upgrade and passenger improvement project. This extensive, six-month upgrade will prepare the vessel for another 20 years of service. It is scheduled to return to service in June 2005. See "Investing in our Capital Assets" below for more detail.



## 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. We expect operating cash flows to fund approximately one half of the capital expenditures over the next decade, with the balance funded by borrowings.

### Long-Term Debt

In May 2004 we entered into a master trust indenture. This indenture establishes common security and a set of common covenants by us 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 present intention of offering common shares to the public or other investors.

Under this indenture, we completed a \$250 million public offering of 5.74% Senior Secured Bonds, Series 04-1, due May 27, 2014. The net proceeds were used primarily to repay a portion of our \$427.7 million indebtedness to the Province and to fund reserves required in connection with these bonds. Interest on these bonds is payable semi-annually on May 27 and November 27 of each year until maturity.

We also entered into a credit facility with a syndicate of Canadian banks which is secured under the indenture. Under the credit facility, we were provided with a 364-day revolving operating facility with a one year term-out, in an amount of \$77.5 million, a three-year revolving extendible facility in an amount of \$77.5 million, and a \$200 million two year non-revolving bridge term facility. The revolving term facilities will be available for working capital purposes, to fund the upgrade and acquisition of vessels and terminal upgrades and other general corporate purposes and are currently undrawn. The bridge term facility was fully drawn to repay the remaining portion of our indebtedness to the Province.

In October, 2004 we completed a \$250 million public offering of 6.25% Senior Secured Bonds, Series 04-4, due October 13, 2034. The net proceeds from the sale of these bonds were used to repay the \$200 million bridge term facility and for general corporate purposes. Interest on these bonds is payable semi-annually on April 13 and October 13 of each year until maturity.

### Terminal Leases

We entered into a master agreement with the British Columbia 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 if the Coastal Ferry Services Contract is renewed. We must manage, maintain and develop the terminals at our own cost.

In fiscal year 2005, we added a total of \$3.9 million of additional lands at Horseshoe Bay and Swartz Bay 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 Bondholders' Trustee which sets out certain limitations of 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

Increases in cash and cash equivalents for fiscal 2005 and 2004 are summarized in the table below.

(\$millions)	Year ended March 31	
	2005	2004
Cash provided by operating activities	102.1	69.5
Cash provided by (used in) financing activities	43.7	(24.4)
Cash used in investing activities	(122.2)	(41.7)
Total increase in cash	23.6	3.4

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

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

Cash provided by operating activities increased in fiscal year 2005 by \$32.6 million or 46.9%. Working capital requirements were down by \$30.4 million, primarily due to accrued interest on bond issuances which are payable semi-annually with payments made in April and May, 2005; accrued payables on vessel refits and upgrades in progress, and increases in accrued employee time banks.

Cash provided by financing activities during the fiscal year 2005 was \$43.7 million, an increase of \$68.1 million over the previous fiscal year. This was mainly due to the proceeds from our two bond issuances generating more cash than required to repay the debt owed to the Province.

Cash used in investing activities increased by \$80.5 million in fiscal year 2005. This increase was mainly due to higher capital expenditures in fiscal year 2005 and higher proceeds from asset disposals in the previous fiscal year. The significant capital transactions this year are described below in "Investing in our Capital Assets".

## Investing in our Capital Assets

Capital expenditures this fiscal year totalled \$127.1 million, funded \$119.8 million through cash and \$7.3 million through non-cash working capital. This level of expenditure reflects significant investments in our fleet, terminals and information systems to increase customer service and operating efficiency. Expenditures in fiscal year 2005 included:

- Vessel upgrades and modifications including \$13.3 million of a \$33.0 million mid-life upgrade to the *Queen of Cowichan*, \$23.0 million of a \$35.4 million mid-life upgrade on the *Queen of Oak Bay*, \$10.9 million for passenger improvements on the *Spirit of British Columbia*, and \$5.4 million for renovations on the *Queen of Prince Rupert*.
- \$18.5 million for preliminary costs for the Super C-class vessel construction.
- \$18.7 million in terminal and building upgrades.
- \$18.5 million in marine structures of which \$11.9 is a replacement at Tsawwassen.
- \$13.5 million in software development which will enhance customer service improvements in areas such as reservations and retail and food services, as well as operational efficiencies in crew scheduling.

### Major vessel upgrades

The *Queen of Oak Bay*, which provides service on our Nanaimo–Horseshoe Bay route, is undergoing an extensive, six-month upgrade at the Vancouver Drydock Company in North Vancouver (which is a part of the Seaspan International Inc. family of companies and an affiliate of the Washington Marine Group). The contract with Vancouver Drydock, which also includes regular annual refit work, is valued at approximately \$33 million. The 23 year-old vessel, which is scheduled to be back in service in June 2005, will undergo a mechanical and passenger service upgrade to prepare it for another 20 years of service. The upgrades will include improved and expanded passenger amenities, as well as safety and mechanical improvements. The *Queen of Oak Bay* is the third of five C-class vessels identified for a mid-life upgrade. The *Queen of Cowichan* completed its mid-life upgrade in May, 2004 and the *Queen of Coquitlam* in June, 2003.

### Super C-class new vessel construction

On September 17, 2004 we entered into contracts with Flensburger Schiffbau-Gesellschaft ("FSG") to build three new major vessels. These contracts, with a total value of €206.4 million or approximately \$325 million, form the majority of the total project budget of \$542 million. The new vessels, scheduled for delivery in late 2007 through mid-2008, will replace aging vessels which currently provide service on our major routes. These are design-build, fixed price contracts that provide us with substantial guarantees related to delivery dates, performance criteria, cost certainty and quality of construction. An initial payment of \$16.3 million was made to FSG upon execution of the contracts. All foreign currency based payments in this project have been fully hedged in Canadian dollars, and we expect this project to be completed on schedule and within budget.

### Intermediate size vessel

On October 15, 2004, we issued a request for proposal to three shipyards short listed for the construction of a new, intermediate-sized vessel that will facilitate the retirement of the 44-year-old *Queen of Tsawwassen*. Of the 14 shipyards that were invited to participate in a prequalification process, Allied Shipbuilders Ltd. (Canada), Vancouver Shipyards Co. Ltd., and Remontowa S.A. (Poland) were short listed. We currently anticipate that a contract will be negotiated in the summer of 2005, enabling the delivery of a new intermediate vessel by December, 2007.

### Tsawwassen Quay

The construction of a new 16,000 square foot retail building is underway at our largest terminal. This building will replace the former food services and retail area and washroom facilities at our Tsawwassen Terminal. The major objective of this 'market-style' facility, scheduled for completion by the summer of 2005, is to enhance the experience of our customers with an expanded selection of food and retail services.



### **Tsawwassen Terminal Marine Structures**

In fiscal year 2005, we completed \$12.0 million of a total budget of \$17.4 million for betterments at our Tsawwassen Terminal. This project includes replacing marine and vehicle ramp structures, constructing a new foot passenger waiting lounge, tower and access walkway as well as upgrading the electrical service. The project is expected to be completed in July 2005.

### **Technology**

Many information and technology enhancements were made in fiscal year 2005.

A "Current Conditions" area was added on our website providing customers with up-to-the minute information on sailings on all of our major routes. This included:

- webcam images of traffic in and around each terminal;
- number of sailing waits (if any) for cars and oversize vehicles;
- deck space committed aboard each vessel;
- direct link to make a reservation; and
- parking capacity, actual departure times, terminal conditions, customer information notices and route maps.

Other customer related improvements included:

- a sign on Highway 17, the only direct access road to the Swartz Bay terminal, providing information on current sailings;
- enhanced Integrated Voice Response system and reporting;
- enhanced security for boarding passes; and
- other customer conveniences such as plasma television screens on the *Spirit of British Columbia*.

Crew scheduling software was implemented, replacing a complex paper-based process.

New Occupational Health and Safety ("OSH") software was introduced that helps manage Workers' Compensation Board claims and related administration costs and ensures compliance with new federal legislation.

A corporate incident tracking and management system was implemented to consolidate the various types of information related to an incident. This includes links to OSH, incident claims reporting, safety and audit.

A new catering revenue collection and warehouse system was also implemented which provides enhanced features of recipe management and food and beverage warehousing.

We also implemented new software for employee and manager self-service. This system allows employees to update their personnel information and assists them in their career development. Employees can also access training via the web, and file for personal expenses on-line.

## **Risk Management**

We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business.

We are implementing an Enterprise Risk Management program which will address risk management from an organization-wide perspective and will complement existing strengths. This will be a comprehensive approach that incorporates organization-wide awareness, prioritized risk identification and risk mitigation strategies that target the highest risk areas.

Understanding and managing risk are important parts of our business. The following are some of the risk factors that we have considered.

### **Safety**

The safety of the public, our employees and the protection of the environment are our highest priorities.

We are regulated by the provincial Workers' Compensation Board and Transport Canada to ensure adequate safety on our vessels and at our other facilities. In addition, we have initiated new programs to ensure a high standard of employee safety.

As well, we were an early voluntary adopter of the International Safety Management ("ISM") code that forms an international standard for the safe management and operation of ships and terminals and for pollution prevention. The ISM code places the responsibility for the safety of ships and the prevention of pollution within the company management structure. This means that the entire organization is responsible for safety, not just the ship's master or shore based managers.

### **Environmental Risk**

Our operations are subject to various environmental laws and regulations dealing with the transportation, storage, presence, use, disposal and handling of hazardous materials and hazardous wastes, discharge of storm water and vessel fuel delivery.

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

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, property damage, and fines or other penalties, any of which could have a material adverse effect. Although we believe we maintain adequate environmental insurance, there can be no guarantee that the insurance coverage will be sufficient to cover all such losses.

## **Traffic Level and Tariff Revenue Risk**

Future vehicle and passenger traffic on our vessels will be affected by, among other things, population levels and economic conditions in British Columbia and also by tariff rates. No assurance can be given as to the level of traffic on our system and the tariff revenue that will result.

There is a risk that over the long term a general decline in travel (or a reduction in the growth rate) may occur as a result of compounding increases in tariffs. Under the *Coastal Ferry Act*, we are permitted to increase tariffs on major routes by 2.8% and on the remaining routes by 4.4% each year during the first performance term. In addition to these permitted annual increases, we may apply to the Commissioner for other tariff increases, the need for which results from extraordinary situations. To date, the price increases we have implemented have not caused an obvious decrease in demand. However, elasticity could change as prices increase, thereby resulting in an increasing negative impact of tariff increases.

A relatively high percentage of our customers travel for leisure purposes - approximately 77% on major routes; 82% on northern routes and 63% on other routes. Traffic on our vessels may decline, or fail to increase as expected, if world or local events have a negative affect on tourism.

## **Competition**

While there are significant barriers to entry, we face the risk of competitors entering the vehicle and passenger ferry market and potentially eroding our market share. This risk is greater on the most profitable routes, potentially from other ferry service providers in addition to other forms of transportation.

## **Asset Risk**

We operate in a capital-intensive industry that requires a substantial amount of capital expenditures. We plan to spend approximately \$1.9 billion in capital expenditures over the next decade, with approximately 70% related to new vessel acquisitions, vessel upgrades and component replacement. Our plan is to replace approximately 25% of our vessels before the end of the 2010/11 fiscal year.

At March 31, 2005, we have a total indebtedness of \$500 million. Future indebtedness is subject to certain limitations. The level of indebtedness could increase our vulnerability to general adverse economic and industry conditions, and limit our flexibility in planning for, or reacting to, changes in business. Also, there can be no guarantee that we will have access to sufficient resources or will be able to maintain our fleet by extending the economic life of existing vessels through major refurbishment.

## **Accident/Casualty Loss**

The occurrence of a vessel related accident or mishap could have a material adverse effect on our business prospects, financial condition or results of operations, and could result in a default under the Coastal Ferry Services Contract unless such accident or mishap qualified as an event of force majeure.

Due to the nature of our business, we may be subject to liability claims arising out of accidents or disasters involving vessels on which our customers are travelling, including claims for serious personal injury or death.

Apart from well established safety programs, we have an insurance program to insure both our physical assets and legal liability for injuries and damage. This is designed to mitigate the financial impact of serious incidents. There can be no guarantee, however, that the insurance coverage will be sufficient to cover all such accidents or disasters.

In addition to conventional insurance, we have recently established our own wholly owned insurance subsidiary, BCF Captive Insurance Company Ltd., which commenced operations April 1, 2005. Its prime purpose is to absorb a large proportion of the deductibles payable under our commercial insurance programs. The objective is to spread the cost of random events among all routes, and protect direct route financial results from unnecessary volatility.

## **Seismic Risk**

Our facilities and operations are located in an area that is subject to seismic activity. There is a risk that a seismic incident of significant magnitude may occur and have an adverse impact on our operations. We carry insurance which covers property damage resulting from such incidents; however, we do not carry business interruption insurance.



### **Tax Risk**

Our company has received an advance income tax ruling from 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 is 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 which are now included in a February 27, 2004 release from the Department of Finance of draft amendments to the *Tax Act*. We have received a non-binding opinion from CRA that proposes 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.

### **Regulatory Risk**

There is a risk that the Commissioner will interpret the *Coastal Ferry Act* in a manner which could have an adverse financial impact on us.

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. There can be no guarantee that regulatory changes in the future will not have an adverse effect on us.

### **Labour Disruption Risk**

Our service is an integral part of British Columbia's coastal transportation system, and has been designated by 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 B.C.

The majority of our employees are members of the BC Ferry and Marine Workers' Union. On October 15, 2004, an interim award was issued by an arbitrator, affecting the terms and conditions of employment for bargaining unit employees. This is a seven-year award, which we expect will provide us with labour stability over that period. There can be no guarantee that other labour disturbances won't occur and have a material adverse effect on our operations.

### **Risk of Default Under Material Contracts**

There is a risk that we will default under the Coastal Ferry Services Contract or the Terminal Leases. The consequences of such default could include, among other things, an adjustment to service fees from the Province or the forced sale of our vessels to the Province for net book value and termination of the Terminal Leases.

### **Aboriginal Land Claims**

Canadian courts have recognized that aboriginal peoples may possess rights at law in respect of land used or occupied by their ancestors where treaties have not been concluded to deal with these rights and where treaties between aboriginal peoples and the Crown set out express rights. These rights may vary from limited rights of use for traditional purposes to a right of aboriginal title and will depend upon, among other things, the nature and extent of the prior aboriginal use and occupation of lands. The courts have encouraged the Canadian federal and provincial governments and aboriginal peoples to resolve rights claims through the negotiation of treaties.

Aboriginal groups have claimed substantial portions of land in British Columbia over which they claim aboriginal title or in which they have a traditional interest and for which they are seeking compensation from various levels of government.

A process is now in place within British Columbia to deal with aboriginal land claims. These negotiations have been and will likely remain ongoing for a number of years, depending on the commitment of the parties involved and the precedents set by the outcomes of the first settlement agreements. Under evolving jurisprudence, Canadian governments may have a duty to consult and accommodate Aboriginal peoples where Crown approvals or licences are required in respect of existing or new terminal facilities or operations at such facilities.

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.

In addition, the Province will reimburse us for damages suffered if there is a final court decision or a treaty settlement that recognizes or confers upon a First Nation a proprietary or other interest in the ferry terminal properties and that right or interest interferes 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.

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

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.

The WCB provided our predecessor company with an actuarial valuation of the unfinalized claims remaining to be paid that relate to incidents on or prior to March 31, 2003. This estimate totalled \$9.3 million at March 31, 2003 and is drawn down as claims are paid out. The remaining balance at March 31, 2005 of \$6.5 million (\$6.9 million at March 31, 2004) is included in deferred employee obligations in our financial statements.

## **Public Service Pension Plan**

Our employees are members of the Public Service Pension Plan (the "Plan"), a defined benefit, multi-employer pension plan. In April 2003, we were converted from a Crown corporation into an independent company incorporated under the provincial *Company Act*. In February 2004, our company and the union representing our employees jointly submitted a formal application for all our employees and our company to remain within the Plan. In March 2004, the Public Service Pension Board of Trustees agreed to the proposal.

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 available to us indicated a surplus in the Basic Account of \$546 million as at March 31, 2002.

## **Retirement Bonus Liability**

We sponsor a plan that provides a post-retirement benefit for 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 was obtained in March, 2005 and the accrued benefit obligation estimated at \$10 million. The liability included in deferred employee obligations in our financial statements at March 31, 2005 was \$9.5 million (\$9.4 million at March 31, 2004).

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 regulated entity, may differ from those otherwise expected in non-regulated businesses. These differences occur when the regulator renders decisions and generally involve the timing of revenue and expense recognition to 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, 2005, we have deferred the difference between amounts included in tariffs for fuel costs and those actually incurred based on the expectation that our regulator will approve the recovery or refund of the deferred balance in future tariffs.

If the regulator's future actions are different from our expectations, the timing and amount of the recovery of deferred fuel costs could be substantially different from that reflected in the 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 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**

On April 1, 2004, we adopted the Canadian Institute of Chartered Accountants ("CICA") Accounting Guideline 13, with revisions, relating to hedging relationships. The guideline addresses the identification, designation, documentation and effectiveness of hedging transactions for the purpose of applying hedge accounting. It also identifies situations where hedge accounting is to be discontinued. Under this guideline, we are required to document and demonstrate that our hedges are sufficiently effective in order to continue accrual accounting for positions hedged with derivatives. We have met the criteria for all designated hedging relationships and adoption of this guideline did not impact our financial statements.

#### **Asset Retirement Obligations**

On April 1, 2004, we adopted the CICA new standard for recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated asset retirement costs. Under the new standard the fair value of a liability for an asset retirement obligation must be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value is added to the carrying amount of the associated asset, which is then expensed over the asset's estimated useful life. The liability is accreted over the estimated useful life of the asset through charges to expenses.

As we are not aware of any future liabilities associated with the retirement of our assets, the adoption of this policy does not result in the recording of an asset retirement liability and therefore our financial statements have not been impacted by this new standard. In addition, as our operations are regulated, there is a reasonable expectation that any significant asset retirement costs would be recoverable through future tariffs.

### **Audit and Finance Committee**

Our Audit and Finance Committee (the "Committee") is appointed by the Board of Directors 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 our 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.
- 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.

Committee membership as at March 31, 2005 was as follows: Graham M. Wilson, Chair; Douglas E. Allen; Sandy M. Fulton; John R. Henderson; and Maureen V. Macarenko. As of April 1, 2005, Thomas W. Harris replaced Sandy M. Fulton on the Committee.

Each of the members of the Audit and Finance Committee have been determined by the Board of Directors 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 judgement. Douglas E. Allen acted as interim Chief Executive Officer of the Company from October 16, 2002 until May 5, 2003.

All members of this 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 1, 2004, all recommendations of the Audit and Finance Committee to nominate or compensate an external auditor were adopted by the Board.

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

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

External Auditor Billings (\$thousands)	Year ended March 31	
	2005	2004
Audit (including involvement in bond prospectus)	189.2	99.8
Tax services (mainly commodity related)	12.7	17.4
All other fees		
Advisory services (mainly employee related)	1.7	6.8
Risk assessment (CHaRTS software project)	0.0	49.4
	<b>203.6</b>	<b>173.4</b>

Pursuant to its terms of reference, the Audit and Finance Committee must pre-approve the retaining of 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 the retaining of 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 the 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 the retaining of the external auditors for any non-audit services to the extent permitted by applicable law.

## 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 BC Ferries' 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.

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, the impact of competition, asset risk, accident/casualty loss risk, tax risk, environmental risk, regulatory risk, labour disruption risk, 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.



# Consolidated Financial Statements of British Columbia Ferry Services Inc.

Years ended March 31, 2005 and 2004

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# Management's Responsibility

BC Ferries management is responsible for presentation and preparation of the annual consolidated financial statements, management's discussion and analysis ("MD&A") and all other information in this annual report.

The accompanying consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements and information in the MD&A necessarily include amounts based on management's informed judgements and best estimates. The financial information presented elsewhere in this annual report is consistent with that in the consolidated financial statements.

To meet its responsibility for reliable and accurate financial statements, management has established systems of internal control which are designed to provide reasonable assurance that assets are safeguarded from loss and that reliable financial records are maintained. These systems are monitored by management and by internal auditors. In addition, the internal auditors perform appropriate tests and related audit procedures.

The consolidated financial statements have been examined by KPMG LLP, independent chartered accountants. The external auditors' responsibility is to express a professional opinion on the fairness of management's consolidated financial statements. The auditors' report outlines the scope of their examination and sets forth their opinion.

The Board of Directors, through its Audit and Finance Committee, oversees management's responsibilities for financial reporting and internal control. The Audit and Finance Committee meets with the internal auditors, the independent auditors and management to discuss auditing and financial matters and to review the consolidated financial statements and the independent auditors' report. The Audit and Finance Committee reports its findings to the Board for consideration in approving the consolidated financial statements for issuance.

[signed]

David L. Hahn  
President and Chief Executive Officer

[signed]

Rob Clarke  
Executive Vice President, Finance and Chief Financial Officer

## Auditors' Report

To the Shareholders of British Columbia Ferry Services Inc.

We have audited the consolidated balance sheets of British Columbia Ferry Services Inc. as at March 31, 2005 and 2004 and the consolidated statements of earnings and retained earnings and cash flows for each of the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

The logo for KPMG LLP, featuring the letters 'KPMG' in a stylized, handwritten font, followed by 'LLP' in a smaller, simpler font.

Chartered Accountants

Victoria, Canada  
May 13, 2005



# Consolidated Balance Sheets

(expressed in thousands)

	As at March 31,	
	2005	2004
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 41,524	\$ 17,939
Restricted short-term investments (note 6c)	15,054	—
Accounts receivable	6,147	5,857
Prepaid expenses	5,095	5,717
Inventories	21,699	23,570
	89,519	53,083
Capital assets (note 2)	630,291	551,474
Deferred financing costs	7,987	1,190
Deferred fuel costs (note 3)	8,000	—
Long-term land lease (note 4)	27,585	24,040
	\$ 763,382	\$ 629,787
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 49,552	\$ 37,262
Interest payable on long-term debt	12,251	61
Accrued employee costs	39,371	36,276
Deferred revenue	13,756	13,003
Current portion of accrued employee future benefits	631	2,415
Current portion of obligation under capital lease	26	—
	115,587	89,017
Accrued employee future benefits (note 5)	16,849	15,644
Long-term debt (note 6)	499,581	427,701
Obligations under capital lease (note 7)	164	—
	632,181	532,362
Shareholders' equity:		
Share capital (note 8)	75,478	75,478
Retained earnings	55,723	21,947
	131,201	97,425
Commitments (notes 2 and 12)		
Contingent liabilities (note 16)		
Subsequent event (note 17)		
	\$ 763,382	\$ 629,787

See accompanying notes to consolidated financial statements.

On behalf of the Board:

[signed]

**Graham M. Wilson**  
Director

[signed]

**Elizabeth J. Harrison, QC**  
Director

# Consolidated Statements of Earnings and Retained Earnings

(expressed in thousands)

	Years ended March 31,	
	2005	2004
Revenue:		
Tariffs	\$ 345,851	\$ 323,023
Ferry service fees (note 10)	106,971	105,806
Federal-Provincial Subsidy Agreement (note 11)	24,343	23,975
Retail	67,776	63,206
Other income	19,514	17,721
	<b>564,455</b>	<b>533,731</b>
Expenses:		
Operations	294,035	286,048
Maintenance	86,746	86,136
Administration	44,511	38,862
Cost of retail goods sold	26,513	23,298
Amortization	47,666	47,355
	<b>499,471</b>	<b>481,699</b>
Earnings from operations	<b>64,984</b>	<b>52,032</b>
(Loss) gain on foreign exchange	(61)	190
Interest expense	(24,480)	(22,672)
Loss on disposal and write-down of capital assets	(629)	(1,565)
Net earnings	<b>39,814</b>	<b>27,985</b>
Retained earnings (deficit), beginning of year	21,947	(40,630)
Transfer from contributed surplus (note 9)	—	40,630
Preferred share dividend (note 8)	(6,038)	(6,038)
Retained earnings, end of year	<b>\$ 55,723</b>	<b>\$ 21,947</b>

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

(expressed in thousands)

	Years ended March 31,	
	2005	2004
Cash provided by (used in):		
Operations:		
Net earnings	\$ 39,814	\$ 27,985
Items not involving cash:		
Amortization	47,666	47,355
Other non-cash charges	1,248	3,227
Fuel costs deferred	(8,000)	—
Change in operating working capital	21,323	(9,092)
	102,051	69,475
Financing:		
Proceeds from issuance of bonds	499,566	—
Proceeds from issuance of bridge financing	199,780	—
Repayment of bridge financing	(199,780)	—
(Repayment of) proceeds from long-term debenture	(427,701)	427,701
Establishment of debt service reserve	(14,988)	—
Deferred financing costs incurred	(7,152)	(1,190)
Dividends paid on preferred shares	(6,038)	(6,038)
Proceeds from issuance of share	—	1
Redemption of shares	—	(427,701)
Payment to the Province (note 9)	—	(17,213)
	43,687	(24,440)
Investing:		
Proceeds from disposal of assets	1,334	17,996
Purchase of capital assets	(119,855)	(59,649)
Increase in lands under long-term lease	(3,632)	—
	(122,153)	(41,653)
Increase in cash and cash equivalents	23,585	3,382
Cash and cash equivalents, beginning of year	17,939	14,557
Cash and cash equivalents, end of year	\$ 41,524	\$ 17,939

Supplemental cash flow information (note 15)

See accompanying notes to consolidated financial statements.



# Notes to Consolidated Financial Statements

(columnar dollars expressed in thousands)

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 Company is subject to the *Coastal Ferry Act* (the "Act") which came into force on April 1, 2003. Its common share is held by the British Columbia Ferry Authority, a corporation without share capital, and it is regulated by the British Columbia Ferry Commissioner to ensure that rates are fair and reasonable and to monitor service levels.

Prior to conversion, the Company operated under the name British Columbia Ferry Corporation and was incorporated under the *Ferry Corporation Act* on June 30, 1976. The Minister of Finance held the shares of British Columbia Ferry Corporation as representative of Her Majesty the Queen in Right of the Province of British Columbia.

To facilitate and effect the conversion, a number of transactions were completed on or around April 1, 2003. These include:

- Land and terminals sold to, and then leased from, the British Columbia Transportation Finance Authority;
- Debt issued in favour of the Province of British Columbia (the "Province");
- Reorganization of share capital;
- Redemption of common shares previously held by the Province;
- Issuance of common share to British Columbia Ferry Authority; and
- Issuance of preferred shares to the Province.

## 1. Significant accounting policies:

### (a) Basis of presentation:

The consolidated financial statements of the Company are prepared in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Deas Pacific Marine Inc. ("DPMI"), Catamaran Ferries International Inc. ("CFI"), Pacific Marine Leasing Inc. ("PMLI"), and BCF Captive Insurance Company Ltd. ("BCF Captive"). All inter-company balances and transactions have been eliminated on consolidation. To date, PMLI has been inactive. BCF Captive was incorporated in March 2005, and commenced operations April 1, 2005.

### (b) Regulation:

The Company is regulated by the British Columbia Ferry Commissioner (the "Commissioner") to ensure that tariffs are fair and reasonable and to monitor service levels. Under the terms of the *Coastal Ferry Act* (the "Act"), the tariffs the Company charges its customers are subject to price caps. Annual increases in price caps have been set for the first five year term through March 31, 2008. The Commissioner will establish the price caps to apply for each subsequent term.

In order to recognize the economic effects of regulation, the timing of recognition of certain revenues and expenses may differ from that otherwise expected under generally accepted accounting principles. These timing differences give rise to assets and liabilities in the financial statements.

### (c) Cash and cash equivalents:

Cash and cash equivalents are comprised of cash and investments that are highly liquid in nature and generally have a maturity date of three months or less.

### (d) Short-term investments:

Short-term investments are valued at the lower of cost or market value and consist of treasury bills with original maturity dates greater than three months.

### (e) Inventories:

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

### (f) Capital assets:

The costs of major replacements, additions, extensions and improvements, including direct overhead and financing costs during construction are capitalized. The costs of maintenance, repairs, refit and minor renewals or replacements are expensed as incurred.

Capital assets, including assets under capital leases, are amortized on a straight-line basis over the estimated useful lives of the assets at the following rates:

Asset class	Estimated useful life
Ship hulls	40 years
Ship propulsion and utility systems	20 years
Marine structures	20 to 40 years
Buildings	20 to 40 years
Equipment and other	3 to 20 years

(g) Impairment of long-lived assets:

The Company reviews capital assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparison of their carrying amount to the future undiscounted cash flows the assets are expected to generate. If such capital assets are considered to be impaired, the impairment to be recognized equals the amount by which the carrying amount of the assets exceeds their fair market value. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(h) Revenue recognition:

Tariff revenue is recognized when transportation is provided. The value of pre-sold vouchers is included in the balance sheets as deferred revenue.

(i) Pension and other employee future benefit plans:

Defined contribution plan accounting is applied to the Company's multiemployer defined benefit pension and long-term disability plans for which the Company has insufficient information to apply defined benefit plan accounting.

The actuarial determination of the accrued benefit obligations for retirement benefits other than pension uses the projected benefit method prorated on service (which incorporates management's best estimate of future salary levels, other cost escalation, retirement ages of employees and other actuarial factors).

For the purpose of calculating the expected return on plan assets, those assets are valued at fair value.

Actuarial gains (losses) arise from the difference between actual long-term rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period or from changes in actuarial assumptions used to determine the accrued benefit obligation. For the Company's retirement bonus and death benefit plans, the excess of the net accumulated actuarial gain (loss) over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active employees. The average remaining service period of the active employees covered by the other (non-pension) retirement benefits plan is 7.5 years.

Past service costs arising from plan amendments are deferred and amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment.

When the restructuring of a benefit plan gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for prior to the settlement.

(j) Use of estimates:

The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the valuation of assets held for resale, the economic life of capital assets and the corresponding period of amortization, the recoverability of capital assets, the valuation of employee future benefits, and provisions for contingencies. Actual results could differ from these estimates.

(k) Taxes:

The Company is a "Tax Exempt Corporation" as described in the *Income Tax Act* and as such, is exempt from federal and provincial income taxes. Commencing calendar year 2004, the Company pays property taxes at assessed values. In calendar years prior to 2004, grants in lieu of property taxes were paid to municipalities within which the Company operated.

Effective April 2, 2003, the Company became subject to GST. The provision of vehicle and passenger ferry services is an exempt supply under the *Excise Tax Act*.

(l) Foreign currency transactions:

The Company's normal operating currency is the Canadian dollar. Monetary assets and liabilities denominated in foreign currency are translated to Canadian dollars at the rate of exchange prevailing at the balance sheet date. Revenues and expenses are translated at rates in effect at the time of the transaction. Foreign exchange gains and losses are recognized in the statement of earnings during the year in which they arise.

# Notes to Consolidated Financial Statements (continued)

(columnar dollars expressed in thousands)

(m) Deferred financing costs:

Legal and financing costs incurred are capitalized and amortized on a straight-line basis over the life of the financing.

(n) Hedging relationships:

Derivative financial instruments are utilized by the Company to manage market risk against the volatility in foreign currency, interest rate, and fuel price exposures. The Company does not utilize derivative financial instruments for trading or speculative purposes.

The Company documents all relationships between hedging instruments and hedged items, as well as its 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. The Company also assesses, 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 deferred and recognized in income in the period in which the underlying hedged transaction is recognized.

(o) Asset retirement obligations:

The Company recognizes a liability at its fair value for any legal obligations associated with the retirement of property, plant and equipment when those obligations result from the acquisition, construction, development or normal operation of the assets. A corresponding asset retirement cost is required to be added to the carrying amount of the related asset and amortized to expense on a systematic and rational basis.

It is possible that the Company's estimates of its ultimate asset retirement obligations could change as a result of changes in regulations, changes in the extent of environmental remediation required, changes in the means of reclamation or changes in cost estimates. Changes in estimates are accounted for prospectively from the period the estimate is revised.

(p) Comparative figures:

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

## 2. Capital assets:

March 31, 2005	Cost	Accumulated amortization	Net book value
Ships owned	\$ 758,130	\$ 458,115	\$ 300,015
Ships under capital lease	50,426	32,845	17,581
Berths, buildings and equipment	86,342	54,286	32,056
Berths, buildings and equipment under capital lease	417,096	209,503	207,593
Land	1,107	—	1,107
Construction-in-progress	71,939	—	71,939
	<b>\$ 1,385,040</b>	<b>\$ 754,749</b>	<b>\$ 630,291</b>

March 31, 2004	Cost	Accumulated amortization	Net book value
Ships owned	\$ 708,087	\$ 440,203	\$ 267,884
Ships under capital lease	50,377	30,892	19,485
Berths, buildings and equipment	73,152	48,066	25,086
Berths, buildings and equipment under capital lease	404,397	202,104	202,293
Land	1,107	—	1,107
Construction-in-progress	35,619	—	35,619
	<b>\$ 1,272,739</b>	<b>\$ 721,265</b>	<b>\$ 551,474</b>



For the year ended March 31, 2005 capitalized financing costs during construction amounted to \$1.5 million (March 31, 2004 - \$0.6 million).

Included in ships under capital lease are the *Queen of Surrey* and the *Queen of Oak Bay*. It is anticipated that the title will pass, without additional payments, for the *Queen of Surrey* and the *Queen of Oak Bay* on January 1, 2006 and January 1, 2007 respectively.

In addition to the construction-in-progress referenced above, contractual commitments at March 31, 2005 for capital assets to be constructed totalled \$339.4 million (March 31, 2004 - \$28.4 million). Included in the contractual commitments as at March 31, 2005 is \$307.4 million committed for design and construction of three Super C-class vessels. Delivery of the three vessels is scheduled to occur during the period from late 2007 to mid 2008.

### 3. Deferred fuel cost:

The Commissioner has authorized the Company to maintain deferral accounts to mitigate the effect on its earnings of unpredictable and uncontrollable price volatility in world fuel oil markets. The Commissioner has established set prices for each of the years until March 31, 2008. Differences between the set prices and the actual prices of fuel oil are recorded in the deferral accounts. These deferral accounts will be maintained until March 31, 2008, at which time the Commissioner will decide on their continuation.

Any balance in the deferral accounts will be taken into account by the Commissioner in setting future price cap increases. It is expected that all deferred fuel costs will be recovered through tariffs as approved by the Commissioner.

### 4. Long-term land lease:

On April 1, 2003, the Company's land and structures comprising its terminals were transferred by the Company to the BC Transportation Financing Authority ("BCTFA"), a British Columbia Crown Corporation and related party at the time of the transaction. In exchange, the Company received recognition of a prepayment for leases of the transferred terminal structures and land. The structures, having lives of less than the lease term, are considered a capital lease and, as such, have been capitalized and included with capital assets and are amortized in accordance with the Company's amortization policy.

The land, having an indefinite useful life, is considered an operating lease. The prepayment of the land lease has been deferred and will be amortized on a straight-line basis over eighty years, being the initial sixty year lease period, plus an additional twenty year bargain renewal option.

The transaction is reflected at the book values of the transferred terminal structures and land.

During the current year, the Company entered into an agreement with BCTFA in which the Company would make improvements to the highways approaching Horseshoe Bay and Swartz Bay terminals in exchange for increased lands under the existing land lease. As at March 31, 2005, the Horseshoe Bay improvements were complete and the Swartz Bay improvements were in progress. Long-term land lease has been increased by \$3.3 million and by \$0.6 million in regard to the Horseshoe Bay and Swartz Bay improvements, respectively. The increases to long-term land lease will be amortized over the remaining lease period, commencing the month following completion of improvements.

### 5. Accrued employee future benefits:

#### (a) Description of benefit plans:

The Company and its employees contribute to the Public Service Pension Plan (the "Plan"). The Pension Corporation of the Province of British Columbia administers the Plan, including the payment of retirement and post-employment benefits on behalf of employers. The Plan is a multi-employer defined benefit pension plan. Under joint trusteeship, which became effective January 1, 2001, the risk and reward associated with the Plan's unfunded liability or surplus is shared between the employers and the plan members and will be reflected in their future contributions. The most recent actuarial evaluation has determined that the Plan is in a surplus position.

In addition, eligible employees are entitled to other retirement and future benefits as provided for under the collective agreement and terms of employment. A retirement bonus and a death benefit, both unfunded defined benefit plans, and both administered by the Company, are based on years of service and final average salary. A funded long-term disability multiemployer plan provides disability income benefits after employment, but before retirement.

The Company also administers an unfunded accumulated sick leave bank ("Sick Bank obligation"), consisting of unused sick time credits, earned prior to the discontinuation of the sick leave accumulation benefit, in 1979. Accumulated sick leave may be drawn down at 100%, or paid out at 50%. Benefits are paid out at current salary rates. No new credits are accumulated to this bank.

# Notes to Consolidated Financial Statements (continued)

(columnar dollars expressed in thousands)

The Company's employees may also receive compensation benefits arising from claims prior to March 31, 2003 administered by the Workers' Compensation Board ("WCB obligation"). Prior to March 31, 2003, the Company participated in the Workers' Compensation Board deposit class coverage system. Subsequent to March 31, 2003 the Company has been covered under the Workers' Compensation Board rate system. The change to the rate system resulted in a residual liability from the deposit class system that has been valued by actuarial assumptions as appropriate for a closed plan. Currently this obligation is unfunded.

(b) Total cash payments:

Total cash payments for employee future benefits for the year ended March 31, 2005, consisting of cash contributed by the Company to its multiemployer defined benefit plans, cash payments directly to beneficiaries for its unfunded other benefit plans, and cash contributed to a third party administrator of an unfunded plan, was \$16.6 million (2004 - \$19.0 million).

(c) Defined benefit plans:

All of the Company's defined benefit plans, except its multiemployer plans, are currently unfunded. The most recent actuarial valuation of the retirement bonus and death benefit plans is as at March 31, 2005, with the next valuation expected as of March 31, 2008. The most recent actuarial valuations of the WCB obligation and the Sick Bank obligation are as at December 31, 2002 and March 31, 2001, respectively. The next valuations for the WCB and Sick Bank obligations are expected during the fiscal year ended March 31, 2006.

Accrued benefit obligations	Other benefit plans	
	2005	2004
Balance, beginning of year	\$ 18,059	\$ 21,293
Current service cost	556	544
Interest cost	853	919
Benefits paid	(1,841)	(4,645)
Actuarial (gains) losses	649	(52)
Balance, end of year	18,276	18,059

Reconciliation of funded status to the benefit plans to the amounts recorded in the financial statements	Other benefit plans	
	2005	2004
Fair value of plan assets	\$ —	\$ —
Accrued benefit obligation	18,276	18,059
Funded status of plans – deficit	\$ (18,276)	\$ (18,059)
Unamortized net actuarial loss	796	—
Accrued benefit liability	\$ (17,480)	\$ (18,059)
Current portion of accrued employee future benefits	631	2,415
Accrued employee future benefits	(16,849)	(15,644)

Elements of defined benefit costs recognized in the year	Other benefit plans	
	2005	2004
Current service cost, net of employee contributions	\$ 556	\$ 544
Interest cost	853	919
Actuarial (gains) losses	649	(52)
Elements of employee future benefits costs before adjustments to recognize the long-term nature of employee future benefit costs	\$ 2,058	\$ 1,411
Difference between actuarial (gain) loss recognized for year and actual actuarial (gain) loss on accrued benefit obligation for year	(796)	—
Defined benefit costs recognized	1,262	1,411

Significant assumptions	Other benefit plans	
The significant assumptions used are as follows (weighted average):	2005	2004
Accrued benefit obligation as of March 31:		
Discount rate	4.6%	4.9%
Rate of compensation increase	2.0%	2.0%
Annual employee retention rate	92.0%	95.0%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%
Benefit cost for years ended March 31:		
Discount rate	5.0%	4.9%
Rate of compensation increase	2.0%	2.0%
Annual employee retention rate	95.0%	95.0%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%

(d) Multiemployer plans:

The total cost recognized for the Company's multiemployer plans is as follows:

	2005	2004
Public Service Pension Plan contributions (i)	\$ 12,682	\$ 12,515
Long-term disability plan contributions	2,086	1,864
Long-term disability plan amortization of surplus (ii)	64	64
	\$ 14,832	\$ 14,443

- (i) Employer contribution rates increased effective April 1, 2004 by 0.25% to help strengthen the Plan's Inflation Adjustment Account, which funds discretionary cost of living increases. The most recent valuation for funding purposes, prepared as at March 31, 2002, determined a surplus for Basic Account pension benefits. The next valuation will be as at March 31, 2005, and it is not yet known when this valuation will be available to the Company.
- (ii) Contribution rates are actuarially determined every three years as a percentage of covered payroll. The most recent valuation, as at March 31, 2002, determined a fund surplus, which is being amortized over a period of ten years, via a reduction in the contribution rate. The next valuation will be as at March 31, 2005 and is expected June, 2006.

## 6. Long-term debt:

	As at March 31,	
	2005	2004
5.74% Senior Secured Bonds, Series 04-1, due May 2014 (a)	\$ 250,000	\$ —
Unamortized discount	(121)	—
	249,879	—
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (a)	\$ 250,000	\$ —
Unamortized discount	(298)	—
	249,702	—
Debenture held by the Province of British Columbia	—	427,701
	\$ 499,581	\$ 427,701

In May 2004, the Company entered into a master trust indenture which established common security and a set of common covenants for the benefit of all lenders under the Company's financing plan. The financing plan encompasses an ongoing program capable of accommodating a variety of corporate debt instruments and borrowings ranking *pari passu*. Currently, the Company has issued two bonds series and entered into a credit facility. The master trust indenture requires the Company to maintain a debt service reserve.



# Notes to Consolidated Financial Statements (continued)

(columnar dollars expressed in thousands)

(a) Bonds:

Bonds are issued under supplemental indentures either as obligation bonds or as pledged bonds. The bonds are secured by a registered first mortgage and charge over vessels, an unregistered first mortgage and charge over ferry terminal leases, and by a general security agreement on property and contracts. The bonds are redeemable in whole or in part at the option of the Company. Interest on the Series 04-1 bonds is payable semi-annually on May 27 and November 27 of each year until maturity. Interest on the Series 04-4 bonds is payable semi-annually on April 13 and October 13 of each year until maturity.

(b) Credit facility:

The Company entered into a credit facility with a syndicate of Canadian banks, secured by pledged bonds. The credit facility makes available to the Company a 364 day revolving operating facility with a one year term-out in an amount up to \$77.5 million, currently undrawn; and a three year revolving extendible facility in an amount up to \$77.5 million, currently undrawn.

During the first quarter, the company fully drew upon a \$200 million two year non-revolving bridge term facility. The amount has been fully repaid during the third quarter, and is no longer available under the credit facility.

(c) Debt service reserve:

The company is required to maintain a debt service reserve for the Series 04-1 and 04-4 bonds and all amounts drawn under the credit facility equal to not less than six months forecasted debt service, to be increased under certain conditions. A debt service reserve of \$7.2 million and \$7.8 million on the Series 04-1 and 04-4 bonds, respectively, is currently invested in short-term investments.

## 7. Obligations under capital lease:

During the year, the Company entered into a lease agreement for a training facility. The initial lease period is for a term of ten years, expiring April, 2015. The Company may, at its option, extend the lease term for up to two periods of five years each. Use of the facility by other organizations is controlled by the Company during the lease period. A discount rate of 6.25% has been used to determine the present value of the obligation under capital lease.

Future minimum lease payments:

Year ended	
2006	\$ 66
2007	66
2008	66
2009	66
2010	66
Thereafter	217
Executory costs and imputed interest included in payments	(357)
	190
Current portion of capital lease liability	(26)
	\$ 164

## 8. Share capital:

(a) Authorized:

1,000,000	Class A voting common shares, without par value
1	Class B voting common share, without par value
80,000	Class C non-voting, 8% cumulative preferred shares, with a par value of \$1,000 per share, convertible to Class A shares upon the sale of the outstanding Class B share by the initial shareholder. Special rights attached to the Class C shares restrict the Company's ability to issue shares and to declare dividends.

Prior to April 2, 2003, authorized share capital consisted of 1,000,000 unclassified common shares without par value with a maximum consideration of one hundred million dollars.

(b) Issued and outstanding:

	As at March 31,			
	2005		2004	
	Number of shares	Amount \$	Number of shares	Amount \$
Class B, common	1	\$ 1	1	\$ 1
Class C, preferred	75,477	75,477	75,477	75,477
		\$ 75,478		\$ 75,478

On April 2, 2003, the Company amended its memorandum of incorporation to revise the number and classes of authorized shares, redeemed 100% of its then outstanding common shares, and issued one new Class B common share and 75,477 new Class C preferred shares.

(c) Dividends:

Dividends on the Class C cumulative preferred shares, if declared, are payable annually on March 31 of each year. All dividend entitlements to date have been paid.

**9. Contributed surplus:**

	As at March 31,	
	2005	2004
Balance, beginning of year	\$ —	\$ 536,957
Share redemption value in excess of paid up capital	—	(496,327)
Elimination of deficit	—	(40,630)
Balance, end of year	\$ —	\$ —

Contributed surplus arose from the difference between the recorded value of certain assets received from the Province in prior years and their cost to the Company and from debt transferred to the Province. The carrying amount was reduced as at March 31, 2000 by the elimination of the accumulated deficit of the Company to reflect the financial restructuring at that time.

The carrying amount was further reduced as at March 31, 2003, upon direction of the Province as the sole shareholder at the time, to pay the Province the proceeds less commission from the auction of the assets held for resale of \$17.2 million.

On April 2, 2003, the Company redeemed 100% of its outstanding shares at a value of \$503.2 million. The amount in excess of paid up capital, \$496.3 million, was charged to contributed surplus. Contributed surplus was then reduced to zero by the elimination of the accumulated deficit.

**10. Ferry service fees:**

The Company has entered into an agreement with the Province commencing April 1, 2003 to provide ferry services that would not be commercially viable under the current regulated tariff structure. In exchange for fees, the Company provides agreed ferry service levels on specified routes and administers certain social policy initiatives on behalf of the Province. The agreement is for a period of sixty years, the details of which are renegotiated after a first term of five years and each four-year term thereafter. The initial term provides for an annual fee of approximately \$107 million.

**11. Federal-Provincial Subsidy Agreement:**

The Company receives revenue provided to the Province of British Columbia from the Government of Canada pursuant to a contract between the federal and provincial governments for the provision of ferry, coastal freight and passenger services in the waters of British Columbia. The annual payment increases with the Vancouver Consumer Price Index.

**12. Strategic relationship agreement:**

In April 2003, the Company formed a five-year strategic relationship agreement with IBM Canada Ltd. to lease computer hardware and software, as well as to implement business and technology solutions for the Company. During the year, part of the agreement was extended for one year.

# Notes to Consolidated Financial Statements (continued)

(columnar dollars expressed in thousands)

Commitments made by the Company under this agreement are estimated as follows:

Year ended	
2006	\$ 7,924
2007	6,748
2008	6,524
2009	1,514
	\$ 22,710

## 13. Risk management:

### (a) Fuel management:

The Company may manage its exposure to vessel fuel price volatility by entering into swap agreements with certain financial intermediaries in order to add a fixed component to the inherent floating nature of fuel prices. When fuel hedging instruments are used, it is solely for the purpose of reducing fuel price risk, not for generating trading profits. Gains and losses resulting from the contracts are recognized as a component of fuel costs. As at March 31, 2005, the Company has no outstanding fuel hedges (see also note 3).

### (b) Credit and interest rate risk:

Management does not believe that the Company is subject to any significant concentration of credit risk. Most of the Company's receivables result from tickets sold to passengers through the use of major credit cards. These receivables are short-term, generally being settled shortly after sale. The Company manages the credit exposure related to financial instruments by selecting credit-worthy counter-parties and by limiting its exposure to a single counter-party.

The Company may enter into interest rate agreements to manage its exposure on debt instruments. As at March 31, 2005, the Company has no active interest rate agreements.

### (c) Foreign exchange risk:

The Company may enter into foreign exchange forward contracts to manage its exposure on future purchase commitments. As at March 31, 2005, the Company has entered into foreign exchange forward contracts valued at Cdn \$449.9 million, for the committed cost, including customs and duty, of three new Super C-class vessels that are payable in euros (March 31, 2004 - nil).

### (d) Fair value of financial instruments:

The fair values of cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued liabilities, and interest payable on long-term debt approximate their carrying amounts due to their short term to maturity.

## 14. Related party transactions:

In accordance with the *Coastal Ferry Act*, the Company processes transactions on behalf of its parent, British Columbia Ferry Authority ("BCFA"), without charge. During the year ended March 31, 2005, the Company paid management fees of \$31,796 to BCFA (March 31, 2004 - \$24,651).

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

Prior to April 2, 2003, the Company's common shares were held by the Minister of Finance as representative of Her Majesty the Queen in Right of the Province of British Columbia.

The Company engages in transactions with provincial government agencies, departments and Crown corporations, notably British Columbia Hydro and Power Authority, British Columbia Buildings Corporation and Information Technology Services Division of the Ministry of Finance and Corporate Relations, on normal commercial terms. Prior to April 2, 2003, these entities were related parties.



**15. Supplemental cash flow information:**

	Years ended March 31,	
	2005	2004
Cash paid during the year for interest	\$ 12,828	\$ 22,420
Non-cash transactions:		
Issuance of preferred shares	—	75,477
Disposal of terminals, net book value	—	230,232
Terminal structures capital lease, net prepaid	—	205,888
Terminal land operating lease, net prepaid	—	24,344

**16. Contingent liabilities:**

The Company, in conducting its usual business activities, is involved in various legal proceedings and litigation, the outcome of which is indeterminable. It is the Company's policy to carry adequate insurance to minimize the financial risk associated with such matters. Management is of the opinion that the aggregate net liability, if any, of these proceedings and litigation would not be significant to the Company. Any additional future costs or recoveries, which differ from the accrued amounts, will be recorded as expenses or revenues as determined.

**17. Subsequent event:**

On April 1, 2005, BCF Captive commenced operations. BCF Captive has been licensed to operate as a captive insurance company by the Financial Institutions Commission of British Columbia. The Company provided \$5 million initial capital to BCF Captive in April 2005.

# Corporate Directory

## Board of Directors (April 1, 2005)

Elizabeth J. Harrison, QC  
Chair

Thomas W. Harris<sup>1</sup>  
Vice Chair

Douglas E. Allen<sup>1,2</sup>

Peter R.B. Armstrong<sup>2</sup>

Sandy M. Fulton<sup>3</sup>

David L. Hahn

John R. Henderson, FCA<sup>1,2</sup>

Doreen J. Hewitt<sup>3</sup>

Maureen V. Macarenko<sup>1,3</sup>

Robert W. McCaskill<sup>2,3</sup>

G. Raymond Whitehead<sup>3</sup>

Graham M. Wilson<sup>1,2</sup>

- 1. Audit & Finance Committee
- 2. Governance & Human Resources Committee
- 3. Safety, Health & Environment Committee

## Board of Directors (April 1, 2004 to March 31, 2005)

Elizabeth J. Harrison, QC  
Chair

Thomas W. Harris  
Vice Chair

Douglas E. Allen

Marilyn Baker

Sandy M. Fulton

John R. Henderson, FCA

Maureen V. Macarenko

G. Raymond Whitehead

Graham M. Wilson

## Senior Officers of the Company

David L. Hahn  
President & CEO

Robert P. Clarke  
Executive Vice President, Finance & CFO

Michael J. Corrigan  
Executive Vice President, Business Development

William R. Cottick  
Executive Vice President, Corporate Affairs, General Counsel  
& Corporate Secretary

Glen N. Schwartz  
Executive Vice President, Human Resources  
& Organizational Development

Mark S. Stefanson  
Vice President, Communications

Captain Trafford M. Taylor  
Executive Vice President, Operations

## Officers of the Company

Captain George A. Capacci  
Vice President, Fleet Operations

Mark F. Collins  
Vice President, Engineering

Geoffrey H. Dickson  
Vice President, Marketing & Retail Services

L. Blaine Ellis  
Vice President, Employee Relations

M. Alana Gallagher  
Treasurer

# B.C. Ferry Authority

Annual Report 2004/05

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## A Message from the Chair

The B.C. Ferry Authority is a corporation without share capital, which owns the only issued common voting share in the operating entity, British Columbia Ferry Services Inc.

In accordance with the *Coastal Ferry Act*, we have a nine-member Board of Directors comprised of experienced individuals, three of whom are appointed each year on a rotating basis for continuity.

Under the *Coastal Ferry Act*, four directors are appointed from nominations received from four appointment areas comprised of thirteen coastal regional districts. In addition, a qualified candidate is nominated by the union representing the employees of British Columbia Ferry Services Inc., two members are appointed from the community-at-large and two additional members are appointed by the provincial government.

The B.C. Ferry Authority appoints the Board of Directors of British Columbia Ferry Services Inc. The members of the B.C. Ferry Authority Board are also directors of British Columbia Ferry Services Inc.

The Board has adopted strict standards of accountability that require the Authority's financial and operating performance to be open to public review.

A handwritten signature in black ink, appearing to read 'Elizabeth J. Harrison', with a stylized flourish at the end.

Elizabeth J. Harrison, QC  
Chair

# B.C. Ferry Authority 2004/05 Annual Report

B.C. Ferry Authority ("the Authority") holds an important position in the governance framework of BC Ferries. Established under the *Coastal Ferry Act*, the Authority is a corporation without share capital that owns the single issued common voting share in the operating company, British Columbia Ferry Services Inc. As sole shareholder in the operating company, the Authority is responsible for appointing its Board of Directors.

The Authority is governed by a nine member Board of Directors. Four members are appointed from the nominees of four appointment areas, comprised of coastal regional districts, and one member is appointed from the BC Ferry and Marine Workers' Union, the trade union representing the employees of BC Ferries. The Board also includes two members appointed by the Province of British Columbia and two additional members appointed by the Board from the community-at-large. Directors serve in a dual capacity also being Directors of British Columbia Ferry Services Inc.

## By-laws of the Authority

The practices and procedures the Board follows in the conduct of its business are set out in the by-laws of the Authority. The by-laws reflect best practices for Board governance and have remained in effect, without amendment, since their formal adoption by the Board in fall 2003. A copy of the by-laws is available for public review on the Authority's website: [www.bcferryauthority.com](http://www.bcferryauthority.com).

## Meetings of the Board

The Board and its Committees met on 18 occasions during the year. In September 2004 the Authority held its first annual general meeting that was open to the public. The annual general meeting was well attended and provided an opportunity for members of the public to obtain information about BC Ferries and ask questions of the Board and senior management. A summary of the meetings of the Board and its Committees is presented in figure 1.

## Appointment of New Directors

The *Coastal Ferry Act* requires that the terms of three Directors of the Authority expire each year. To meet this requirement, the first appointments to the Board were staggered such that three appointments were made for each of one, two and three years. Directors appointed from the Southern Mainland and Southern Vancouver Island appointment areas, as well as one Director appointed by the Province of British Columbia, had terms expiring March 31, 2005. During the year the Board sought and received nominations of qualified individuals to serve as Directors from the two appointment areas. Two nominees, one of whom was an incumbent Director, were selected and appointed to serve for three-year terms commencing April 1, 2005. The Province of British Columbia also reappointed its incumbent Director to serve for a further three-year term.

In selecting individuals to serve as new Directors, the Board was cognizant of the importance of having a group of qualified individuals with the appropriate skills, experience and personal attributes to ensure the continued good governance of the Authority. The criteria that guided the Board in the appointment process undertaken during the year are reflected in the Skills and Experience Profile adopted by the Authority as part of its by-laws and presented in figure 2.

Effective April 1, 2005, the Board of Directors comprises members with the following terms of appointment:

B.C. FERRY AUTHORITY BOARD OF DIRECTORS	TERM OF APPOINTMENT
<b>B.C. Ferry Authority Appointments</b>	
Central Vancouver Island and Northern Georgia Strait Appointment Area	April 1, 2004 - March 31, 2006
Northern Coastal and North Island Appointment Area	April 1, 2004 - March 31, 2006
Southern Mainland Appointment Area	April 1, 2005 - March 31, 2008
Southern Vancouver Island Appointment Area	April 1, 2005 - March 31, 2008
BC Ferry and Marine Workers' Union	April 1, 2004 - March 31, 2007
Community-at-large	April 1, 2004 - March 31, 2006
Community-at-large	April 1, 2004 - March 31, 2007
<b>Provincial Appointments</b>	
Province of British Columbia	April 1, 2004 - March 31, 2007
Province of British Columbia	April 1, 2005 - March 31, 2008

# B.C. Ferry Authority Summary of Meetings 2004/05

(figure 1)

DATE	TYPE	OUTCOMES
May 20, 2004	Audit and Finance Committee	<ul style="list-style-type: none"> <li>• 2004/05 operating budget for the Authority recommended for approval to the Board</li> <li>• Financial Statements of the Authority for the year ended March 31, 2004 recommended for approval to the Board</li> <li>• Independence letter and oral findings report on the audit process received from the External Auditor</li> </ul>
May 20, 2004	Governance Committee	<ul style="list-style-type: none"> <li>• Review of the Board governance manual initiated</li> <li>• Process for Committee composition and selection of members discussed</li> <li>• Process for 2005/06 Director appointments discussed</li> </ul>
May 21, 2004	Board of Directors	<ul style="list-style-type: none"> <li>• 2004/05 operating budget for the Authority approved</li> <li>• Financial Statements of the Authority for the year ended March 31, 2004 approved</li> </ul>
July 7, 2004	Board of Directors	<ul style="list-style-type: none"> <li>• Annual General Meeting of the Authority discussed; date and location confirmed</li> </ul>
August 13, 2004	Audit and Finance Committee	<ul style="list-style-type: none"> <li>• Financial Statements of the Authority for the three months ended June 30, 2004 recommended for approval to the Board</li> <li>• Reappointment of the External Auditor of the Authority for a five-year term recommended to the Board</li> </ul>
August 13, 2004	Board of Directors	<ul style="list-style-type: none"> <li>• Financial Statements of the Authority for the three months ended June 30, 2004 approved</li> <li>• External Auditor of the Authority reappointed for a five-year term</li> <li>• Corporate Secretary authorized to execute, on behalf of the Authority, the shareholder's unanimous consent resolutions pertaining to all of the business required to be transacted at the Annual General Meeting of British Columbia Ferry Services Inc.</li> <li>• 2003/04 Annual Report of the Authority approved</li> </ul>
September 14, 2004	Audit and Finance Committee	<ul style="list-style-type: none"> <li>• 2003/04 management letter from the External Auditor reviewed and discussed</li> </ul>
September 27, 2004	Board of Directors	<ul style="list-style-type: none"> <li>• Report from the Chair of the Governance Committee on the review of completed conflict of interest forms received for the Directors whose terms commenced April 1, 2004 considered</li> </ul>
September 27, 2004	Annual General Meeting	<ul style="list-style-type: none"> <li>• Annual General Meeting held pursuant to the <i>Coastal Ferry Act</i> (section 18)</li> </ul>
November 8, 2004	Audit and Finance Committee	<ul style="list-style-type: none"> <li>• Financial Statements of the Authority for the six months ended September 30, 2004 recommended for approval to the Board</li> <li>• 2004/05 terms of engagement for the External Auditor approved</li> <li>• Amended Terms of Reference for the Audit and Finance Committee recommended for approval to the Governance Committee and the Board</li> </ul>
November 9, 2004	Governance Committee	<ul style="list-style-type: none"> <li>• Amended Terms of Reference for the Audit and Finance Committee and the Governance Committee recommended for approval to the Board</li> <li>• Process for 2005/06 Director appointments discussed</li> <li>• Review of the Board Governance Manual conducted</li> </ul>
November 10, 2004	Board of Directors	<ul style="list-style-type: none"> <li>• Financial Statements of the Authority for the six months ended September 30, 2004 approved</li> <li>• Amended Terms of Reference for the Audit and Finance Committee and the Governance Committee approved</li> </ul>
February 14, 2005	Governance Committee	<ul style="list-style-type: none"> <li>• Status and next steps in the consideration of the nominations received from the appointment areas for appointment to the Board effective April 1, 2005 discussed</li> </ul>
February 15, 2005	Audit and Finance Committee	<ul style="list-style-type: none"> <li>• Financial Statements of the Authority for the nine months ended December 31, 2004 recommended for approval to the Board</li> </ul>
February 16, 2005	Board of Directors	<ul style="list-style-type: none"> <li>• Financial Statements of the Authority for the nine months ended December 31, 2004 approved</li> </ul>



DATE	TYPE	OUTCOMES
March 17, 2005	Governance Committee	<ul style="list-style-type: none"> <li>• Appointment of Directors nominated by the Southern Vancouver Island and the Southern Mainland appointment areas for three-year terms effective April 1, 2005 recommended for approval to the Board</li> <li>• Ratification of provincial appointment to Board of Directors for a three-year term effective April 1, 2005 recommended to the Board</li> <li>• Appointments of Chair and Vice Chair effective April 1, 2005 recommended for approval to the Board</li> <li>• Membership of Committees of the Board effective April 1, 2005 recommended for approval to the Board</li> <li>• An increase in the number of Directors of British Columbia Ferry Services Inc. effective April 1, 2005 recommended for approval to the Board</li> <li>• Appointment of Directors for British Columbia Ferry Services Inc. effective April 1, 2005 recommended for approval to the Board</li> <li>• Results of Directors' self-assessment evaluation reviewed and discussed</li> <li>• Compensation levels for Directors reviewed and discussed</li> </ul>
March 17, 2005	Audit and Finance Committee	<ul style="list-style-type: none"> <li>• 2005/06 operating budget for the Authority recommended for approval to the Board</li> </ul>
March 30, 2005	Board of Directors	<ul style="list-style-type: none"> <li>• 2005/06 operating budget for the Authority approved</li> <li>• Directors nominated by the Southern Vancouver Island and the Southern Mainland appointment areas appointed for three-year terms effective April 1, 2005</li> <li>• Provincial appointment to Board of Directors for a three-year term effective April 1, 2005 ratified</li> <li>• Chair and Vice Chair effective April 1, 2005 appointed</li> <li>• Committee members effective April 1, 2005 appointed</li> <li>• The number of Directors of British Columbia Ferry Services Inc. increased from nine to twelve effective April 1, 2005</li> <li>• Directors of British Columbia Ferry Services Inc. effective April 1, 2005 appointed</li> </ul>

# Skills and Experience Profile

(figure 2)

Appointments to the Board of Directors of the B.C. Ferry Authority will be guided by the following selection criteria.

## Statutory Qualifications:

Persons appointed to the Board must be “qualified individuals” as defined in the *Coastal Ferry Act*. Specifically, this means an individual who:

- Is not an employee or an officer, other than the Chief Executive Officer, of British Columbia Ferry Services Inc;
- Does not hold elected public office of any type;
- Is not an employee, steward, officer, director, elected official or member of any union representing employees of British Columbia Ferry Services Inc.; and
- Is not an employee of a municipality, regional district, trust council or greater board, as those terms are defined in the *Local Government Act* (British Columbia), within the appointment areas, as defined by the Lieutenant Governor-in-Council.

As well, all appointments to the Board must comply with the provisions related to Director qualifications and conflicts addressed in sections 8 and 9 of the *Coastal Ferry Act*.

## Personal Attributes:

All persons appointed to the Board should possess the following personal attributes:

1. High ethical standards and integrity in professional and personal dealings;
2. Ability and willingness to raise potentially controversial issues in a manner that encourages dialogue;
3. Flexibility, responsiveness and willingness to consider change;
4. Ability and willingness to listen to others;
5. Capability for a wide perspective on issues; and
6. Ability to work as a team member.

## Core Competencies:

All Directors should possess the following core competencies:

1. Well-developed faculty for critical analysis;
2. Financial literacy, including an ability to read financial statements and ability to understand the use of financial ratios and other indices to measure performance;
3. Appreciation of the unique role of the B.C. Ferry Authority as the governing body of British Columbia Ferry Services Inc.;
4. Thorough knowledge of the responsibilities and duties of a director; and
5. Ability to distinguish corporate governance from management.

## Representation:

The B.C. Ferry Authority Board should, in its composition, reflect the diversity of the people served by coastal ferry services in British Columbia.

## Key Skills and Experience:

The Board of Directors of the B.C. Ferry Authority, as a whole, should possess all of the following skills and experience, while individual directors must possess more than one.

1. **Leadership** – experience at a senior level managing the operations of a large or complex commercial or non-profit entity.
2. **Business** – experience in operating a business in British Columbia.
3. **Board Experience** – previous experience as a member of a Board of Directors of a commercial or non-profit entity.
4. **Accounting and Finance** – an accounting or financial advisor designation or senior level experience as a Chief Financial Officer in a large or complex commercial or non-profit entity.
5. **Legal** – a law degree or experience in managing legal issues of a complex commercial nature.
6. **Transportation** – knowledge of and experience in addressing transportation issues, including environmental and safety issues.

7. **Marketing** – experience in developing and/or leading marketing or customer service initiatives.
8. **Tourism** – knowledge of and experience in the tourism industry in British Columbia, including the hospitality and retail sectors.
9. **Labour Management** – knowledge of and experience in human resources and labour relations practices in British Columbia.
10. **Regulatory** – experience working in or significant knowledge of the issues associated with a commercial entity regulated by statute.
11. **Community and Aboriginal Relations** – experience in leading consultation processes with local governments and/or aboriginal interests in British Columbia.

# Auditors' Report

To the Board of Directors, B.C. Ferry Authority

We have audited the statement of financial position of B.C. Ferry Authority as at March 31, 2005 and the statements of operations and changes in net assets for the year then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Authority as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The logo for KPMG LLP, featuring the letters 'KPMG' in a stylized, handwritten font, followed by 'LLP' in a smaller, simpler font.

Chartered Accountants

Victoria, Canada  
May 13, 2005



# Statement of Financial Position

(expressed in thousands)

	As at March 31,	
	2005	2004
<b>Assets</b>		
Investment in British Columbia Ferry Services Inc.	\$ 55,724	\$ 21,948
	\$ 55,724	\$ 21,948
<b>Net Assets</b>		
Invested in common share of British Columbia Ferry Services Inc.	\$ 1	\$ 1
Accumulated undistributed earnings of British Columbia Ferry Services Inc.	55,723	21,947
	\$ 55,724	\$ 21,948

See accompanying notes to financial statements.

On behalf of the Board:

[signed]

**Graham M. Wilson**  
Director

[signed]

**Elizabeth J. Harrison, QC**  
Director

# Statement of Operations

(expressed in thousands)

	Years ended March 31,	
	2005	2004
Revenue:		
Distributable earnings of British Columbia Ferry Services Inc. (note 2)	\$ 33,776	\$ 21,947
Contribution from Province of British Columbia	—	1
	33,776	21,948
Expenses:		
Administration	32	17
Directors' fees	—	8
Recovery from British Columbia Ferry Services Inc. (note 3)	(32)	(25)
	—	—
Excess of revenue over expenses	\$ 33,776	\$ 21,948

See accompanying notes to financial statements.

# Statement of Changes in Net Assets

(expressed in thousands)

	Invested in BCFSI	Undistributed Earnings of BCFSI	Total
Balance, March 31, 2004	\$ 1	\$ 21,947	\$ 21,948
Excess of revenue over expenses	—	33,776	33,776
Balance, March 31, 2005	\$ 1	\$ 55,723	\$ 55,724

See accompanying notes to financial statements.

# Notes to Financial Statements

(expressed in thousands)

B.C. Ferry Authority (the "Authority") was established by the *Coastal Ferry Act* (British Columbia) (the "Act") on April 1, 2003 as a corporation without share capital. The Authority is governed by a board of nine directors. The board of directors appoints replacements for outgoing directors for seven of the positions as follows:

- four appointed from nominees provided to the board by each of the four appointment areas consisting of those coastal regional districts that the Lieutenant Governor-in-Council for British Columbia may prescribe, with one director appointed from each area;
- one appointed from nominees provided by the trade union representing the employees of the British Columbia Ferry Services Inc. ("BCFSI"); and
- two appointed from qualified individuals as defined in the Act.

The Lieutenant Governor-in-Council for British Columbia appoints the other two director positions from qualified individuals as terms expire.

The Authority's primary purpose is to hold the shares of BCFSI, a company incorporated under the *Business Corporations Act* (British Columbia), which provides coastal ferry services in British Columbia. The Province of British Columbia (the "Province") contributed the initial capital to the Authority to fund the purchase of the BCFSI common share. The Act provides that upon a sale of the common share of BCFSI held by the Authority, the Province is to be repaid its initial contribution and the Authority is dissolved. The Act also provides that upon dissolution of the Authority, all remaining assets of the Authority, if any, vest in the Province.

## 1. Significant accounting policies:

- (a) Basis of presentation:  
The financial statements are prepared in accordance with Canadian generally accepted accounting principles for not-for-profit entities. The Authority's investment in its wholly owned subsidiary, BCFSI is accounted for by the equity method. Under the equity method the original cost of the investment is adjusted for the Authority's share of post-acquisition earnings or losses less dividends.
- (b) Revenue recognition:  
The Authority follows the deferral method of accounting for contributions. The Authority does not expect to receive endowment contributions.
- (c) Taxes:  
The Authority and BCFSI are exempt from federal and provincial income taxes.
- (d) Statement of cash flows:  
A statement of cash flows has not been included with these statements as it does not provide additional information.

## 2. Distributable earnings of British Columbia Ferry Services Inc.:

The distributable earnings of BCFSI consist of the current period net earnings, less any dividends paid in the current period and less a reserve for undeclared preferred share dividend, if any.

	Years ended March 31,	
	2005	2004
Net earnings of BCFSI	\$ 39,814	\$ 27,985
Dividends paid on 8% cumulative preferred shares	(6,038)	(6,038)
	\$ 33,776	\$ 21,947

## 3. Recovery from British Columbia Ferry Services Inc.:

The Act provides that BCFSI is responsible for paying any expenses that are incurred by the Authority.



#### 4. Subsidiary supplemental information:

The consolidated financial position and operating results for BCFSI and its wholly-owned subsidiaries are summarized below:

	Years ended March 31,	
	2005	2004
Current assets	\$ 89,519	\$ 53,083
Capital and other assets	673,863	576,704
	<b>\$ 763,382</b>	<b>\$ 629,787</b>
Current liabilities	\$ 115,587	\$ 89,017
Accrued employee future benefits	16,849	15,644
Long-term debt and capital lease obligations	499,745	427,701
	<b>632,181</b>	<b>532,362</b>
Shareholders' equity		
Common share held by the Authority	1	1
Preferred shares (a)	75,477	75,477
Retained earnings	55,723	21,947
	<b>131,201</b>	<b>97,425</b>
	<b>\$ 763,382</b>	<b>\$ 629,787</b>
Revenue (including gains)	\$ 564,455	\$ 533,921
Expenses (including losses)	524,641	505,936
Net earnings	39,814	27,985
Cash flows from operating	102,051	69,475
Cash flows from financing	43,687	(24,440)
Cash flows from investing	(122,153)	(41,653)

- (a) The outstanding non-voting, 8% cumulative preferred shares are held by the Province and are convertible to common shares upon a sale of the outstanding common share. Special rights attached to the preferred shares restrict BCFSI's ability to issue share capital and to declare dividends.

# Corporate Directory

## Board of Directors (April 1, 2005)

**Elizabeth J. Harrison, QC**

Chair (Community-at-large appointment)

**Thomas W. Harris<sup>1</sup>**

Vice Chair (Central Vancouver Island and Northern Georgia Strait appointment area)

**Douglas E. Allen<sup>1,2</sup>**

(Community-at-large appointment)

**Sandy M. Fulton**

(Province of B.C. appointment)

**John R. Henderson, FCA<sup>1,2</sup>**

(Southern Mainland appointment area)

**Doreen J. Hewitt**

(Southern Vancouver Island appointment area)

**Maureen V. Macarenko<sup>1</sup>**

(Northern Coastal and North Island appointment area)

**G. Raymond Whitehead**

(Organized labour appointment)

**Graham M. Wilson<sup>1,2</sup>**

(Province of B.C. appointment)

1. Audit & Finance Committee

2. Governance Committee

## Officers

**Elizabeth J. Harrison, QC**

Chair

**Thomas W. Harris**

Vice Chair

**William R. Cottick**

Executive Vice President, Corporate Affairs, General Counsel & Corporate Secretary

## Board of Directors (April 1, 2004 to March 31, 2005)

**Elizabeth J. Harrison, QC**

Chair

**Thomas W. Harris**

Vice Chair

**Douglas E. Allen**

**Marilyn Baker**

**Sandy M. Fulton**

**John R. Henderson, FCA**

**Maureen V. Macarenko**

**G. Raymond Whitehead**

**Graham M. Wilson**





## Life on the Coast