2009/10
Annual Reports

BRITISH COLUMBIA FERRY SERVICES INC.
& B.C. FERRY AUTHORITY

British Columbia Ferry Services Inc.

B.C. Ferry Authority

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

Forward looking statements included in this document include statements with respect to our:

- Short and long-range business plans;
- Estimates of future customer demand;
- Asset renewal programs for vessels and terminals; and
- Expectations regarding the impacts of *Bill 20.*

In some cases, forward looking statements can be identified by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue" or the negative of these terms or other comparable terminology.

A number of factors could cause actual events or results to differ materially from the results discussed in the forward looking statements. In evaluating these statements, prospective investors should specifically consider various factors including, but not limited to, the risks and uncertainties associated with traffic volume and tariff revenue risk, safety and security, asset risk, accident risk, tax risk, environmental risk, regulatory risk, labour disruption risk, 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 report 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 report, and British Columbia Ferry Services Inc. assumes no obligation to update or revise them to reflect new events or circumstances except as may be required by applicable law.

Corporate Profile

BC Ferries is one of the largest ferry operators in the world, providing year-round vehicle and passenger service on 25 routes to 47 terminals, with a fleet of 36 vessels. We are an essential transportation link that connects coastal communities and facilitates the movement of people, goods and services. In fiscal 2010, we carried 21.0 million passengers and 8.3 million vehicles throughout coastal British Columbia.

OUR VISION

To provide a continuously improving west coast travel experience that consistently exceeds customer expectations and reflects the innovation and pride of our employees.

OUR MISSION

To provide safe, reliable and efficient marine transportation services which consistently exceed the expectations of our customers, employees and communities, while creating enterprise value.

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.
- **Employees:** Always deal from a position of honesty, integrity and mutual respect, and ensure that our employees develop to their full potential.

OUR GOALS

In support of our vision, we are focused on five key goals, none more important than safety.

1. **Safety:** To protect our customers and employees by continuously improving the safety of our operations, inclusive of vessels, terminals and facilities.
2. **Operational Reliability:** To continuously improve the operational reliability of vessels, terminals and facilities.
3. **Continuous Improvement:** To be better at everything we do.
4. **Value For Money:** To continuously improve value to our customers at every point along the customer experience chain.
5. **Financial Integrity:** To achieve key financial targets, ensuring that sufficient capital and retained earnings are available to revitalize our fleet, facilities and infrastructure, while minimizing fare escalation.

Message from the Chair

Donald P. Hayes: Chair, Board of Directors

Since 2003, a solid foundation for the business has been established and the results of this hard work are evident in the seven new ships, terminal upgrades and countless passenger service improvements.

On behalf of the Board, I'd like to congratulate BC Ferries on the progress the company and its employees have made in a number of key areas including safety, customer service excellence and fiscal responsibility.

Since 2003, a solid foundation for the business has been established and the results of this hard work are evident in the seven new ships that have been brought into service, upgrades at major and minor terminals, and countless service improvements for our passengers. I would like to extend my gratitude to the women and men of BC Ferries who have made this possible in such a short period of time.

While so much has been accomplished over the past seven years, BC Ferries must continue, as it has done, to reinvest its earnings into the infrastructure of the ferry system to constantly improve, enhance and renew the service.

I join everyone at BC Ferries in extending a special thank you to retiring Board member Mark Cullen for his valuable contributions to the company and to outgoing Chair, Elizabeth Harrison, QC for six years of excellent service in leading the Board.

This year we celebrate BC Ferries' 50th year of service. We are a company with a proud maritime history and as we commemorate this special anniversary, we recognize the contributions of every employee, past and present, for over half a century of service.

Finally, the Board is dedicated and committed to making BC Ferries a world-class transportation system that is second to none.

DONALD P. HAYES
Chair

Message from the President & CEO

David L. Hahn: President & Chief Executive Officer

As I look back on the past year, I reflect on all of the accomplishments we've made as a company of 4,500 dedicated employees to improve the travel experience for our customers in all areas of our business. I'm very proud of the work we have achieved collectively, and for the individual contributions of each and every staff member who has made a difference in the delivery of our service.

I am also very proud of the fact that since inception in April 2003, BC Ferries has repaid to the people of British Columbia, approximately $500 million through dividends, debt repayment and interest.

2010 marks BC Ferries' 50th Anniversary; a major milestone we are all very proud of. We hope you'll join us aboard the fleet to help us celebrate this momentous occasion. Over the last 50 years BC Ferries has become one of the premier ferry operators in the world and our employees deserve the credit. This milestone is very important and we should also recognize the vision of W.A.C. Bennett who established this company 50 years ago.

One of our new initiatives in pursuing tourism opportunities is the launch of our new BC Ferries Vacations Centre on May 11, 2010 which offers a variety of travel packages that have been created in partnership with our many tourism partners. The 2,675-square foot centre is located directly across the street from the newly expanded Vancouver Convention Centre and provides BC Ferries with a significant presence in this major tourism market.

Also, BC Ferries launched a new drop-trailer service on two of our major routes serviced by the Tsawwassen terminal. Now our commercial customers can drop off their trailers at one terminal and pick them up at another. This new service has been well received by the commercial market and improves our overall productivity and efficiency by utilizing unused space on our vehicle decks. This new service will continue to help us keep fares down on our major routes while reducing costs for our commercial customers and introducing valuable competition in the drop-trailer market.

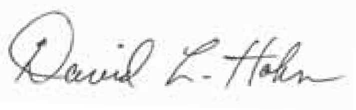
With the inaugural sailing of the *Northern Expedition* on our Inside Passage route last May, we are now offering a spectacular experience. This vessel, along with the *Northern Adventure* which services Haida Gwaii, offers tourists from around the globe an adventure travel getaway on our northern routes and all passengers a reliable and safe service.

Now that we've completed our vessel replacement program for the northern routes and the major routes, we are turning our attention to the minor routes. The *Quinsam*, which services our Gabriola Island route, just completed the second-half of a major asset betterment project which basically saw a complete rebuild of the ship including upgrades to engine components, lifesaving equipment and passenger amenities. Next we are undertaking a major modernization of the *Quadra Queen II*, which serves the route connecting Alert Bay and Sointula with Port McNeill on northern Vancouver Island.

This year major upgrades to marine structures commenced at many of our terminals. Berth 4 at Tsawwassen is being completely rebuilt, and the aging berthing structures at Quathiaski Cove on Quadra Island were replaced.

While I am still concerned about the impacts that the world economy has on discretionary spending, I am optimistic about the year ahead. We have implemented cost management initiatives in order to achieve our profit targets and are continually looking at new revenue streams in support of our business.

Thank you for a great 50 years.



DAVID L. HAHN
President & Chief Executive Officer

Celebrating 50 Years

On June 15, 1960, the British Columbia Toll Authority Ferry System launched its new service with two ships, two terminals, and 200 employees. Now, as we celebrate our 50th Anniversary, BC Ferries is one of the largest ferry operators in the world.

Currently with 4,500 dedicated employees, 36 vessels and 47 ports of call, we've hosted over 700 million customers on our ships to date. BC Ferries has a proud maritime history on the west coast and this extraordinary milestone is one in which every employee, past and present, can celebrate with us.

- 1960's – Fifty years ago, the very first two BC Ferries, the *Sidney* and *Tsawwassen* serviced the Tsawwassen – Swartz Bay route. Throughout the 1960's, new construction, fleet acquisitions and route expansion dominated.
- 1970's – In the 1970's, four major vessels were "stretched" to accommodate more traffic. Also in the 1970's three C-Class ships were built.
- 1980's – By 1981, five C-Class ships joined the fleet and some ships that were previously "stretched" were now "lifted" to include an upper car deck. BC Ferries took over many of the Ministry of Transportation and Highways' minor routes in the 1980's.
- 1990's – The 1990's saw the construction of the two Spirit Class vessels as well as three minor vessels.
- 2000's – In recent years, we've brought three Coastal Class vessels, two northern ships and two minor vessels into service.

While the scope and complexity of what we do has expanded, the company continues to hold strong the values established half a century ago: safety; reliability; and customer service.

As we celebrate our 50th year, we want to take this opportunity to thank our customers for their patronage. They've journeyed with us as we've adapted to the increasing and ever-changing transportation needs of coastal British Columbia.

We will continue to build on a rich history and are committed to providing our customers with the best service possible. We look forward to the next 50 years.

BCFerries 50th ANNIVERSARY 1960~2010

Key Accomplishments

The Travel Experience…

- Achieved an overall customer satisfaction rating of 91 per cent.
- Held the inaugural voyage of the new *Northern Expedition* on our northern route through the Inside Passage from Port Hardy to Prince Rupert. This 150-metre vessel, which replaced the *Queen of Prince Rupert*, has 55 staterooms and accommodates up to 130 vehicles and 600 passengers. The total project budget was $200 million. The project was completed on time and on budget.
- Offered mid-week CoastSaver promotion from June 2 – September 10, 2009. The $39 car and driver CoastSaver fare was offered on the three major routes between Vancouver and Vancouver Island on all sailings on Tuesdays, Wednesdays and Thursdays.
- Continued our popular Coastal Naturalist program on the Tsawwassen–Swartz Bay and Horseshoe Bay–Departure Bay routes for the summer months. In partnership with Parks Canada, the Coastal Naturalists delivered entertaining and educational programs about the spectacular natural scenery and environment of the south coast of British Columbia.
- Continued to offer fuel rebates of between 2 to 10 per cent on many of our routes.
- Adopted the new provincial *Public Health Act* regulation which restricted trans-fat in all food service establishments. BC Ferries was one of the first companies in B.C. to do so.
- Proudly hosted the Vancouver 2010 Olympic Torch Relay on six vessels throughout the fleet.
    - On October 31, 2009, the *Howe Sound Queen* carried the Olympic Flame from Vesuvius on Salt Spring Island to Crofton on Vancouver Island.
    - On February 1, 2010, the *Northern Adventure* carried the Olympic Flame from Prince Rupert to Port Hardy.
    - On February 3, 2010, the *Queen of Burnaby* carried the Olympic Flame from Comox to Powell River.
    - On February 4, 2010, the *Island Sky* carried the Olympic Flame from Saltery Bay on the Northern Sunshine Coast to Earls Cove on the Southern Sunshine Coast. The Olympic Cauldron was then lit on a special sailing of the *Coastal Renaissance* carrying the Olympic Flame from Langdale on the Sunshine Coast to Horseshoe Bay. This was the first time the Olympic Flame arrived in the Lower Mainland.
    - On February 10, 2010, the *Queen of Capilano* carried the Olympic Flame from Bowen Island to Horseshoe Bay.
- Scheduled extra early morning and late night sailings from February 12 – 28, 2010 on the Tsawwassen – Swartz Bay, Horseshoe Bay – Departure Bay and Horseshoe Bay – Langdale routes so that residents of Vancouver Island and the Sunshine Coast could attend Olympic events in Vancouver and return home the same day. In total, 210 extra sailings were added at a significant cost to the company during this world class event.

Investing in our Vessels and Terminals…

- Returned the 45-year old *Queen of New Westminster* to service following an extensive $52 million upgrade at Vancouver Drydock in North Vancouver. The upgrade prepared the ship for another 13 years of service. The *Queen of New Westminster*, which formerly operated on the Duke Point–Tsawwassen route now services the Tsawwassen–Swartz Bay run.
- Held decommissioning ceremonies for both the *Queen of Vancouver* and *Queen of Prince Rupert* in recognition of the valuable service these ships and their crews provided to millions of local and international customers during their respective 47 and 43 years of service.
- As approved under the federal government's Infrastructure Stimulus Fund program, BC Ferries will qualify for partial reimbursements of eligible costs for eleven terminal projects including eight sewage pump-ashore and waste water treatment projects. The net funding expected to be received is $7.5 million.
- Removed the *MV Quinsam* from service for the second phase of its asset betterment project. The $17 million life extension project will prepare the 28-year-old vessel, which serves on BC Ferries' Gabriola Island route, for another 17 years of service.
- Completed renovations to the Departure Bay terminal foot passenger waiting room.

Key Accomplishments

Building a Better BC Ferries…

- Received notification that DBRS Limited (DBRS) upgraded BC Ferries' long-term credit rating to A from A(low). DBRS acknowledged BC Ferries' tight management of service offerings and expenses as important factors contributing to this upgrade. Credit rating agency Standard & Poor's also upgraded BC Ferries' long-term credit rating to A+ from A-.
- Reduced employee time loss injuries by 24.5 per cent through our SailSafe program, a joint initiative with the BC Ferry and Marine Workers' Union.
- Opened our new operations and security centre (OSC). This state-of-the-art facility assists the company in monitoring its operations up and down the coast, 24 hours a day, 365 days per year. The primary purpose of the OSC is to collect information throughout the company, provide enhanced situational awareness and assessments, increased security monitoring and a coordinated response during incidents.
- Expanded self-ticketing for foot passengers to the Departure Bay and Duke Point terminals. The self-ticketing process is designed to simplify and speed up the foot passenger ticketing process.
- Introduced new features for mobile devices such as current conditions at major terminals, vessel tracking maps and service notices at mobile.bcferries.com.
- Carried out security enhancements at nine terminals and on twelve vessels in order to comply with Transport Canada's new regulations that came into effect where domestic ferries and facilities are now included within the *Marine Transportation Security Act* framework.
- Introduced the use of B5 biodiesel on the *Queen of Alberni* as a pilot project in September 2009. Now all vessels use a B5 fuel blend in all service areas where the product is available.

Connecting with the Communities We Serve…

- Consulted regularly with our twelve Ferry Advisory Committees.
- Hosted public open houses in Prince Rupert, Haida Gwaii and Port Hardy to give members of the public an early preview of the new vessel, the *Northern Expedition*. Thousands of people attended these highly successful events.
- Raised $50,000 to help underprivileged children participate in organized sport along with members of British Columbia's media, business and government communities for the fourth consecutive year.
- Sponsored the BC Bike Race.
- Continued to support travel and tourism and the 2010 Olympic and Paralympic Winter Games via our three Coastal Class ships, with each vessel featuring unique images of Canadian athletes as well as the natural beauty of British Columbia.
- Contributed $110,000 in cash and travel services to help children and adults in coastal communities participate in organized sport through the joint BC Ferries-Sport BC Sporting Life on the Coast travel assistance program.
- Participated in the TD Great Canadian Shoreline Cleanup. More than 235 BC Ferries employees volunteered their time to clean 17 beaches throughout our service areas from Victoria to Prince Rupert.

British Columbia Ferry Services Inc.

PROVINCIAL RECEIPTS & PAYMENTS
Fiscal 2003 through 2010

Receipts from the Province to BC Ferries

($ thousands)	2004	2005	2006	2007	2008	2009	**2010**	**TOTAL**
Ferry Transportation fees	91,817	91,833	91,849	90,953	103,801	103,294	**125,599**	**699,146**
Contracted Routes fee	1,747	1,724	1,700	1,700	1,700	1,939	**1,849**	**12,359**
Social Programs fee	12,317	13,414	14,674	15,967	17,248	19,252	**22,060**	**114,932**
Other [1]				7,000		4,113	**1,620**	**12,733**
Other [2]						20,750		**20,750**
	105,881	106,971	108,223	115,620	122,749	149,348	**151,128**	**859,920**
Federal-Provincial subsidy	23,975	24,343	24,890	25,309	25,856	26,294	**26,924**	**177,591**
Total receipts	129,856	131,314	133,113	140,929	148,605	175,642	**178,052**	**1,037,511**

Payments from BC Ferries to the Province

	2004	2005	2006	2007	2008	2009	**2010**	**TOTAL**
Debenture repayment [3]		427,701						**427,701**
Interest on debenture	22,480	3,399						**25,879**
Dividends on preferred shares	6,038	6,038	6,038	6,038	6,038	6,038	**6,038**	**42,266**
Provincial Fuel tax adjustments	75			224	47			**346**
Fuel on northern routes [4]							**1,273**	**1,273**
Total payments	28,593	437,138	6,038	6,262	6,085	6,038	**7,311**	**497,465**

1 Contributions used to reduce the balances in the deferred fuel cost accounts include a one-time payment in fiscal 2007, fuel costs of $2,429 over the set price on the northern routes reimbursed in fiscal 2009 and, in fiscal 2009 and 2010, a contribution equal to the transportation fee reduction related to import duties remission and related GST obtained on the *Northern Adventure*.

2 $19,550 to allow for a 33% fare reduction and $1,200 additional funding for reimbursement of costs to reinstate previously eliminated off-peak sailings.

3 On April 2, 2003, the assets held by the Province were sold to the newly incorporated British Columbia Ferry Services Inc. in exchange for a $427,701 debenture with interest at 5.18% and 75,477 non-voting 8% cumulative preferred shares. In fiscal 2005, the Company issued two $250 million debentures and the proceeds were used to repay the Provincial debt.

4 Fuel costs under the set price on the Northern Routes.

Management’s Discussion & Analysis

Management’s Discussion & Analysis of Financial Condition and Results of Operations For the fiscal year ended March 31, 2010

Dated May 19, 2010

The following is our discussion and analysis of the financial condition and results of operations for British Columbia Ferry Services Inc. as of May 19, 2010. This should be read in conjunction with our audited consolidated financial statements and related notes for the years ended March 31, 2010 (fiscal 2010) and March 31, 2009 (fiscal 2009). These documents are available on SEDAR at www.sedar.com and on our Investor webpage at http://www.bcferries.com/about/investors/index.html.

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

Business Overview

British Columbia Ferry Services Inc. is an independent company providing ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world, providing frequent year-round transportation service on 25 routes, supported by 36 vessels and 47 terminals. Our service is an integral part of British Columbia’s coastal transportation system and has been designated by the Province of British Columbia (the Province) as an essential service for purposes of the provincial Labour Relations Code. This designation means our services are considered necessary for the protection of the health, safety and welfare of the residents of British Columbia.

We provide a wide and varied range of ferry services for our customers. In fiscal 2010, we provided more than 186,000 sailings, carrying 21.0 million passengers and 8.3 million vehicles.

In fiscal 2010, we experienced a 1.5% increase in both vehicle and passenger traffic levels, as economic conditions began to improve and vehicle fuel prices declined compared to the prior year.

Fiscal 2010 marked the first full year of our drop-trailer service launched in March 2009. With this service, commercial customers on two of our Major Routes can drop their trailers off at one terminal and pick them up at another. This drop-trailer service has been well received in the commercial market and improves our overall productivity by utilizing otherwise unused capacity.

During fiscal 2010, we assessed the feasibility of enhancing our northern service to Prince Rupert by commencing periodic service from our Tsawwassen terminal on the Lower Mainland to our Port Hardy terminal on Vancouver Island, with the objective of increasing tourism and providing a new service to our existing customers. We were not able to receive unanimous support for this initiative from the various northern communities; therefore we suspended our efforts to launch this enhanced service. We remain committed to creating new and innovative travel options for our customers.

In December 2009, the Province and First Nations signed the Coastal Reconciliation Protocol. This agreement includes $25 million in funding from the federal and provincial governments which will be used by the Province to build a new, larger ferry terminal at Klemtu, an isolated community 200 kilometres north of Vancouver Island. This new terminal will be able to accommodate the *Northern Expedition*, one of the vessels providing service on our Northern Routes, which cannot utilize the current facility at Klemtu. The new terminal is expected to be completed by March 31, 2011.

Significant events during or subsequent to fiscal 2010:

- On April 3, 2009, the 45-year-old *Queen of New Westminster*, which formerly operated on our Duke Point–Tsawwassen route, returned to service on our Tsawwassen–Swartz Bay route following an extensive $52 million upgrade to prepare it for another 13 years of service.

- On April 15, 2009, the 47-year-old *Queen of Vancouver* was decommissioned and on April 20, 2009, the 43-year-old *Queen of Prince Rupert* was decommissioned. The *Queen of Vancouver* and the previously decommissioned *Queen of Saanich* have been sold, while the *Queen of Prince Rupert* remains available for sale. Losses on disposal and impairment of $2.9 million relating to these three vessels have been reflected in our fiscal 2010 financial results.
- On May 18, 2009, the new *Northern Expedition* made its inaugural voyage on our northern route through the Inside Passage from Port Hardy to Prince Rupert. This 150-metre vessel, which replaced the 43-year-old *Queen of Prince Rupert*, has 55 staterooms and accommodates up to 130 vehicles and 600 passengers. The total project budget for this vessel was $200 million. The project was completed on schedule and on budget.
- On May 21, 2009, our new operations and security centre (OSC) officially began operations. The OSC is a central location for monitoring day-to-day operations and providing incident management support. The primary purpose of the OSC is to collect information from throughout the company, provide enhanced situational awareness and assessments, increased security monitoring and a coordinated response during any incidents.
- From June 2 to September 10, 2009, we offered our "CoastSaver" program. This promotional fare incentive program provided mid-week price discounts of 33% on passenger and passenger vehicle fares on our Major Routes. This program will be offered again from May 25 through July 29, 2010.
- On July 15, 2009, fares were reduced as average fuel rebates were increased from 5% to 8% on many of our routes. On September 1, 2009, the fuel rebates were further increased to 10% on these routes and then subsequently reduced to 5% on January 25, 2010, due to higher fuel prices. On April 1, 2010, a fuel rebate of 2% was implemented on our Major Routes. Fuel rebates are not currently in place on our Northern Routes.
- On July 23, 2009, the Province announced its intention to harmonize its existing 7% provincial sales tax with the 5% federal goods and services tax into a single harmonized sales tax (HST) of 12%, effective July 1, 2010. We expect this tax to add approximately $5 to $6 million annually to the cost of our operations. It will also increase the price to our customers for our food and certain retail offerings.
- On September 24, 2009, the provincial government announced that, as part of the federal government's Infrastructure Stimulus Fund program, BC Ferries will qualify for partial reimbursements of eligible costs of eight sewage pump-ashore and waste water treatment projects, as well as other terminal projects. The net funding expected to be received is $7.5 million. (See "Investing in our Capital Assets" below for more project detail).
- On December 1, 2009, we opened new self-ticketing kiosks at two of our major terminals. The self-ticketing system is designed to simplify and speed up the foot passenger ticketing process. Customers now have the option of using a self-ticketing machine or purchasing a ticket from a ticket agent.
- On December 14, 2009, we were advised by the credit rating agency DBRS that they have upgraded our long-term rating from A (low) to A. DBRS acknowledged our tight management of service offerings and expenses as an important factor contributing to this upgrade. On February 24, 2010, Standard & Poor's also upgraded our long-term rating from A- to A+.
- On April 29, 2010, the Province introduced legislation, *Bill 20 - Miscellaneous Statutes Amendment Act (No.3), 2010 (Bill 20)*, to amend several statutes, including the *Coastal Ferry Act*. The amendments respond to the Comptroller General's Report on Review of Transportation Governance Models released November 6, 2009, and include changes to the governance and regulatory framework within which we operate. (See "Corporate Structure" below for more detail).
- On March 18, 2010, we reached an agreement with British Columbia Institute of Technology Marine Campus (BMC) to participate, along with other industry partners, in BMC's simulator renewal initiative which will provide our employees with access to the most modern marine simulation centre in the world.
- On May 11, 2010, our new vacations centre in downtown Vancouver officially opened to the public. With the aid of a 37-foot long interactive media wall display, customers are able to view route maps, vessel schematics, and destination images to help them choose from a variety of travel package options.
- Results of our Customer Satisfaction Tracking surveys in 2009 indicated that 91% of customers surveyed report being satisfied with their overall trip experience, up from 86% in the prior year.

Management's Discussion & Analysis

Corporate Structure

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, which commenced April 1, 2003, stipulates, among other things, the number of round trips that must be provided for each regulated ferry service route in exchange for specified fees (ferry transportation fees). The contract was amended to, among other things, establish the ferry service levels and ferry transportation fees for the second performance term commencing April 1, 2008. The Coastal Ferry Services Contract also includes fees for the provision of specific social program services delivered on behalf of the Province.

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

ECONOMIC REGULATORY ENVIRONMENT

The office of the British Columbia Ferries Commissioner (the Commissioner) was created under the *Coastal Ferry Act*, enacted by the Province on April 1, 2003. The Commissioner establishes price caps for designated ferry route groups for the purpose of regulating our tariffs. The Commissioner is also responsible for regulating the reduction of service, discontinuance of routes and certain other matters. The *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.

Our first performance term ended March 31, 2008, and our second performance term will end March 31, 2012. The price cap increase authorized by the Commissioner for the second performance term was 7.3% on the Major Routes and 4.0% on all other routes effective April 1, 2008, starting from a level which included fuel surcharges in place at March 31, 2008. On each April 1 for the subsequent three years, the price cap increases by 2.7% plus 0.49 times the latest reported annual change in the Consumer Price Index (British Columbia) on the Major Routes and 5.7% plus 0.73 times the change in the Consumer Price Index (British Columbia) on all other routes. On April 1, 2010, the price cap increased by 2.68% (3.74% on April 1, 2009) on the Major Routes and 5.68% (7.25% on April 1, 2009) on all other routes. These price cap increases reflect changes in the Consumer Price Index (British Columbia) of -0.03% applied April 1, 2010 and 2.13% applied April 1, 2009.

AMENDMENTS TO THE *COASTAL FERRY ACT*

On April 29, 2010, the Province introduced legislation, *Bill 20*, to amend several statutes, including the *Coastal Ferry Act*. The amendments respond to the Comptroller General's Report on Review of Transportation Governance Models released November 6, 2009, and include changes to the governance and regulatory framework within which we operate.

The proposed governance changes include: a broadening of the mandate of the B.C. Ferry Authority (Authority) to include responsibility for the compensation plans of our directors and certain executive officers, such compensation plans to be comparable to those of public sector organizations; a requirement that effective September 30, 2010, a director of the Authority cannot also be a director of British Columbia Ferry Services Inc. (BC Ferries); and, the subjection of the records of the Authority and BC Ferries to the *Freedom of Information and Protection of Privacy Act*.

The proposed amendments included in *Bill 20* also expand the regulatory responsibilities of the Commissioner to include: consideration of the interests of ferry users; regulation of our reservation fees; approval and public disclosure of our process for handling customer complaints; and review and public disclosure of our ten year capital plan, our plan for improving efficiency in the next performance term, and our methodology for allocating costs among the regulated routes. These amendments also broaden the Commissioner's role in regulating ferry transportation services where the Commissioner determines that we have an unfair competitive advantage. *Bill 20* further includes amendments modifying the process by which the Commissioner regulates our activities in seeking additional or alternative service providers on our regulated routes; and requires the Commissioner to issue an opinion on the performance of the Authority in carrying out its legislated responsibilities.

We are currently assessing the cost of these regulatory and administrative changes, which could be in the range of $2 million to $3 million per annum.

Financial and Operational Overview

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

Year ended March 31 ($ millions)	2010	2009	2008
Total revenue	**732.3**	681.8	640.7
% Growth	**7.4%**	6.4%	7.4%
Operating expenses	**660.0**	624.2	569.6
Earnings from operations	**72.3**	57.6	71.1
Interest and other	**68.9**	48.6	34.0
Net earnings and comprehensive income	**3.4**	9.0	37.1

As at March 31	2010	2009	2008
Total assets	**1,807.0**	1,842.2	1,550.5
Total long-term financial liabilities	**1,363.9**	1,369.0	1,059.5
Dividends on preferred shares	**6.0**	6.0	6.0

Our earnings from operations in fiscal 2010 were $14.7 million higher and net earnings were $5.6 million lower than in fiscal 2009. As expected, the reduction in net earnings reflects increased amortization and financing costs as a result of new capital assets that have entered service with the completion of our fleet and asset renewal program for our Major and Northern Routes. Earnings from operations and net earnings in fiscal 2009 were $13.5 million and $28.1 million lower, respectively, than in the previous year, also reflecting the added costs of the new capital assets.

We have now completed the first phase of our SailSafe program, which is a partnership initiative with the BC Ferry & Marine Workers' Union to achieve world class safety performance. We implemented more than 90% of the 48 action items identified to be completed in the first phase, with the balance deliberately carried forward into subsequent phases. We have seen significant improvements in overall safety performance. During fiscal 2010, the number of lost time injuries was down 20% and work days lost to injury were down 26%, compared to the prior year. The next phase, encompassing 41 action plan items, will focus on continuously improving and sustaining our safety performance.

Transport Canada regulates the safety of our vessels by authority of the *Canada Shipping Act 2001*, which came into effect on July 1, 2007. Certain revised regulations resulted in a requirement for vessel upgrades which principally included improvements to lifesaving appliances for a number of vessels and the installation of marine evacuation systems. On January 1, 2009, a new Transport Canada requirement took effect whereby each domestic ferry must have a minimum safe manning document. This document dictates the minimum crew complement and crew certification required to operate the vessel at various passenger levels. In order to comply with these changes for vessels providing service on certain of our Other Routes, either the number of crew would need to increase or the allowable number of passengers carried would need to be lowered. We completed a comprehensive analysis of our capacity requirements on these routes and have either increased crew levels, reduced allowable passenger levels while still maintaining the passenger capacity required by the Coastal Ferry Services Contract or introduced multiple license levels. Multiple license levels permit the ability to manage crew levels higher or lower to match short term passenger demand. These actions have resulted in reducing the potential impact that the regulatory changes would have otherwise had on future fares. As always, the safety of our customers and employees remains our highest priority.

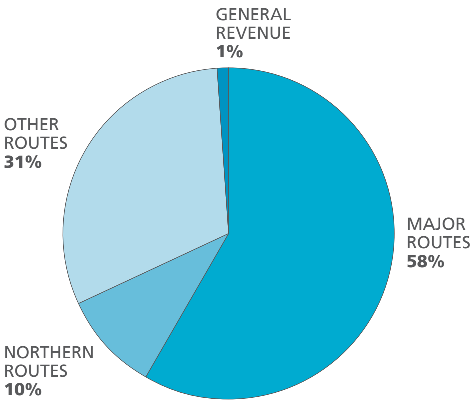
In 2001, the federal government enacted the *Marine Transportation Security Act*. Initially the legislation and the associated regulations were limited to international ports and vessels. Effective January 15, 2010, new regulations came into effect and domestic ferries and facilities are now included within the *Marine Transportation Security Act* framework. We are now required to satisfy a specific level of security on our vessels and at our terminals servicing our Major and certain Other Routes. Following our corporate security strategy, location-specific enhancements have been completed and we have received a security certificate of compliance from Transport Canada. Enhancements included perimeter fencing and gates, closed circuit TV, better access controls, canine screening and patrols.

Management's Discussion & Analysis

We have now switched all of our vessels to biodiesel where the product is available. This fuel blend is 5% canola-based biodiesel with 95% low sulphur petroleum diesel. Biodiesel is cleaner with significantly less unburned hydrocarbons, carbon monoxide and particulate matter in emissions.

Revenue

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



In fiscal 2010, the greatest portion of our revenues, 58%, was earned on our three Major Routes connecting Vancouver Island to Vancouver and the Lower Mainland. The revenue from the Northern Routes contributed 10% and Other Routes contributed 31%.

Year ended March 31 ($ millions)	**2010**	2009	2008
Direct Route Revenue			
Vehicle traffic (volume)	**8,255,409**	8,130,356	8,578,703
Vehicle tariff	**281.2**	269.1	240.6
Passenger traffic (volume)	**21,035,644**	20,727,493	21,788,461
Passenger tariff	**169.3**	160.0	141.6
Social program fees	**22.1**	19.3	17.3
Catering & on-board	**79.1**	76.4	77.4
Other revenue	**22.2**	20.7	24.0
Total Direct Route Revenue	**573.9**	545.5	500.9
Indirect Route Revenue			
Ferry transportation fees	**127.4**	105.2	105.5
Federal-Provincial subsidy	**26.9**	26.3	25.8
Total Route Revenue	**728.2**	677.0	632.2
Other general revenue	**4.1**	4.8	8.5
Total Revenue	**732.3**	681.8	640.7

Our largest revenue source is vehicle and passenger tariffs. The price cap increase authorized by the Commissioner, effective April 1, 2008, was 7.3% on the Major Routes and 4.0% on all other routes, starting from a level which included fuel surcharges in place at March 31, 2008. Effective April 1, 2009, the Commissioner authorized further price cap increases of 3.74% on the Major Routes and 7.25% on all other routes. In response to these price cap increases, we implemented tariff increases. On each remaining April 1 of the four-year performance term, ending March 31, 2012, the price cap increases by 2.7% plus 0.49 times the latest reported annual change in the Consumer Price Index (British Columbia) on the Major Routes and 5.7% plus 0.73 times the change in the Consumer Price Index (British Columbia) on all other routes. On April 1, 2010, the price caps increased by 2.68% on the Major Routes and 5.68% on all other routes. These price cap increases reflect a change in the Consumer Price Index (British Columbia) of -0.03%.

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

Our traffic levels have historically been relatively stable. However, during fiscal 2009, vehicle and passenger traffic were lower than the prior year by 5.2% and 4.9%, respectively. Dramatically higher vehicle fuel prices during the first part of fiscal 2009, lower levels of tourism, and the general economic decline all contributed to this reduction. In fiscal 2010, we experienced a 1.5% increase in both vehicle and passenger traffic levels, as economic conditions began to improve and vehicle fuel prices declined compared to the prior year.

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

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

YEAR TO YEAR COMPARISON OF REVENUES 2010 – 2009

Major Routes

Fiscal year ended March 31 ($ thousands)	**2010**	2009	Increase	(Decrease)
Direct Route Revenue				
Vehicle traffic (volume)	**3,739,735**	3,696,322	43,413	1.2%
Vehicle tariff	**209,530**	203,192	6,338	3.1%
Passenger traffic (volume)	**10,804,836**	10,664,158	140,678	1.3%
Passenger tariff	**122,697**	117,617	5,080	4.3%
Social program fees	**10,774**	9,907	867	8.8%
Catering & on-board	**64,226**	62,302	1,924	3.1%
Reservation fees	**12,245**	12,038	207	1.7%
Parking	**3,474**	3,229	245	7.6%
Assured loading	**2,365**	2,040	325	15.9%
Other revenue	**2,035**	1,538	497	32.3%
Total Direct Route Revenue	**427,346**	411,863	15,483	3.8%
Indirect Revenue				
Ferry transportation fees	**0**	0	0	0.0%
Federal-Provincial subsidy	**0**	0	0	0.0%
Total Route Revenue	**427,346**	411,863	15,483	3.8%

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

Social program fees are reimbursements from the Province of discounts provided on fares for BC seniors, students travelling to and from school, persons with disabilities and persons travelling under the Ministry of Health Travel Assistance Program. Social program fees increased as a result of higher program usage, higher fares and a $0.4 million billing correction in fiscal 2009. Neither ferry transportation fees nor federal/provincial subsidies are received in support of services provided on our Major Routes.

Management's Discussion & Analysis

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

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

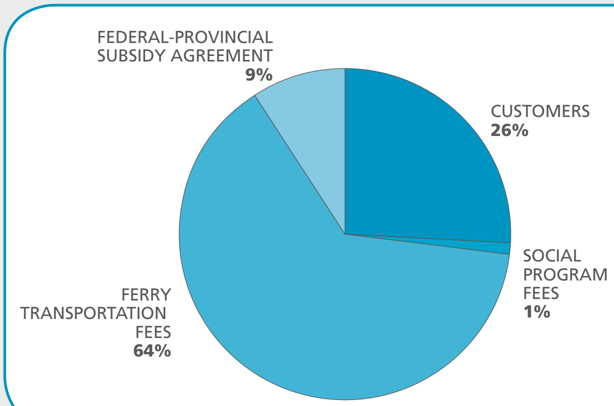
Other revenue increased mainly as a result of hostling[1] fees from our new drop-trailer service for commercial customers.

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

Northern Routes

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

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



Fiscal 2010 revenue from our Northern Routes consisted of 26% from customers and 74% from the Province (1% social program fees, 64% transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

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

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

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

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

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

We receive ferry transportation fees for these routes under the Coastal Ferry Services Contract, which relate, in part, to the capital cost of the vessels serving these routes. The fees have increased as a result of the capital cost of the new *Northern Expedition*.

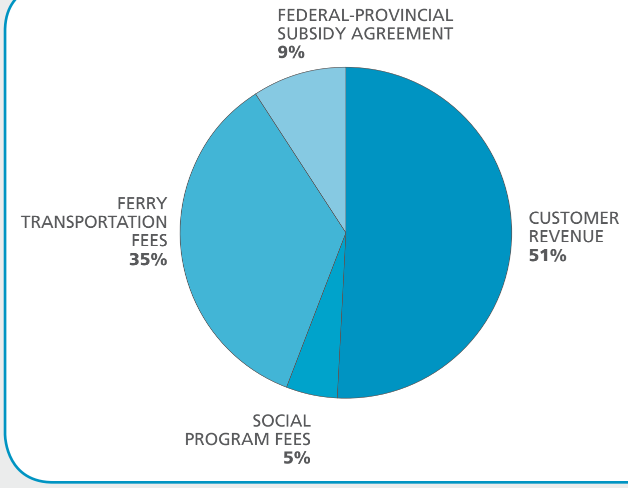
The total Federal-Provincial subsidy has increased by the Consumer Price Index (Vancouver).

Other Routes

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

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

Management's Discussion & Analysis



Fiscal 2010 revenue from our Other Routes consisted of 51% from customers and 49% from the Province (5% social program fees, 35% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

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

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

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

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

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

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

YEAR TO YEAR COMPARISON OF REVENUES 2009 – 2008

Major Routes

Fiscal year ended March 31 ($ thousands)	2009	2008	Increase	(Decrease)
Direct Route Revenue				
Vehicle traffic (volume)	3,696,322	3,912,269	(215,947)	(5.5%)
Vehicle tariff	203,192	182,280	20,912	11.5%
Passenger traffic (volume)	10,664,158	11,304,042	(639,884)	(5.7%)
Passenger tariff	117,617	104,292	13,325	12.8%
Social program fees	9,907	8,790	1,117	12.7%
Catering & on-board	62,302	63,785	(1,483)	(2.3%)
Reservation fees	12,038	14,035	(1,997)	(14.2%)
Parking	3,229	3,110	119	3.8%
Assured loading	2,040	2,662	(622)	(23.4%)
Other revenue	1,538	1,209	329	27.2%
Total Direct Route Revenue	411,863	380,163	31,700	8.3%

Both vehicle traffic and passenger traffic decreased in fiscal 2009 from the prior year. The impact on total tariff revenue of these lower traffic levels was more than offset by the increase in average tariffs. The increase in average tariff revenue per vehicle was $8.38 or 18.0% while the increase in average tariff revenue per passenger was $1.80 or 19.5%. Most of this increase represents fuel surcharges previously paid by customers and credited to fuel cost deferral accounts, which are now included in tariff revenue by order of the Commissioner. During fiscal 2008, these surcharges paid by customers amounted to $24.1 million. The April 1, 2008 price cap increase on the Major Routes was 7.3% starting from a level which included fuel surcharges in place at March 31, 2008. The higher average fares, partially offset by the decrease in traffic resulted in a total increase of $34.2 million in tariff revenue.

Included in tariff revenue is $15.0 million ($9.6 million for vehicles and $5.4 million for passengers) in funding provided by the Province to allow a 33% reduction of fares during the months of December 2008 and January 2009.

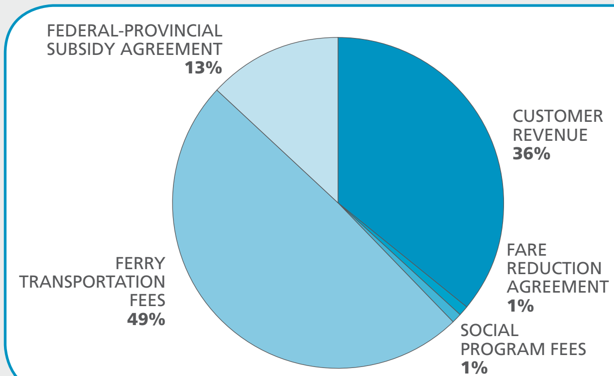
Social program fees have increased mainly as a result of higher fares.

In fiscal 2009, the average spending per passenger for food services increased by 4.2% while the average spending per passenger for gift shop items remained at the same level. The increase in average spending per passenger was more than offset by the reduction in revenue caused by lower traffic levels.

Fees for reservations and assured loading revenue also declined as a result of lower traffic levels. Parking revenue increased while other revenue decreased as a result of reduced video and vending revenues partially offset by retail commissions.

Northern Routes

Fiscal year ended March 31 ($ thousands)	2009	2008	Increase	(Decrease)
Direct Route Revenue				
Vehicle traffic (volume)	31,739	33,789	(2,050)	(6.1%)
Vehicle tariff	8,253	7,053	1,200	17.0%
Passenger traffic (volume)	93,964	101,751	(7,787)	(7.7%)
Passenger tariff	7,233	6,282	951	15.1%
Social program fees	565	581	(16)	(2.8%)
Catering & on-board	2,237	2,324	(87)	(3.7%)
Reservation fees	69	80	(11)	(13.8%)
Stateroom rental	783	964	(181)	(18.8%)
Hostling & other	211	210	1	0.5%
Total Direct Route Revenue	19,351	17,494	1,857	10.6%
Indirect Revenue				
Ferry transportation fees	25,283	27,350	(2,067)	(7.6%)
Federal-Provincial subsidy	6,505	4,389	2,116	48.2%
Total Route Revenue	51,139	49,233	1,906	3.9%



Fiscal 2009 revenue from our Northern Routes consisted of 36% from customers and 64% from the Province (1% fare reduction agreement, 1% social program fees, 49% transportation fees, and 13% from payments under the Federal-Provincial subsidy agreement).

Both vehicle traffic and passenger traffic decreased from the prior year. The impact on total tariff revenue of these lower traffic levels was more than offset by the increase in average tariffs. The average tariff revenue per vehicle increased $51.29 or 24.6%. The average passenger tariff revenue increase was $15.24 or 24.7%. Most of this increase represents fuel surcharges previously paid by customers and credited to fuel cost deferral accounts, which are now included in tariff revenue by order of the Commissioner. During fiscal 2008, these surcharges paid by customers amounted to $2.2 million. The April 1, 2008 price cap increase on the Northern Routes was 4.0% starting from a level which included fuel surcharges in place at March 31, 2008. The higher average tariff, partially offset by lower traffic, resulted in a total tariff revenue increase of $2.2 million.

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

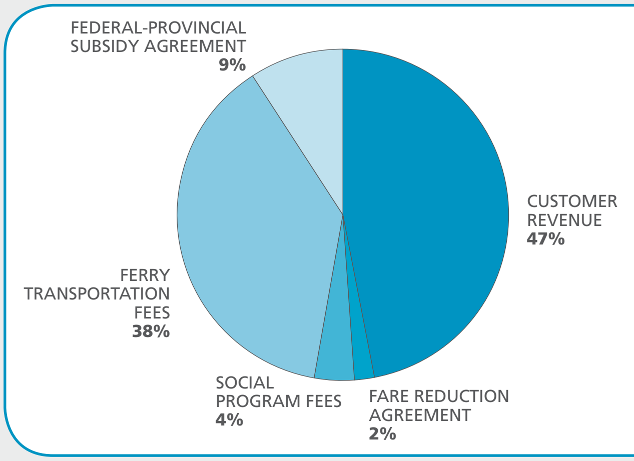
Reimbursements from the Province for social program fees, revenue from catering and on-board services, fees for reservations, and stateroom rental have all decreased primarily as a result of lower traffic levels.

The decrease in ferry transportation fees reflects, in part, the reduction in the capital cost of the *Northern Adventure* as a result of the import duties remission and related GST obtained on that vessel. The Province paid $1.7 million, an amount equal to the fee reduction related to the duty remission, which was applied to the deferred fuel cost accounts of the Other Routes.

The Federal-Provincial subsidy increase was a result of a redistribution of the subsidy between the Northern and Other Routes. The total subsidy increased by the Consumer Price Index (Vancouver).

Other Routes

Fiscal year ended March 31 ($ thousands)	2009	2008	Increase	(Decrease)
Direct Route Revenue				
Vehicle traffic (volume)	4,402,295	4,632,645	(230,350)	(5.0%)
Vehicle tariff	57,638	51,319	6,319	12.3%
Passenger traffic (volume)	9,969,371	10,382,668	(413,297)	(4.0%)
Passenger tariff	35,129	31,004	4,125	13.3%
Social program fees	8,780	7,877	903	11.5%
Catering & on-board	11,128	11,276	(148)	(1.3%)
Reservation fees	1,198	1,388	(190)	(13.7%)
Parking & other	421	361	60	16.6%
Total Direct Route Revenue	114,294	103,225	11,069	10.7%
Indirect Revenue				
Ferry transportation fees	79,950	78,151	1,799	2.3%
Federal-Provincial subsidy	19,789	21,467	(1,678)	(7.8%)
Total Route Revenue	214,033	202,843	11,190	5.5%



Fiscal 2009 revenue from our Other Routes consisted of 47% from customers and 53% from the Province (2% fare reduction agreement, 4% social program fees, 38% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).

Both vehicle traffic and passenger traffic decreased from the prior year. The impact on total tariff revenue of these lower traffic levels was more than offset by the increase in average tariffs. The increase in average tariff revenue per vehicle was $2.01 or 18.1% while the average passenger tariff revenue increase was $0.53 or 17.7%. Most of this increase represents fuel surcharges previously paid by customers and credited to fuel cost deferral accounts, which are now included in tariff revenue by order of the Commissioner. During fiscal 2008, these surcharges paid by customers amounted to $13.1 million. The April 1, 2008 price cap increase on our other regulated routes was 4.0% starting from a level which included fuel surcharges in place at March 31, 2008.

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

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

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

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

Revenue from catering and on-board services and fees for reservations decreased primarily as a result of lower traffic levels.

The increase in parking and other income is mainly a result of higher retail commissions.

Ferry transportation fees are higher as a result of the renegotiated fees from the Province for the provision of service on our Northern and Other Routes.

The Federal-Provincial subsidy decrease was a result of a redistribution of the subsidy between the Northern and Other Routes. The total subsidy increased by the Consumer Price Index (Vancouver).

Expenses

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

Year ended March 31 ($ millions)	**2010**	2009	2008
Operating Expenses			
Operations	**398.8**	387.8	347.4
Maintenance	**85.6**	77.2	88.4
Administration	**30.3**	37.2	37.1
Total operations, maintenance & administration	**514.7**	502.2	472.9
% Increase	**2.5%**	6.2%	6.4%
Cost of retail goods sold	**30.1**	28.9	29.9
Amortization	**115.2**	93.1	66.8
Total operating expenses	**660.0**	624.2	569.6
% Increase	**5.7%**	9.6%	7.8%

Expenses (continued)

Year ended March 31 ($ millions)	**2010**	2009	2008
Interest and other			
Interest expense			
Bond interest	**63.3**	56.9	45.3
KfW bank group (KfW) loans	**11.2**	9.0	0.6
Short-term loans	**0.3**	0.8	0.6
Interest on deferred accounts	**0.3**	0.1	(0.9)
Structured Financing Facility Program	**(4.7)**	(2.4)	(2.1)
Capitalized interest	**(2.8)**	(14.3)	(10.4)
Total interest expense	**67.6**	50.1	33.1
(Gain) on foreign exchange	**(0.1)**	(0.3)	(0.1)
Loss (gain) on disposal of capital assets	**1.4**	(1.2)	1.0
Total interest and other	**68.9**	48.6	34.0

RESTRUCTURING

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

YEAR TO YEAR COMPARISON OF EXPENSES 2010 – 2009

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

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

These increases were partially offset by:

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

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

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

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

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

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

Interest expenses increased $17.5 million primarily due to:

- $6.4 million additional interest relating to our $140 million bond series issued in December 2008;
- $2.2 million additional interest relating to our $108 million KfW loan received in January 2009, to partially finance the purchase of the *Northern Expedition*;
- $11.5 million less interest capitalized reflecting the completion of our vessel replacement program for our Major and Northern Routes; partially offset by;
- $2.3 million in additional interest rate support through the Structured Financial Facility (SFF) program offered by the Government of Canada, reflecting the fiscal allocation relating to the purchase of the *Island Sky* and the life extension of the *Queen of New Westminster*. In October 2009, we received approval for up to $1.0 million of interest rate support payments through the SFF program relating to the life extension of the *Quinsam*.

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

YEAR TO YEAR COMPARISON OF EXPENSES 2009 – 2008

The $40.4 million increase in fiscal 2009 operations expenses consists of:

- $40.9 million increase in fuel expense as a result of higher set prices and the operation of the fuel pricing mechanism as ordered by the Commissioner, totalling $42.4 million, partially offset by $1.5 million in lower fuel consumption;
- $4.6 million increase in wages and benefits, including:
  - Approximately $6.9 million in wage rate increases averaging about 3% in accordance with the existing Collective Agreement;
  - $2.2 million increase in benefit costs;
  - $0.5 million in training and familiarization; less
  - $5.0 million from reductions of management and other shore-based positions, in incentive compensation and costs of illness and other paid leave; and
- $5.1 million decrease reflecting $1.2 million in funding from the Province for reimbursement of costs to reinstate previously eliminated off-peak sailings and lower discretionary expenditures from cost reduction initiatives.

The $11.2 million decrease in maintenance costs reflects variations in vessel refit scheduling and the reduced costs of maintaining a newer fleet, partially offset by increased maintenance on our terminals. We completed 16 refits in fiscal 2009 and had a further two in progress at March 31, 2009.

Administration expenses increased $0.1 million as a result of costs of restructuring and transition of IT systems support to an in-house model, mainly offset by reduced consulting, travel, marketing, advertising and other discretionary expenditures.

Amortization increased a total of $26.3 million mainly as a result of additional assets coming into service, including $16.4 million due to the *Coastal Renaissance*, the *Coastal Inspiration*, and the *Coastal Celebration* entering service in March 2008, June 2008 and November 2008, respectively; and $4.6 million in amortization of deferred fuel cost balances. The Commissioner has included $18.5 million of deferred performance term one fuel costs in determining the price caps for the four-year second performance term commencing April 1, 2008.

Interest expenses increased $17.0 million primarily due to:

- $11.2 million additional interest relating to our $200 million and $140 million bond series issued in January 2008 and December 2008 respectively; and
- $8.4 million additional interest relating to our two KfW loans which partially financed the purchase of the *Coastal Inspiration* and *Coastal Celebration*; and partially offset by
- $3.9 million of additional interest capitalized reflecting our investment in revitalizing our fleet and terminal facilities.

During the third quarter of fiscal 2009, agreements were completed that would provide us with a further $10.7 million of interest rate support through the SFF program, relating to the purchase of the new intermediate vessel, the *Island Sky*, and the life extension of the *Queen of New Westminster*. During fiscal 2009, $2.4 million of this amount was recorded as a reduction in interest expense and $3.6 million as a reduction of capitalized interest.

DEFERRED FUEL COST ACCOUNTS

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

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

For the Northern Routes, the per litre cost of fuel included in the determination of price caps (the set price) and one-half of the first 5 cents per litre of difference between the actual price paid per litre (including realized hedge gains and losses) and the set price are recorded in expense. The remaining one-half of the first 5 cents per litre of difference is recorded in the deferred fuel cost accounts. Any difference beyond 5 cents per litre is recovered from or paid to the Province. The total to be paid to the Province relating to fuel costs on the Northern Routes was $1.3 million for fiscal 2010 ($2.4 million recovered from the Province in fiscal 2009).

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

There is a mechanism in place to allow price cap adjustments to provide for implementation of fuel surcharges or rebates when appropriate. Throughout fiscal 2010, fares on many of our routes, with the exception of our Major and Northern Routes, were reduced by fuel rebates ranging from 2% to 10% on average. There are no fuel surcharges or rebates on our Northern Routes. In fiscal 2010, we refunded $6.3 million in fuel rebates to customers. In fiscal 2009, we collected $16.5 million in fuel surcharges, net of rebates. These amounts were applied to the outstanding deferred fuel cost account balances.

Under an agreement reached during fiscal 2008, the Province agreed to pay $1.3 million for fiscal 2008, $1.7 million for fiscal 2009, and $1.6 million for fiscal 2010, which was applied to the deferred fuel cost accounts. These benefits are equal to the amount by which annual ferry transportation fees payable by the Province were reduced as a result of the lower cost of the *Northern Adventure* due to remission and refund of import duties paid. These reductions in the deferred fuel cost accounts benefit our customers through reduced fuel surcharges or earlier fuel rebates.

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

The balances in our deferred fuel cost accounts totalled less than $0.1 million at March 31, 2010 ($16.0 million, including $0.9 million in unrealized fuel hedge losses at March 31, 2009).

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

Liquidity and Capital Resources

LIQUIDITY AND CAPITAL RESOURCES

We fund our operations and capital acquisitions with cash flow generated from operations, as well as bank financing and debt issues. With the receipt of the $108 million KfW loan in January 2009, our major financing requirements are complete. Our ongoing capital expenditures are expected to be significantly lower than in the previous few years. Over the next five years, we expect our cash requirements will be met through operational cash flows and by accessing our credit facility from time to time. At March 31, 2010, our unrestricted cash and cash equivalents totalled $11 million.

We target maintaining a strong investment-grade credit rating to allow capital market access at reasonable interest rates. At March 31, 2010, DBRS assessed our credit rating as A and Standard & Poor's assessed our rating as A+, both with a stable trend.

LONG-TERM DEBT

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

In the last three years, we completed two private placements of senior secured bond offerings. These bonds bear interest payable semi-annually. The details of each are:

- $200 million issued January 2008 with interest at 5.58%, due January 2038; and
- $140 million issued December 2008 with interest at 6.21%, due December 2013.

The net proceeds of these offerings were used to fund capital expenditures, the related debt service reserve and for general corporate purposes.

We are also party to a credit agreement with a syndicate of Canadian banks that is secured under the master trust indenture. Under this agreement, we have available a revolving facility in the amount of $155 million. The facility, maturing May 12, 2013, is available to fund capital expenditures and other general corporate purposes. At March 31, 2010, there were no draws on this credit facility.

In fiscal 2006 we executed two loan agreements with KfW. These agreements are secured under the master trust indenture. The agreements allow us to borrow up to $90 million per loan, with the net proceeds to be used for partial financing of the purchase of two of the three Super C-class vessels. In February 2008, to coincide with conditional acceptance of the *Coastal Inspiration*, we received $90 million in proceeds under the loan agreements. In May 2008, to coincide with conditional acceptance of the *Coastal Celebration*, we received a further $90 million in proceeds under the loan agreements. These are 12-year amortizing loans at a fixed interest rate of 4.98%, payable quarterly. The agreements defer the principal payments for the first three years to a second tranche on which interest is payable at a floating rate and the principal is due at maturity.

In January 2009, to coincide with conditional acceptance of the *Northern Expedition*, we received $108 million in proceeds under a further loan agreement with KfW. This is a 12-year amortizing loan at a fixed interest rate of 2.95%, payable semi-annually. The proceeds were applied toward the purchase of the new vessel.

Amount outstanding as at March 31 ($ thousands)	Effective interest rate	2010	2009	2008
Senior Secured Bonds				
5.74%, Due May 2014	5.92%	**250**	250	250
6.25%, Due October 2034	6.41%	**250**	250	250
5.02%, Due March 2037	5.06%	**250**	250	250
5.58%, Due January 2038	5.60%	**200**	200	200
6.21%, Due December 2013	6.33%	**140**	140	–
12 Year KfW Loans				
Tranche A, Due March 2020	5.17%	**75**	82	90
Tranche B, Due March 2020	Floating*	**15**	8	
Tranche A, Due June 2020	5.18%	**77**	84	–
Tranche B, Due June 2020	Floating*	**13**	6	
2.95% KfW Loan, Due January 2021	3.08%	**99**	108	–
		1,369	1,378	1,040

* CAD LIBOR plus 30 basis points at March 31, 2010

TERMINAL LEASES

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

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

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

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

In addition to the above, we have entered into a 40-year lease agreement with the Town of Sidney, BC, to manage an existing ferry terminal owned by the town. This terminal is the western end of a Washington State Ferries route connecting Vancouver Island with Anacortes, WA.

OTHER LONG-TERM LIABILITIES

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

SOURCES & USES OF CASH

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

Sources and uses of cash and cash equivalents for fiscal 2010 and 2009 are summarized in the following table.

Year ended March 31 ($ millions)	2010	2009
Net earnings	**3.4**	9.0
Items not involving cash:		
Amortization	**115.2**	93.1
Other non-cash charges	**1.8**	(0.3)
Regulatory costs deferred	**10.3**	(6.0)
Change in non-cash operating working capital	**(9.4)**	(6.8)
Cash provided by operating activities	**121.3**	89.0
Cash (used) provided by financing activities	**(33.5)**	339.3
Cash used in investing activities	**(89.6)**	(532.2)
Total (decrease) in cash	**(1.8)**	(103.9)

In fiscal 2010, cash provided by operating activities included an increase in non-cash working capital of $9.4 million. This increase in working capital was primarily due to:

- $3.3 million reduction in accrued employee costs;
- $2.8 million reduction in regulatory liabilities reflecting the return to customers through discount fare promotions tariff revenues collected in excess of price caps in the last quarter of fiscal 2009;
- $2.4 million reduction in payables and accrued liabilities relating to refit and maintenance and other operating activities;
- $1.6 million increase in accounts receivable, mainly due to social program fees receivable; and
- $1.2 million increase in total inventories.

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

- $1.3 million reduction in prepaid expenses mainly due to a $1.5 million lower fuel prepayment; and
- $0.6 million increase in deferred revenue.

Cash used in financing activities reflects the $9.0 million principal repayment on the 2.95% KfW loan, the $18.0 million repayment of draws on our $155 million credit facility, and payment of the $6.0 million dividend on preferred shares.

Cash used in investing activities consists mainly of $84.2 million used to purchase capital assets and $7.5 million used to purchase short-term investments, partially offset by $2.2 million in proceeds from the disposal of land and vessels. The significant capital transactions are described below in "Investing in Our Capital Assets".

Fourth Quarter Results

The following provides an overview of our financial performance for the three months ended March 31, 2010, compared to the three months ended March 31, 2009.

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

Three months ended March 31 ($ millions)	2010	2009	Variance $	Variance %
Total revenue	**142.3**	128.5	13.8	10.7%
Expenses	**161.8**	153.6	(8.2)	(5.3%)
Loss from operations	**(19.5)**	(25.1)	5.6	22.3%
Interest and other	**17.3**	13.3	(4.0)	(30.1%)
Net loss	**(36.8)**	(38.4)	1.6	4.2%

Revenue

Our total revenues have increased as shown in the following table.

Revenue ($ millions) Three months ended March 31	2010	2009	Increase $	(Decrease) %
Direct Route Revenue				
Vehicle traffic (volume)	**1,588,875**	1,628,626	(39,751)	(2.4%)
Vehicle tariff	**53.4**	49.9	3.5	7.0%
Passenger traffic (volume)	**3,955,789**	3,870,171	85,618	2.2%
Passenger tariff	**30.9**	27.6	3.3	12.0%
Social program fees	**4.9**	3.1	1.8	58.1%
Catering & on-board	**14.6**	14.0	0.6	4.3%
Other revenue	**3.7**	3.3	0.4	12.1%
Total Direct Route Revenue	**107.5**	97.9	9.6	9.8%
Indirect Route Revenue				
Ferry transportation fees	**27.2**	22.8	4.4	19.3%
Federal-Provincial subsidy	**6.7**	6.6	0.1	1.5%
Total Route Revenue	**141.4**	127.3	14.1	11.1%
Other general revenue	**0.9**	1.2	(0.3)	(25.0%)
Total Revenue	**142.3**	128.5	13.8	10.7%

Total tariff revenue increased $6.8 million in the last quarter of fiscal 2010 compared to the prior year. The effect of higher average fares and increased passenger traffic was partially offset by lower vehicle traffic. A significant contributing factor to the variation in traffic was the 2010 Winter Olympics in Vancouver in February 2010. In February 2010, our passenger traffic was up 52,959 or 4.5% while vehicle traffic was down 38,125 or 7.6% compared to February 2009. The fourth quarter increase in average tariff revenue per vehicle was $2.97 or 9.7% while the increase in average tariff revenue per passenger was $0.68 or 9.5%.

Included in tariff revenue in the prior year is $8.6 million in funding provided by the Province to allow a 33% reduction of fares on all routes during January 2009 and for our Prince Rupert-Skidegate route during February 2009.

The social program fee increase was mainly as a result of a $1.4 million billing adjustment recorded during the fourth quarter of fiscal 2009.

Catering and on-board revenues increased mainly as a result of higher passenger traffic.

Other revenue reflects a $0.2 million increase in reservation fees and $0.2 million additional parking revenue.

Ferry transportation fees were higher on the Northern Routes, reflecting the increase in fees related to the capital cost of the new *Northern Expedition.*

EXPENSES

Expenses are shown in the following table:

Three months ended March 31 ($ millions)	2010	2009	(Increase) $	Decrease %
Operations	**93.0**	87.2	(5.8)	(6.7%)
Maintenance	**25.0**	21.5	(3.5)	(16.3%)
Administration	**8.0**	12.2	4.2	34.4%
Cost of retail goods sold	**5.8**	5.7	(0.1)	(1.8%)
Amortization	**30.0**	27.0	(3.0)	(11.1%)
Total operating expenses	**161.8**	153.6	(8.2)	(5.3%)
Interest & other	**17.3**	13.3	(4.0)	(30.1%)
Total expenses	**179.1**	166.9	(12.2)	(7.3%)

The increase in operations costs reflects wage rate increases averaging about 3%, higher incentive compensation, increased operating costs of vessels used on the Northern Routes, extra early morning and late night sailings during the Olympics, advertising costs of new travel products and venue, and other miscellaneous cost increases.

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

Administration costs decreased from the same period in the prior year due to $3.6 million lower wages and benefits and reductions in discretionary expenditures. Wage costs in the fourth quarter of fiscal 2009 included a charge for $3.1 million in restructuring costs.

Amortization increased as a result of additional assets that came into service in fiscal 2010, including $2.1 million for the *Northern Expedition* which entered service in May 2009.

Interest expenses increased primarily due to $2.7 million lower capitalized interest reflecting the completion of our asset renewal program for the Major and Northern Routes and $0.4 million lower funding under the SFF program.

Investing in our Capital Assets

Capital expenditures in the three and twelve months ended March 31, 2010, totalled $30.4 million and $81.4 million, respectively. This level of expenditure reflects the significant reduction in our capital program compared to previous years. Total capital expenditures were:

March 31, 2010 ($ millions)	3 Months	12 Months
Capital expenditures		
New vessels, vessel upgrades and modifications	**12.3**	**28.3**
Terminal marine structures	**12.2**	**22.5**
Terminal and building upgrades and equipment	**0.6**	**15.1**
Information technology	**5.3**	**15.5**
Total capital expenditures	**30.4**	**81.4**

NEW VESSELS, VESSEL UPGRADES AND MODIFICATIONS

Capital expenditures for new vessels, vessel upgrades and vessel modifications in the three and twelve months ending March 31, 2010, included the following:

March 31, 2010 ($ millions)	3 Months	12 Months
New vessels, vessel upgrades and modifications		
Quinsam upgrade and betterment (Phase 2)	6.9	10.2
New northern vessel, the *Northern Expedition*	0.1	4.6
Sewage treatment upgrade program	1.6	3.9
Voyage Data Recorders and navigational aids and upgrade of vessel connectivity	0.4	1.8
Bow thruster replacement on the *Spirit of British Columbia*	0.9	1.7
Vessel security upgrades	–	1.3
Other projects	2.4	4.8
	12.3	28.3

The second and final phase of the upgrade and betterment of the *Quinsam* includes new lifesaving systems, new electrical switchboard and generators, new right-angle drives, upgrades to the engines, and various interior improvements. This phase ($12 million) of the project is expected to be complete by the end of the first quarter of fiscal 2011. In October 2009, we received approval for up to $1.0 million of interest rate support payments through the SFF program relating to the life extension of the *Quinsam* The first phase ($5 million) was completed in the prior fiscal year.

On April 13, 2010, we received approval for up to $1.8 million of additional interest rate support payments through the SFF program relating to the life extension of the *Quadra Queen II* expected to be completed in fiscal 2011.

On May 18, 2009, the new *Northern Expedition* made its inaugural voyage on our northern route through the Inside Passage from Port Hardy to Prince Rupert. This 150-metre vessel, which replaced the 43-year-old *Queen of Prince Rupert*, has 55 staterooms and has a capacity of up to 130 vehicles and 600 passengers. A $133 million contract with Flensburger Schiffbau-Gesellschaft to build this new vessel was signed in July 2006 and completed on schedule and on budget. The import duties and taxes on this contract total approximately $44 million while the import duties and taxes on the contract to build the *Coastal Renaissance*, the *Coastal Celebration* and the *Coastal Inspiration* were $99 million. We are seeking a remission of import duties and related GST of approximately $119 million on these contracts, but are uncertain as to the outcome of our applications.

Implementation of a multi-year sewage and waste water treatment program to upgrade 20 vessels and eight terminals for treatment of sewage generated by the vessels is underway. The program involves major modifications and upgrades to ensure that all vessels comply with new *Canada Shipping Act, 2001* sewage regulations, which will apply effective July 1, 2012. Wherever possible, the vessels will convey sewage to a terminal through pump-ashore infrastructure. In all other cases, the vessels will be fitted with compliant marine sanitation devices. We have received approval from the local government to connect the Swartz Bay terminal to their existing infrastructure and we are working with the remaining local governments to seek approval to pump effluent into their systems at our cost. Modification of the first two vessels, the *Skeena Queen* and the *Kwuna*, is complete. As part of the Federal government's Infrastructure Stimulus Fund program, we estimate we will receive $7.5 million to assist with sewage pump-ashore projects and other major terminal projects.

The two-year program to install Voyage Data Recorders and navigational aids and upgrade vessel connectivity is complete. The remaining few vessels will be completed as they undergo their planned refits.

TERMINAL MARINE STRUCTURES

Capital expenditures for terminal marine structures in the three and twelve months ending March 31, 2010, included the following:

Terminal marine structures ($ millions)

Terminal	Description	March 31, 2010 3 Months	March 31, 2010 12 Months
Tsawwassen	Major berth replacement and refurbishment	4.8	7.3
Quathiaski Cove	Replacement of ramp, wingwalls, towers and waiting shelter	3.5	3.8
Langdale	Replacement of wingwall	0.1	1.7
Fulford Harbour	Replacement of two dolphins and maintenance walkway	–	1.6
Tsawwassen	Restoration of the concrete transfer deck	0.8	1.5
Horseshoe Bay	Berth upgrades	0.9	1.0
Campbell River	Replacement of wingwalls and dolphins	0.7	0.7
Prince Rupert	Addition of a tie up dolphin for the *Northern Expedition*	–	0.6
Denman Island	Apron replacement and wingwall refurbishment	–	0.5
Skidegate	New pontoon, ramp, ramp abutment and two dolphins	–	0.5
Various	Other projects	1.4	3.3
		12.2	22.5

The $39 million replacement and refurbishment of one of the berths (Berth 4) at Tsawwassen terminal is a multi-year project to replace all 13 dolphins, the port wingwall and the lower ramp. The lower ramp will be replaced with a new multi-apron ramp with two-lane commercial vehicle capacity and the foundations and ramp supports will be upgraded and a new hydraulic lift system installed.

TERMINAL AND BUILDING UPGRADES AND EQUIPMENT

Capital expenditures for terminal and building upgrades and equipment in the three and twelve months ending March 31, 2010, included the following:

March 31, 2010 ($ millions)	3 Months	12 Months
Terminal and building upgrades and equipment		
Terminal security upgrades	0.8	8.6
Less: federal funding	(5.8)	(9.1)
Departure Bay terminal	0.8	5.7
Vehicles, machinery & equipment	1.6	4.1
Swartz Bay waste water program	0.9	1.3
Vacations centre	0.8	1.0
Other terminal projects	1.5	3.5
	0.6	15.1

At nine terminals, mainly serving our Major and Northern Routes, we continued our multi-year project to upgrade security. This project primarily involves fencing, gating, lighting, access controls, and closed circuit television, as well as upgrades to foot passenger ticketing areas and baggage screening. We expect to receive $9.1 million of federal funding through the Transport Canada Marine Security Contribution Program to help offset our costs of perimeter security, access control measures, and training. The program requires us to apply for reimbursement of 75% of the eligible costs of security enhancements on approved projects as capital expenditures are incurred. As of March 31, 2010, we had submitted claims for reimbursement of the full $9.1 million available to us of which $5.9 million was received. The remaining $3.2 million was approved for reimbursement.

At Departure Bay terminal, the new waiting room is complete and in use. Also, waste management facilities have been consolidated and employee parking has been expanded and paved. To complete this project, the holding compound and short-term parking will be expanded. This is a continuation of the master plan for improvements at this terminal that began last fiscal year and is expected to be completed in fiscal 2011.

The costs incurred for vehicles, machinery, and equipment include the purchase of five additional hostling units in the fourth quarter (20 for the year) to support our new drop-trailer service. These units will be used to move commercial trailers to and from our holding compounds. We also continued with our planned replacement of certain vehicles and baggage carts and replaced machinery at our shipyard.

As part of the multi-year sewage and waste water treatment program for treatment of sewage generated by the vessels, connection of Swartz Bay terminal to the existing municipal infrastructure has been completed.

Information Technology

Capital expenditures for information technology in the three and twelve months ending March 31, 2010, included the following:

March 31, 2010 ($ millions)	3 Months	12 Months
Information technology		
Enterprise resource planning upgrade	**1.3**	**5.6**
Network for the operations centre	**1.2**	**2.9**
IT hardware replacement program	**1.1**	**2.1**
Data privacy projects	**0.4**	**1.2**
Automated ticketing software	**0.3**	**0.9**
Other projects	**1.0**	**2.8**
	5.3	**15.5**

The most significant information technology project has been our enterprise resource planning system upgrade, which includes financial and related operating systems. The first and largest phase of this project was implemented on August 30, 2009. The second phase, which included enhancements to enable reporting under International Financial Reporting Standards (IFRS) has since been completed. This upgrade will provide future opportunities for operational improvements through its advanced functionality.

Our new operations and security centre went into service in May 2009. This project included video terminals, wall displays, cameras, and computer hardware and software that allow for real-time situational awareness and monitoring of fleet operations. Work on expanding the network for the centre has been completed.

During the year $1.2 million was spent as part of our ongoing initiatives to ensure the protection of privacy of our customers and others.

On December 1, 2009, we opened new self-ticketing kiosks at two of our major terminals. The self-ticketing system is designed to simplify and speed up the foot passenger ticketing process.

On December 17, 2009, we completed a website enhancement to allow our internet services to be more accessible to customers. Anyone using a handheld device with web connectivity can now view up-to-the-minute ferry travel information.

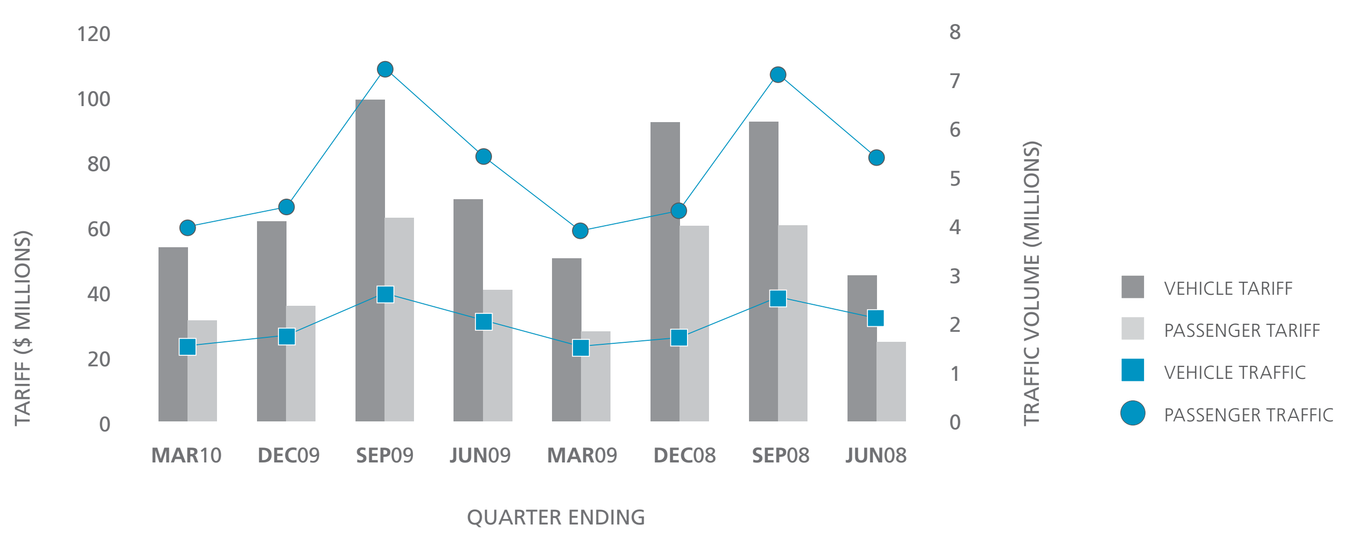
Summary of Quarterly Results

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

($ millions)	**Mar 10**	Dec 09	Sep 09	Jun 09	Mar 09	Dec 08	Sep 08	Jun 08
Quarter Ended (unaudited)								
Total revenue	**142.3**	159.9	251.8	178.3	128.5	149.4	232.1	171.9
(Loss) earnings from operations	**(19.5)**	(1.9)	81.5	12.2	(25.1)	(1.7)	66.2	18.4
Net (loss) earnings and comprehensive (loss) income	**(36.8)**	(20.4)	64.2	(3.6)	(38.4)	(14.6)	53.7	8.4

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

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



Outlook

TRAFFIC LEVELS

Ferry traffic levels are affected by a number of factors, including the economy, weather, transportation costs, the value of the Canadian dollar, global security, tourism levels, disposable personal income, demographics and population growth.

The Canadian economy experienced turbulence in the financial markets and a recessionary period in fiscal 2009. This had a negative impact on our operations. While our ridership had been stable over several years, we experienced a downturn in traffic in fiscal 2009 which was at least partly due to the economic conditions. In fiscal 2009, British Columbia experienced fewer housing starts, reduced tourism, plant closures in the forest product industry, falling auto sales, rising unemployment, and generally reduced consumer confidence. These and other declining economic conditions all negatively impacted our commercial and discretionary travel markets.

In fiscal 2010, our vehicle and passenger traffic levels increased by 1.5% over the prior year as world and local economies began to recover.

(thousands)	**2010**	2009	2008	2007	2006
Vehicle Traffic by fiscal year					
Major routes	**3,739.7**	3,696.3	3,912.3	3,826.5	3,790.4
Other routes	**4,484.6**	4,402.4	4,632.6	4,669.6	4,715.8
Northern routes	**31.1**	31.7	33.8	25.8	37.1
Total	**8,255.4**	8,130.4	8,578.7	8,521.9	8,543.3
Increase (decrease)	**1.5%**	(5.2%)	0.7%	(0.3%)	(0.2%)

(thousands)	**2010**	2009	2008	2007	2006
Passenger Traffic by fiscal year					
Major routes	**10,804.8**	10,664.2	11,304.0	11,146.3	11,055.9
Other routes	**10,142.6**	9,969.3	10,382.7	10,440.5	10,556.7
Northern routes	**88.2**	94.0	101.8	78.2	117.0
Total	**21,035.6**	20,727.5	21,778.5	21,665.0	21,729.6
Increase (decrease)	**1.5%**	(4.8%)	0.5%	(0.3%)	(1.3%)

The Bank of Canada, in its Monetary Policy Report dated April 2010, is projecting growth in the world economy of 4.2% (3.7% in Canada) in 2010 and 4.0% (3.1% in Canada) in 2011.

Over the near term we anticipate a limited recovery in discretionary traffic levels, and over the next few years we anticipate a modest increase in overall traffic volume on all our routes.

CABLE FERRY

We are continuing to review the feasibility of using cable ferry technology on one of our shortest routes with the expectation that this review will be complete in fiscal 2011. Cable ferry technology uses small engines in combination with drive and guide cables to move the vessel. Not only do cable ferries have a lower capital cost than conventional ferries, but there is also potential for a reduction in operating costs. It has been determined using a cable ferry is technically feasible, while detailed engineering and design work and a final cost assessment are required to determine if the concept is fully feasible. In addition, there are a number of regulatory and environmental issues that must be addressed before such a service could be implemented. Safety, reliability and quality of service will continue to be important considerations in the overall assessment of this concept. This initiative is part of our ongoing efforts to identify and pursue opportunities that have the potential to enhance our effectiveness in delivering safe, reliable, and quality ferry service.

OPERATING COST MANAGEMENT

In response to the decline in traffic levels and resulting revenues in fiscal 2009, we determined the need to restructure our business to align expenses with reduced revenues while continuing to ensure that safety remains our top priority. We continue to regularly review and update our financial and operating plans to ensure appropriate alignment of expenses with revenues.

MARKET OPPORTUNITIES

Notwithstanding the pressure on traffic volumes generally, we see opportunities for growth in certain segments of our business.

In March 2009, we launched our drop-trailer service on two of our Major Routes. Our commercial customers on these routes can now drop their trailers off at one terminal and pick them up at another. This drop-trailer service has been well received in the commercial market and improves our overall productivity by utilizing otherwise unused capacity. We expect to see slow growth in commercial traffic in the first half of fiscal 2011. Higher fuel prices and currency appreciation are expected to negatively impact lumber exports which will affect our business. We do expect to see some modest growth in the latter part of fiscal 2011 driven by an improvement of general economic conditions. We expect to see our overall commercial market share remain relatively stable.

On May 11, 2010, we officially opened our new vacations centre in downtown Vancouver. Using a 37-foot long interactive media wall display, customers are able to view route maps, vessel schematics, and destination images to help them choose from a variety of travel package options. The 2,675 square-foot travel centre in the new Fairmont Pacific Rim property is conveniently located to the tourist sector. Over 20 unique BC coastal vacation packages and more than 100 individual products that include extra hotel nights, activities and adventures are available for purchase at the centre, through our website or by telephone. We believe that this will expand our market reach and increase our profile in the Lower Mainland and within the tourism industry. This is expected to lead to increased traffic volumes as well as incremental non-tariff revenue.

We are constantly looking for innovative ways to serve our customers and have partnered with a local company to offer spa services on one of our Major Routes. This new service commenced May 13, 2010.

We have also expanded the number of cash dispensing machines available to our customers, as paying by debit card is not yet available on our vessels. We now have cash dispensing machines on all of our vessels and at all terminals on our Major Routes.

ALTERNATIVE SERVICE PROVIDERS

In an effort to reduce costs on our regulated routes and as mandated by the *Coastal Ferry Act*, we are exploring opportunities to have ferry services provided by additional or alternative service providers (ASP). While we maintain responsibility for the long-term delivery of ferry services, we are required to test the market to determine if another operator, under contract to us, could provide safe, reliable and high quality service that is more cost-effective.

We issued a Request for Proposal in June 2009 to identify a prospective ASP to provide service to the mid-coast ports of Ocean Falls and Shearwater on our Northern Routes. We performed an assessment of the responses received from the proponents and concluded that an ASP could provide the service on a more cost-effective basis. However, the Province was not in a position to confirm that we could proceed as per the Coastal Ferry Services Contract. Consequently, we cancelled this ASP initiative. We will continue to be the provider of the service to these ports, which is called for under the Coastal Ferry Services Contract.

ASSET RENEWAL PROGRAM

We have one of the largest fleets in the world. The average age of our assets was among the oldest of major ferry operators worldwide. To address this, we instituted a major fleet and asset renewal program. The recent additions to our fleet have been:

- the *Northern Adventure* and the *Kuper* in March 2007;
- the Super C-class vessels: the *Coastal Renaissance*, the *Coastal Inspiration*, and the *Coastal Celebration* in March, June, and November 2008, respectively;
- the *Island Sky* in February 2009; and
- the *Northern Expedition*, a northern vessel, in May 2009.

The entry of these vessels into service has reduced the average age of our vessels and completes the most significant portion of our asset renewal program.

Upgrading and replacing a large share of our fleet through new vessel acquisitions and our revitalization program also assists in maintaining operational reliability.

We continue to reinvest our cash generated from operations into our asset renewal program. The entry of these new assets into service has resulted in an increase in amortization and financing costs, causing a significant decrease in our earnings. This reduced level of earnings is expected to continue over the near term.

Our vessel replacement program is now complete for the Major and Northern Routes. Our capital expenditures over the next few years are expected to be significantly lower as we transition into more of a maintenance mode. Our next significant vessel renewal program will commence for the Other Routes within the next five years.

REGULATORY CHANGES

On April 29, 2010, the Province introduced legislation, *Bill 20*, to amend several statutes, including the *Coastal Ferry Act*. The amendments respond to the Comptroller General's Report on Review of Transportation Governance Models released November 6, 2009, and include changes to the governance and regulatory framework within which we operate.

The proposed changes impact a significant number of operational areas. We are currently evaluating what impact the changes could have on our results of operations and on our profitability. (See "Business Risk Management – Economic Regulatory Environment").

Financial Risks and Financial Instruments

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

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

CREDIT RISK

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

Our credit risk from trade customers is limited by having a large and diversified customer base and is managed through the review of third party credit reports, utilizing pre-authorized payment plans, monitoring of aging of receivables, and collecting deposits and adjusting credit terms for higher-risk customers. Amounts due from the Province and the Government of Canada are considered low credit risk. At March 31, 2010, 59% of our accounts receivable was comprised of amounts due from the Province and the Government of Canada.

LIQUIDITY RISK

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

We manage liquidity risk through daily monitoring of cash balances, the use of long-term forecasting models and the maintenance of debt service reserves. At March 31, 2010, DBRS assessed our credit rating as A and Standard & Poor's assessed our rating as A+, both with a stable trend.

MARKET RISK

Interest Rate

Our exposure to interest rate risk is limited to our short-term borrowings and floating rate debt and interest rate movement beyond the term of the maturity of fixed rate short-term investments. To manage this risk, we maintain between 70% and 100% of our debt portfolio in fixed rate debt, in aggregate. A 50 basis point change in interest rates would not have had a significant effect on our fiscal 2010 earnings.

Foreign Currency

We are also exposed to risk from foreign currency prices on financial instruments, such as accounts payable denominated in currencies other than the Canadian dollar. To manage exposure on future purchase commitments, we review our foreign currency denominated commitments and hedge through derivative instruments as necessary. A 10% change in the US dollar or Euro foreign exchange rates would not have had a significant effect on our fiscal 2010 earnings.

Fuel Price

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

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

High levels of fuel pricing could translate into significant fuel surcharges and result in unprecedented total tariff levels. There is uncertainty of the impact on future ferry traffic levels if fuel surcharges and therefore total tariff costs rise significantly. There is a risk of a decline in ferry traffic levels as a result of increasing customer costs resulting from the implementation of fuel surcharges. Throughout fiscal 2010, fuel rebates rather than surcharges were in place on many of our routes and further rebates were implemented on April 1, 2010. (See "Expenses – Deferred Fuel Cost Accounts" above for more detail).

We also may manage our exposure to fuel price volatility by entering into swap agreements in order to add a fixed component to the inherent floating nature of fuel prices. Fuel price hedging instruments are used solely for the purpose of reducing fuel price risk, not for generating trading profits. Our Commodity Risk Management Policy limits hedging to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period to March 31, 2011, and to a maximum of 90% of anticipated monthly fuel consumption for the 12 months thereafter to the end of the second performance term ending March 31, 2012. At March 31, 2010, we did not have any outstanding fuel swaps. Gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs.

Derivatives

We hedge our exposure to fluctuations in fuel prices and foreign currency exchange rates through the use of derivative instruments. At March 31, 2010, we had no derivative instruments in place while at March 31, 2009, we held 13 commodity fixed price swap instruments with both a carrying and fair value of $0.9 million.

The commodity derivatives fair value reflects only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel. These fair values reflect the estimated amounts that we would receive or pay should the derivative contracts be terminated at the stated dates. Any gains or losses related to fuel commodity swaps are charged to our deferred fuel cost accounts. At March 31, 2009, we recorded a payable of $0.9 million as the estimated loss to terminate the contracts as at that date.

Non-Derivative Financial Instruments

The carrying and fair values of non-derivative financial instruments at March 31, 2010, and 2009 are as follows:

($ millions)	2010 Carrying Value	2010 Fair Value	2009 Carrying Value	2009 Fair Value
Financial Assets				
Cash and cash equivalents	**10.6**	**10.6**	12.4	12.4
Restricted cash equivalents and short-term investments	**37.2**	**37.2**	37.2	37.2
Other short-term investments	**7.7**	**7.7**	0.2	0.2
Accounts receivable	**17.7**	**17.7**	13.2	13.2
	73.2	**73.2**	63.0	63.0
Financial Liabilities				
Accounts payable and accrued liabilities	**38.9**	**38.9**	41.8	41.8
Short-term debt	**–**	**–**	18.0	18.0
Interest payable on long-term debt	**18.3**	**18.3**	18.4	18.4
Accrued employee costs	**48.6**	**48.6**	51.9	51.9
Long-term debt, including current portion	**1,357.2**	**1,458.1**	1,365.2	1,344.0
Other long-term liabilities	**0.2**	**0.2**	0.2	0.2
	1,463.2	**1,564.1**	1,495.5	1474.3

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

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

Business Risk Management

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

As part of our risk management strategies, we have considered many items such as profitability levels, cash generating potential, cash utilization requirements including debt repayment schedules and future capital expenditures, and working capital requirements. We have taken measures to allow us to weather the economic downturn and we believe that we continue to have a viable future.

CUSTOMER DEMAND

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

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

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

SECURITY

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

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

Risk mitigation: Security initiatives are in place to counter intentional attacks. We opened our 24-hour operations and security centre in May 2009 to provide enhanced situational awareness and assessments, increased security monitoring, and a coordinated response during any incidents.

We are committed to our multi-year project to upgrade security at our terminals. This project primarily involves fencing, gating, lighting, access controls, and closed circuit television, as well as upgrades to foot passenger ticketing areas and baggage screening.

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

SAFETY

The safety of the public and our employees is our highest priority. However, there is a risk of compromised passenger or employee safety and/or property damage as a result of failure to meet regulatory requirements, mechanical failure, employee error, negligence and/or complacency.

We also have significant revenues from food sales, both on our vessels and at our terminals, and there is a risk of a food-borne illness contracted from consuming contaminated foods or beverages purchased from our food services.

An event of injury or illness could have a material adverse effect on our financial position and results of operations.

Risk mitigation: In fiscal 2007, we commissioned former BC Auditor General, George L. Morfitt to conduct an independent review of our safety policies, procedures and practices. We also plan to conduct a similar comprehensive operational safety review at a minimum of every five years as part of our ongoing commitment to ensuring the safety of our passengers and employees.

Some of the recommendations in the Morfitt report were put into practice in fiscal 2007 while others have been incorporated into our safety program, SailSafe, which was launched in fiscal 2008. SailSafe involves employees in identifying areas and methods for enhancing current safety practices and ensuring that safety is our first priority each and every day.

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

We also adhere to a program of internal and external safety audits designed to verify our compliance with our safety management system and have participated in a major multi-agency training exercise to test the coordinated response to a major marine disaster.

PERFORMANCE RISK

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

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

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

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

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

REGULATIONS – ENVIRONMENTAL

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

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

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

Risk mitigation: We will continue to comply with environmental laws and regulations and to actively develop strategies to help us become an industry leader in environmental management.

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

We have programs in place to protect the environment and reduce greenhouse gas emissions. Besides using biodegradable hydraulic oils, we recycle beverage containers, cardboard, newsprint, spent fluorescent tubes, batteries and used cooking oil. We have replaced chemical products with more environmentally friendly solutions and have replaced gasoline powered terminal vehicles with electric vehicles and gasoline powered baggage vans with propane powered tugger units.

We are also introducing new initiatives to further mitigate our environmental impact. Implementation of a multi-year sewage and waste water treatment program to upgrade 20 vessels and eight terminals for treatment of sewage generated by the vessels is underway. Wherever possible, the vessels will convey sewage to a terminal through pump-ashore infrastructure. In all other cases, the vessels will be fitted with compliant marine sanitation devices. (See "Investing in our Capital Assets" above for more detail).

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

ECONOMIC REGULATORY ENVIRONMENT

We cannot predict what changes the Province may make to the *Coastal Ferry Act* or to other legislation beyond those contained in *Bill 20*, nor can we predict how the present or future Commissioner's interpretation and administration of the *Coastal Ferry Act* may change over time. Such changes may impact our profitability. (See "Corporate Structure – Amendments to the *Coastal Ferry Act*" above regarding recent legislation).

The appointment term of the current Commissioner expires on June 30, 2010 and whether he will be re-appointed or replaced is unknown. We are currently developing our submission with respect to the third performance term price caps. This submission is due by law to the Commissioner by September 30, 2010. While there is inherent risk to any application to the Commissioner as to whether he will rule favourably, this risk is amplified by not knowing who the adjudicating Commissioner of this submission will be.

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

With respect to the expiring term of the Commissioner, the appointment term of the existing Deputy Commissioner does not expire until June 30, 2014, providing some continuity in the adjudication of our submission for the third performance term price caps.

REGULATIONS – OTHER

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

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

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

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

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

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

VESSEL REPAIR FACILITIES

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

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

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

Risk mitigation: We plan our vessel maintenance to maximize use of our vessel repair facility in Richmond. We are also developing a plan to upgrade the capabilities at our facility. Also, alternatives to using local facilities are being researched.

LABOUR RELATIONS – COLLECTIVE AGREEMENT

The majority of our employees are members of the BC Ferry & Marine Workers' Union. On March 8, 2007, a final award was released by arbitrator Vince Ready, building on the October 2004 interim award. This is expected to provide us with labour stability until the end of the term on October 31, 2012.

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

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

LABOUR RELATIONS – APPLICATION FOR EXCLUSIONS

We currently have an application in to Mr. Ready for the exclusion of several positions of authority onboard our vessels. Following an award by Mr. Ready, there is a risk that we are unable to implement in accordance with our desired timetable.

Risk mitigation: A comprehensive transition adjustment plan has been developed which provides for a gradual, phased implementation of the newly excluded positions over a longer timeframe so as to ensure the optimum retention of current staff and the orderly placement and orientation of staff into the new positions. This plan includes the assignment of leaders, employee mentors and a master overseer-ombudsperson.

TAXES

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

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

As the vast majority of ferry fares charged to our customers will be exempt from HST, we have limited opportunity to recover HST paid through input tax credits. The total effect of the upcoming HST on our financial position and results of operations is not yet known.

Risk mitigation: We will review and update our financial and operating plans in consideration of the increased costs resulting from the HST.

We have the opportunity to apply to the Commissioner under Section 42 of the *Coastal Ferry Act* for an extraordinary price cap increase if the introduction of new safety or other regulations imposes a new, unexpected and significant cost burden. We will also ensure that the impact of this tax is formally included in our submission respecting our third performance term price caps.

TREATY NEGOTIATIONS: ABORIGINAL RIGHTS AND TITLE

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

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

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

Accounting Practices

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

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

Workers' Compensation Claims Liability

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

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. In fiscal 2007 we received an actuarial valuation estimating that the unfinalized claims remaining to be paid at March 31, 2006, totalled $4.7 million. As a result we reduced the unfinalized claims liability and decreased expenses by $1.8 million during fiscal 2007. The remaining balance at March 31, 2010, of $1.7 million ($2.1 million at March 31, 2009) is included in accrued employee future benefits in our financial statements.

Public Service Pension Plan

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

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

Retirement Bonus Liability

We sponsor a plan that provides a post-retirement benefit for eligible long service employees. The valuation of this plan is estimated based on complex actuarial calculations using several assumptions. These assumptions are determined by management with significant input from our actuary. The valuation of the obligation depends on such assumptions as discount rate, projected salary increases, retirement age and termination rates. An actuarial valuation of the plan at March 31, 2007, was obtained and the accrued benefit obligation estimated at $13.4 million. The liability included in accrued employee future benefits in our financial statements at March 31, 2010, was $10.0 million ($10.4 million at March 31, 2009).

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 issues orders and generally involve the timing of revenue and expense recognition. The principles we follow ensure that the actions of the regulator, which create assets and liabilities, have been reflected in the financial statements.

The accounting for these items is based on an expectation of the future actions of the regulator. As of March 31, 2010, we have two regulatory assets or liabilities:

- Deferred fuel costs: the difference between amounts allowed by the regulator in operating expense and those actually incurred with settlement expected through future tariffs, surcharges or rebates;
- Performance term submission costs: costs for incremental contracted services relating to our second and third performance term submissions. Our regulator has approved recovery of the second performance term submission costs over the second performance term ending March 31, 2012, and recovery of the third performance term submission costs over the third performance term ending March 31, 2016.

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

Amortization Expense

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

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

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

Hedging Relationships

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

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

Asset Retirement Obligations

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

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

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

Adoption of New Accounting Standards

In fiscal 2010, we adopted the following CICA Handbook Sections:

- Effective April 1, 2009; section 3064, *Goodwill and Intangible Assets* did not substantively change the requirement pertaining to goodwill. The changes in requirements pertaining to intangible assets primarily relate to recognition criteria for purchased and internally developed assets which will result in fewer intangible assets being recognized on the balance sheet. Other than reclassifications and additional disclosure in Note 8, the adoption of this section has had no impact on our consolidated financial statements.

- Effective April 1, 2009; amendment to Section 1100 *Generally Accepted Accounting Principles* was adopted prospectively. With release of this amendment, a temporary exemption that permitted assets and liabilities arising from rate regulation to be recognized and measured on a basis other than in accordance with the primary sources of generally accepted accounting principles was removed.

  As no specific guidance is provided in Canadian GAAP, we may consult other sources and, have determined that our regulatory assets and liabilities qualify for recognition under Canadian GAAP consistent with US Statement of Financial Accounting Standard Board's Accounting Standards Codification Topic 980 "Regulated Operations". Therefore, the adoption of this amendment has had no impact on our consolidated financial statements.

- In June 2009, amendments were issued to Section 3862, *Financial Instruments – Disclosures*. The amendments require additional disclosure regarding the fair value measurement of financial instruments and enhanced disclosure of liquidity risk. Other than the additional disclosures in Notes 1(h) and 3, the adoption of these amendments has had no impact on our consolidated financial statements.

Future Accounting Changes

The following is a discussion of accounting changes that will be effective for us in future periods:

- In 2006, the Canadian Accounting Standards Board (AcSB) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian generally accepted accounting principles with IFRS over an expected five year transitional period. Our transition date for the conversion to IFRS is April 1, 2011, and will require the restatement for comparative purposes of amounts reported by us for the year ended March 31, 2011. We are continuing to assess the financial reporting impacts of the adoption of IFRS and are monitoring ongoing standards development as issued by the International Accounting Standards Board and the AcSB as well as regulatory developments as issued by the Canadian Securities Administrators, which may affect the timing, nature or disclosure relating to our adoption of IFRS.

  The transition to IFRS may materially affect our reported financial position and results of operations. As our analysis is still underway and accounting policy choices, as well as exemptions under *IFRS 1 First-Time Adoption of IFRS* (IFRS 1), have not yet been selected, we are unable to quantify the impact of IFRS on the future financial position and results of operations.

  We commenced our IFRS transition project in 2007 and have established a formal project governance structure with regular reporting. We have also engaged a quality assurance advisor to assist in the project.

  Our IFRS transition project consists of three phases:

  1. Scoping and diagnostic phase, which has been completed, involved project planning and resourcing, high level impact assessment of differences between current Canadian GAAP and IFRS, and priority setting;

  2. Analysis and development phase which involves detailed analysis and evaluation of options and alternative methodologies available under IFRS, and the financial impact of these options; and

3. Implementation and review phase which involves implementing and approving changes to accounting policies, information systems, business processes and training, and developing IFRS-compliant financial statements.

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

The following table includes elements of our IFRS transition plan and an assessment of progress towards achieving the key milestones. We are working through a detailed IFRS transition plan and certain project activities and milestones could change. Further, changes in regulation or timing of standard development throughout the project could result in changes to the transition plan.

Financial Statement Preparation

KEY ACTIVITIES

- Identify differences in Canadian GAAP/IFRS accounting policies
- Select ongoing IFRS policies
- Develop financial statement format
- Select IFRS 1 exemptions for transition
- Quantify effects of change at April 1, 2010 (for fiscal 2011 comparative financial statements)

MILESTONES

- Senior management review of policy decisions and illustrative IFRS financial statements and disclosures by June 30, 2010
- Audit & Finance Committee approval of policy decisions and IFRS financial statement format, in principle, by September 30, 2010
- IFRS 1 exemptions finalized and quantified by September 30, 2010
- Policies and procedures in place by March 31, 2011

STATUS

- Scoping and diagnostic phase completed in fiscal 2009, with high-level review of the major differences between Canadian GAAP and IFRS
- Highest areas of impact identified; review prioritized; and in-depth analysis complete in most areas
- Accounting policy alternatives have been analyzed, recommendations made for the majority of key accounting policy decisions
- IFRS 1 exemptions reviewed and analyzed with the exception of the IFRS 1 amendment published May 6, 2010, regarding property, plant and equipment and intangible assets used in operations subject to rate regulation
- Preparation of illustrative financial statements and note disclosures substantially complete
- Drafting of policies and procedures in progress

Information Technology Infrastructure

KEY ACTIVITIES

- Confirm system upgrades required for IFRS reporting
- Review/revise data gathering processes
- Review/revise budgeting and forecasting processes

MILESTONES

- System configuration changes complete by March 31, 2010
- System reporting changes required to accommodate both current Canadian GAAP and IFRS complete by August 31, 2010
- Changes to budgeting and forecasting processes complete by September 30, 2010

STATUS

- Detailed reporting requirements to accommodate the transition to IFRS identified and documented
- Overall system approach selected
- System configuration to accommodate both current Canadian GAAP and IFRS complete
- Changes to accommodate reporting requirements in progress
- Changes to budgeting and forecasting processes in progress

Training, Education & Communication

KEY ACTIVITIES

- Determine required level of IFRS expertise within all areas of the company
- Ensure appropriate training of key members within Finance
- Provide appropriate education and communication to affected departments
- Provide department specific training on revised policies and procedures
- Provide timely communication to both internal and external stakeholders on impacts of the transition to IFRS

MILESTONES

- Topic-specific training for IFRS working committee complete prior to March 31, 2010
- Department-specific training completed by March 31, 2011
- Impacts of transition to IFRS communicated to external stakeholders by March 31, 2011

STATUS

- Core IFRS project team members completed topic-specific training, and successfully completed the "IFRS Award Program, Certificate Level" through the Institute of Chartered Accountants in England and Wales
- Interdepartmental workshops provided on specific topics, including property, plant and equipment; IFRS 1; and the IFRS Framework
- Training requirements identified and training plan developed as implementation plans progress
- Ongoing communications with key stakeholders, including direct communication with the Commissioner, our Agent Bank, rating agencies, our Board of Directors, and with investors indirectly through our website

Control Environment

KEY ACTIVITIES

- Accounting policy determination, documentation and implementation
- MD&A ongoing communications

MILESTONES

- All internal control process descriptions updated by March 31, 2011
- Publish quantitative effects of conversion on April 1, 2010 opening balance sheet in December 31, 2010 MD&A (assuming decisions regarding regulatory assets and liabilities are known)

STATUS

- Analysis of control issues in progress as part of the detailed implementation plan
- Documentation of policies and procedures in progress

Business Policy Assessment

KEY ACTIVITIES

- Financial covenants assessment
- Compensation arrangements assessment
- Customer and supplier contract evaluation

MILESTONES

- Potential impact on compensation arrangements determined by December 31, 2010
- Impact on customer/supplier contracts determined by December 31, 2010
- Impact on financial covenants quantified by March 31, 2011

STATUS

- All relevant GAAP-dependent covenants and contracts have been identified
- Analysis to determine effects of IFRS on existing covenants and contracts in progress

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

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

  On July 23, 2009, the IASB published an Exposure Draft "Rate-regulated Activities" (ED) to define regulatory assets and regulatory liabilities, set out criteria for their recognition, specify how they should be measured and require disclosures about their financial effects. We reviewed this ED and responded to the IASB requesting clarification of scope as defined in the ED. More than 150 comment letters with significantly differing comments and views were received by the IASB.

  At its February 2010 meeting, the IASB began discussions on the responses to the ED. They also discussed the logistical considerations impacting the rate-regulated activities project and reviewed the potential paths forward including a project timetable prepared by its staff. The IASB did not make any tentative decisions on specific aspects of the project, except to tentatively finalize an amendment to IFRS 1 to provide transition relief for first-time adopters. This amendment was published on May 6, 2010. It provides an exemption for property, plant and equipment and intangible assets used in operations subject to rate regulation. A first-time adopter may elect to use, on an item by item basis, the previous GAAP carrying amount of such items as deemed cost at the date of transition to IFRS. We are currently assessing the impact of the options available to us as a result of this IFRS 1 amendment.

  The IASB directed the staff to continue its research and analysis on this project and to focus on the key issue of whether regulatory assets and liabilities exist in accordance with the current Framework for the Preparation and Presentation of Financial Statements and whether they are consistent with other current IFRS standards.

  The IASB plans to continue its deliberation of this project at a future meeting and expects to issue a new standard by the end of June, 2011.

  The continued uncertainty regarding IFRS treatment of regulatory assets and liabilities has resulted in an inability to reasonably estimate and conclude the impact of IFRS on our future financial position and results of operations with respect to differences, if any, in accounting for rate-regulated activities.

- Property, plant and equipment:

  - **Inspections and major overhauls:** The capitalization of inspections and major overhauls of our vessels is the largest change affecting us. A process to track these items has been finalized and necessary system configuration changes have been completed. We are currently in the process of:

    - defining and identifying inspection and major overhaul items for each class of vessel;
    - quantifying those inspections and major overhauls for reclassification of property, plant and equipment at transition date; and
    - determining the best solution for reporting of these costs.

    As the analysis is in progress, the effect on our consolidated financial statements of the adoption of this guidance cannot be quantified at this time.

- **Valuation subsequent to transition:** We have a choice under IFRS to value our property, plant and equipment using either a historical cost model or a revaluation model. We plan to defer this decision until we have completed our impact assessment of the recently published IFRS 1 amendment discussed above.

- *IFRS 1 First-Time Adoption of IFRS*: With the exception of the May 2010 amendment, which provides transition relief for rate-regulated entities, the elections and exemptions under IFRS 1 have been reviewed. The exemptions that are expected to apply to us upon adoption are summarized as follows:

  - **Employee Benefits:** There is a choice to either recognize all cumulative actuarial gains and losses of defined benefit plans through opening retained earnings or recalculate the actuarial gains and losses under IFRS from the inception of the defined benefit plans. We have elected to recognize all cumulative actuarial gains and losses through opening retained earnings at April 1, 2010.

  - **Property, plant and equipment and Intangible assets:** There is a choice of valuation of property, plant and equipment and intangible assets at April 1, 2010, either to retrospectively apply IFRS to the valuation of the assets or to revalue items, on an asset by asset basis, at fair value and use that fair value as deemed cost. The IFRS 1 amendment published May 6, 2010, provides a further option to use previous GAAP carrying amounts at transition as the deemed cost for assets used in rate-regulated operations. We are continuing with our review and analysis of the available options.

As actuarial valuations of our defined benefit plans at April 1, 2010 have not yet been completed and the amendment relating to rate-regulated entities has not yet been fully reviewed, the effect on our consolidated financial statements of the adoption of IFRS 1 cannot be quantified at this time.

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

- Asset impairment: We are currently defining indications of impairment. Processes to track any asset impairment and potential subsequent reversals have been determined. The adoption of this guidance is not expected to have any significant effect on our consolidated financial statements.

Corporate Structure and Governance

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

Forward Looking Statements

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

Forward looking statements included in this document include statements with respect to our short and long-range business plans, estimates of future customer demand, asset renewal programs for vessels and terminals, vessel maintenance plans, expectations regarding how our cash requirements will be met, and expectations regarding the impacts of *Bill 20* and IFRS. In some cases, forward looking statements can be identified by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue" or the negative of these terms or other comparable terminology. A number of factors could cause actual events or results to differ materially from the results discussed in the forward looking statements. In evaluating these statements, prospective investors should specifically consider various factors including, but not limited to, the risks and uncertainties associated with customer demand, safety and security, accident risk, tax risk, environmental risk, regulatory risk, labour disruption risk, limitations of vessel repair facilities, risk of default under material contracts and aboriginal land claims.

Actual results may differ materially from any forward looking statement. Although management believes that the forward looking statements contained in this management's discussion and analysis are based upon reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward looking statements. These forward looking statements are made as of the date of this management's discussion and analysis, and British Columbia Ferry Services Inc. assumes no obligation to update or revise them to reflect new events or circumstances except as may be required by applicable law.

Schedule A

CORPORATE STRUCTURE AND GOVERNANCE
BOARD OF DIRECTORS

The Board has responsibility for the stewardship of British Columbia Ferry Services Inc. (BCF or the Company) by overseeing the conduct of the business, supervising management, which is responsible for the day-to-day conduct of the business, and endeavouring to ensure that all major issues affecting the business and affairs of the Company are given proper consideration.

At March 31, 2010, the Board was comprised of the following directors:

Chair: Elizabeth J. Harrison, Q.C.

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

Effective April 1, 2010, Donald P. Hayes became Chair of the Board and Mark L. Cullen ceased to be a director of the Board.

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

Subsequent to March 31, 2010, the Province introduced legislation amending the *Coastal Ferry Act*, which includes changes to the governance structure of the B.C. Ferry Authority (BCFA) and the Company. This is discussed further below.

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

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

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

The recruitment of directors is undertaken with the objective of ensuring the Board is composed of a majority of strong, qualified, independent directors. The Board supports the concept that the role of the Board Chair is separate from that of the President & CEO and that the Board Chair should be an independent director. These principles are reflected in the Board Governance Manual.

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

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

Mr. David L. Hahn, President & CEO, is the only director who is a member of management of the Company. By virtue of his being a member of management, Mr. Hahn is not independent. The other directors of the Company, including the Chair of the Board, have been determined by the Board to be independent pursuant to the definition of independence adopted by the Board.

DIRECTORSHIPS

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

Brian G. Kenning:
Director, MacDonald Dettwiler & Associates Inc.

Jane L. Peverett:
Director, Canadian Imperial Bank of Commerce
Director, EnCana Corporation
Director, Northwest Natural Gas Company

Graham M. Wilson:
Director, ITRON Inc.
Director, Naikun Wind Energy Group Inc.
Director, Daylight Energy Limited
Trustee, Hardwoods Distribution Income Trust

ORIENTATION AND CONTINUING EDUCATION

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

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

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

ETHICAL BUSINESS CONDUCT

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

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

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

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

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

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

NOMINATION OF DIRECTORS

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

Each year, the skill sets and experience of the incumbents and any retiring directors of BCF are reviewed by the Governance & Nominating Committee in the context of the skills and experience profile adopted by the BCF Board and the ongoing governance needs of BCF. Any gaps are identified. Potential conflicts of interest and other extenuating circumstances are also identified.

The Governance & Nominating Committee makes recommendations to the BCF Board of Directors on suitable candidates for appointment to the BCF Board. These recommendations take into account the talents of the existing BCF Board, and the talents of all nominees, taking the skills and experience profile established for BCF directors into account.

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

COMPENSATION

Each year, the Governance & Nominating Committee reviews the compensation of directors, and the Human Resources & Compensation Committee reviews the compensation of the President & CEO and members of executive management. The Committees engage an external compensation advisor to research and provide independent advice on the level and types of compensation for directors, the President & CEO, and members of executive management. In making their recommendations to the Board, the Committees take into account the types of compensation and the amounts paid by other comparable companies.

BOARD COMMITTEES

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

Audit & Finance Committee:

Voting members at March 31, 2010:
Chair: Graham M. Wilson

Members: Christopher C. Gardner, Donald P. Hayes, Brian G. Kenning, and Stephen E. Smith

Voting members effective April 1, 2010:
Chair: Brian G. Kenning

Members: Christopher C. Gardner, Elizabeth J. Harrison, and Graham Wilson

The Audit & Finance 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 the Company's management have established;
- monitor the management of the principal risks that could impact the financial reporting of the Company, and the Company's compliance with legal and regulatory requirements as they relate to the Company's financial statements;
- review and approve the audit plan, process, results, and performance of the Company's External Auditors and the Internal Audit department (the Internal Auditor) while providing an open avenue of communication between the Board, Management, External Auditors, and the Internal Auditor; and
- assess the qualifications and independence of the External Auditors, and recommend to the Board the nominations of the External Auditors and the compensation to be paid to the External Auditors.

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

Each of the members of the Committee has been determined by the Board 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 judgment.

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

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

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

External Auditor Billings

Year ended March 31 (thousands)	2010	2009
Audit and audit related	**151.3**	136.7
Tax services	**4.5**	2.0
All other fees		
Advisory services (IFRS and environmental pre-assessment)	**44.1**	32.1
	199.9	170.8

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

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

Safety, Health, Environment & Security Committee:

Voting members at March 31, 2010:

Chair: A. Daniel Miller

Members: Holly A. Haston-Grant, Donald P. Hayes, Gordon R. Larkin, and Wayne H. Stoilen

Voting members effective April 1, 2010:

Chair: Wayne H. Stoilen

Members: Holly A. Haston-Grant, Gordon R. Larkin, and Stephen E. Smith

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

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

Governance & Nominating Committee:

Voting members at March 31, 2010:

Chair: Brian G. Kenning

Members: Mark L. Cullen, Christopher C. Gardner, Holly A. Haston-Grant, Gordon R. Larkin, Jane L. Peverett, and Graham M. Wilson

Voting members effective April 1, 2010:

Chair: A. Daniel Miller

Members: Christopher C. Gardner, Elizabeth J. Harrison, Holly A. Haston-Grant, Brian G. Kenning, and Jane L. Peverett

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

- review, assess, and make recommendations regarding the effectiveness of the policies and practices of the Board;
- ensure the Board's continuing ability to fulfill its legislative mandate;
- implement effective due diligence over the operations of the Company;
- ensure that the Board of BCF is comprised of Board members that collectively and individually have the skills, experience, and backgrounds to appropriately lead the organization;
- establish and implement effective processes for identifying and recommending suitable candidates for appointment as directors of BCF; and
- review and recommend the compensation plan for directors.

Human Resources & Compensation Committee:
Voting members at March 31, 2010:
Chair: Mark L. Cullen

Members: Brian G. Kenning, A. Daniel Miller, Jane L. Peverett, Stephen E. Smith, and Wayne H. Stoilen

Voting members effective April 1, 2010:
Chair: Jane L. Peverett

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

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

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

ASSESSMENTS

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

The Governance & Nominating Committee annually reviews and makes recommendations to the Board on the method and content for annual evaluations.

The Board has engaged an independent governance consultant to coordinate the evaluation. The evaluation undertaken in the year ended March 31, 2010, involved individual discussions between each director and the consultant on matters related to Board effectiveness. The consultant presented the results of the evaluation, together with recommendations for action to the Board. The Board will consider the recommendations in the upcoming year.

The Board also regularly assesses the performance of individual directors. This occurs through discussions between the individual directors and the Board Chair.

GOVERNMENT REVIEW

On April 29, 2010, the Province introduced legislation *(Bill 20 - Miscellaneous Statutes Amendment Act (No.3), 2010)* to amend several statutes, including the *Coastal Ferry Act*. The amendments respond to the Comptroller General's Report on Review of Transportation Governance Models, released November 6, 2009. *Bill 20* sets out changes to the governance and regulatory framework within which BCFA and BCF operate. The governance changes include: a broadening of the mandate of BCFA to include responsibility for the compensation plans for the directors and certain executive officers of BCF, such compensation plans to be comparable to public sector organizations; and, a requirement that effective September 30, 2010, a director of BCFA cannot also be a director of BCF. Changes to the General Bylaws of BCFA and the Articles of BCF will be required should the legislative amendments be brought into force, and the existing directors of BCF will be replaced on September 30, 2010.

Management's Report

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 that 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.

DAVID L. HAHN
President & Chief Executive Officer

ROBERT P. CLARKE
Executive Vice President & Chief Financial Officer

Victoria, Canada
May 15, 2010

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, 2010 and 2009 and the consolidated statements of earnings, comprehensive income 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, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

CHARTERED ACCOUNTANTS
Victoria, Canada

May 12, 2010

Consolidated Financial Statements

British Columbia Ferry Services Inc.

CONSOLIDATED BALANCE SHEETS (EXPRESSED IN THOUSANDS)

As at March 31	2010	2009
Assets		
Current assets:		
Cash and cash equivalents	$ 10,608	$ 12,402
Restricted cash equivalents and short-term investments (note 2(e))	37,240	37,240
Other short-term investments	7,678	153
Accounts receivable (note 4(a))	17,707	13,181
Prepaid expenses	6,813	8,132
Inventories	18,040	16,835
Regulatory assets (note 6)	4,775	4,775
	102,861	92,718
Property, plant and equipment (note 7)	1,644,069	1,683,576
Intangible assets (note 8)	26,406	19,866
Assets held for sale (note 9)	200	435
Regulatory assets (note 6)	–	11,687
Long-term land lease (note 10)	33,437	33,896
	$ 1,806,973	$ 1,842,178
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 38,884	$ 41,825
Short-term debt (note 2(d))	–	17,956
Interest payable on long-term debt	18,319	18,395
Accrued employee costs	48,644	51,923
Deferred revenue	16,023	15,409
Derivative liabilities (note 4 (c))	–	923
Regulatory liabilities (note 6)	–	2,858
Current portion of long-term debt (note 2)	9,000	9,000
Current portion of accrued employee future benefits (note 11)	800	800
Current portion of obligations under capital lease (note 12)	398	541
	132,068	159,630
Accrued employee future benefits (note 11)	11,130	12,047
Regulatory liabilities (note 6)	4,325	–
Long-term debt (note 2)	1,348,183	1,356,239
Obligations under capital lease (note 12)	139	537
Other long-term liabilities	172	153
	1,496,017	1,528,606
Shareholders' equity:		
Share capital (note 13)	75,478	75,478
Retained earnings	235,478	238,094
	310,956	313,572
Commitments (notes 7 and 18)		
Contingent liabilities (notes 1(t) and 20)		
Subsequent event (note 22)		
	$ 1,806,973	$ 1,842,178

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Director, Donald P. Hayes

Director, Brian G. Kenning

CONSOLIDATED STATEMENTS OF EARNINGS, COMPREHENSIVE INCOME AND RETAINED EARNINGS (EXPRESSED IN THOUSANDS)

Years ended March 31	2010	2009
Revenue:		
Tariffs (note 14)	$ **450,508**	$ 429,063
Ferry service fees (note 15)	**149,507**	124,485
Federal-Provincial Subsidy Agreement (note 16)	**26,924**	26,294
Retail	**80,809**	78,060
Other income	**24,557**	23,898
	732,305	681,800
Expenses:		
Operations	**398,792**	387,782
Maintenance	**85,579**	77,124
Administration	**30,330**	37,220
Cost of retail goods sold	**30,127**	28,929
Amortization	**115,175**	93,088
	660,003	624,143
Earnings from operations	**72,302**	57,657
Gain on foreign exchange	**144**	244
Interest expense (note 17)	**(67,638)**	(50,111)
(Loss) gain on disposal and impairment of capital assets (notes 7 and 9)	**(1,386)**	1,239
Net earnings	**3,422**	9,029
Other comprehensive income (note 1(v))	**–**	–
Net earnings and comprehensive income	**3,422**	9,029
Retained earnings, beginning of year	**238,094**	235,103
Preferred share dividend (note 13)	**(6,038)**	(6,038)
Retained earnings, end of year	$ **235,478**	$ 238,094

See accompanying notes to consolidated financial statements.

Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS (EXPRESSED IN THOUSANDS)

Years ended March 31	2010	2009
Cash provided by (used in):		
Operations:		
Net earnings	**$ 3,422**	$ 9,029
Items not involving cash:		
Amortization	**115,175**	93,088
Other non-cash charges	**1,854**	(289)
Long-term regulatory costs deferred	**10,314**	(6,039)
Change in non-cash operating working capital (note 21)	**(9,468)**	(6,783)
	121,297	89,006
Financing:		
Dividends paid on preferred shares	**(6,038)**	(6,038)
Proceeds from issuance of bonds and other long-term debt	**–**	338,000
Debt service reserves	**–**	(8,170)
Repayment of long-term debt	**(9,000)**	–
(Repayment of) proceeds from short-term loans	**(17,956)**	17,956
Repayment of capital lease obligations	**(541)**	(775)
Deferred financing costs incurred	**–**	(1,704)
	(33,535)	339,269
Investing:		
Proceeds from disposal of property, plant and equipment	**2,135**	1,697
Purchase of property, plant and equipment and intangible assets	**(84,166)**	(530,713)
Increase in lands under long-term lease	**–**	(5,083)
(Purchase of) proceeds from other short-term investments	**(7,525)**	1,897
	(89,556)	(532,202)
(Decrease) in cash and cash equivalents	**(1,794)**	(103,927)
Cash and cash equivalents, beginning of year	**12,402**	116,329
Cash and cash equivalents, end of year	**$ 10,608**	$ 12,402

Supplemental cash flow information (note 21)

See accompanying notes to consolidated financial statements.

YEARS ENDED MARCH 31, 2010 AND 2009
(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 B.C. Ferry Authority (the "Authority"), a corporation without share capital, and it is regulated by the British Columbia Ferries Commissioner (the "Commissioner") to ensure that rates are fair and reasonable and to monitor service levels.

1. SIGNIFICANT ACCOUNTING POLICIES:

(a) Basis of presentation:

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and include the accounts of the Company and its wholly owned subsidiaries, Pacific Marine Leasing Inc. ("PML"), BCF Captive Insurance Company Ltd. ("BCF Captive"), Pacific Marine Ventures Inc. ("PMV"), and BCF Global Services Inc. ("Global"). All inter-company balances and transactions have been eliminated on consolidation.

(b) Adoption of new accounting standards:

Goodwill and Intangible Assets:
Effective April 1, 2009, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3064 "*Goodwill and Intangible Assets*" which replaces Sections 3062 and 3450. This section establishes standards for the recognition, measurement and disclosure of goodwill and other intangible assets and requires retrospective application. As a result, the Company has reclassified the net book value of certain computer software and license costs. As at March 31, 2009, the net book value of intangible assets was increased by $19.9 million and the net book value of property, plant and equipment was reduced by $19.9 million. Other than these reclassifications and the disclosures included in note 8, there has been no significant impact on the Company's consolidated financial statements from the adoption of this section.

Rate-regulated operations:
Effective for the Company April 1, 2009, the CICA removed a temporary exemption in Section 1100, "*Generally Accepted Accounting Principles*", of the CICA Handbook. This exemption had provided relief to those entities subject to rate regulation from the requirement to apply the Section to the recognition and measurement of assets and liabilities arising from rate regulation by permitting them to be recognized and measured on a basis other than in accordance with the primary sources of Canadian GAAP.

The assets and liabilities arising from rate-regulation as described in Note 6 do not have specific guidance under a primary source of Canadian GAAP. In such instances and when developing accounting policies, the Company may consult other sources including pronouncements issued by bodies authorized to issue accounting standards in other jurisdictions. The Company has determined that its regulatory assets and liabilities qualify for recognition under Canadian GAAP consistent with US Financial Accounting Standard Board's Accounting Standards Codification Topic 980 "Regulated Operations". Therefore, there was no effect on the Company's consolidated financial statements as a result of the removal of the temporary exemption in Section 1100.

Financial instruments:
In June 2009, the CICA issued amendments to Section 3862, "*Financial Instruments – Disclosures*", of the CICA Handbook. The amendments require additional disclosure about the fair value measurement of financial instruments and enhanced liquidity risk disclosures. These disclosures have been included in notes 1(h) and 3.

(c) Future accounting changes:

International Financial Reporting Standards ("IFRS"):
The Company's transition date for the conversion to IFRS will be April 1, 2011, and will require the restatement for comparative purposes of amounts reported by the Company for the year ending March 31, 2011. While the Company is continuing to assess the adoption of IFRS, the financial reporting impact of the transition cannot be reasonably estimated at this time.

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

On July 23, 2009, the IASB issued an exposure draft ("ED") addressing rate-regulated activities. The ED proposes new standards which define regulatory assets and regulatory liabilities, sets out criteria for their recognition, specifies how they should be measured and requires disclosures about their financial effect. The Company reviewed the ED and responded to the IASB requesting clarification of scope as defined in the ED. More than 150 comment letters with significantly differing comments and views were received by the IASB.

At its February 2010 meeting, the IASB began discussions on the responses to the ED. They also discussed the logistical considerations impacting the rate-regulated activities project and reviewed the potential paths forward including a project timetable prepared by its staff. The IASB did not make any tentative decisions on specific aspects of the project, except to tentatively finalize an amendment to IFRS 1 to provide transition relief for first-time adopters. This amendment was issued in May 2010 and is currently being assessed by the Company. The IASB directed the staff to continue its research and analysis on this project and to focus on the key issue of whether regulatory assets and liabilities exist in accordance with the current Framework for the Preparation and Presentation of Financial Statements and whether they are consistent with other current IFRS standards.

The IASB plans to continue its deliberation of this project at a future meeting and expects to issue a new standard by the end of June 2011.

The continued uncertainty regarding IFRS treatment of regulatory assets and liabilities has resulted in an inability to reasonably estimate and conclude the impact of IFRS on the Company's future financial position and results of operations with respect to differences, if any, in accounting for rate-regulated activities.

(d) Regulation:

The Company is regulated by the Commissioner to ensure that tariffs are fair and reasonable and to monitor service levels. 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 regulatory assets and regulatory liabilities in the financial statements.

The Company follows Accounting Guideline 19 "*Disclosures by Entities Subject to Rate Regulation*" (AcG-19) of the CICA Handbook which establishes guidelines on certain aspects of the disclosure and presentation of information in the financial statements of entities subject to rate regulation. AcG-19 requires the disclosure of general information regarding the nature and economic effects of rate regulation, as well as additional information on how rate regulation has affected the financial statements (note 6). The guideline does not address recognition and measurement issues associated with the accounting for rate-regulated operations.

(e) Cash and cash equivalents:

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

(f) Short-term investments:

Short-term investments consist of financial instruments with original maturity dates greater than three months and less than a year.

(g) Inventories:

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

(h) Financial instruments:

The Company establishes the classification of financial instruments at their initial recognition. Financial assets are classified as held-for-trading, available for sale, held to maturity, or loans and receivables. Financial liabilities are classified as held for trading or other liabilities.

All financial instruments, including derivatives, are included on the consolidated balance sheet and are initially measured at fair value. Subsequent measurement and recognition of changes in fair value of financial instruments depends on their initial classification. Held for trading financial instruments are measured at fair value and all gains and losses are included in net income in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in other comprehensive income until the asset is removed from the balance sheet at which time the cumulative gain or loss previously reported in other comprehensive income is recognized in net earnings. Loans and receivables, investments held-to-maturity and other financial liabilities are initially measured at fair value and are subsequently measured at amortized cost. Derivative instruments are recorded as either assets or liabilities measured at their fair value unless exempted from derivative treatment as a normal purchase and sale.

In estimating fair value, the Company uses quoted market prices when available. Models incorporating observable market data along with transaction specific factors are also used in estimating fair value. Financial assets and liabilities are classified in the fair value hierarchy according to the lowest level of observability of inputs that are significant to the fair value measurement. Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect placement within the following fair value hierarchy levels:

- level 1 – quoted prices in active markets for identical assets or liabilities,
- level 2 – techniques (other than quoted prices included in Level 1) that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices), and
- level 3 – techniques which use inputs which have a significant effect on recorded fair values for the asset or liability that are not based on observable market data (unobservable inputs).

(i) Embedded derivatives:

As at March 31, 2010, the Company has no embedded derivatives that meet the requirements of Section 3855 which would require that they be separated from host contracts and valued separately at fair value.

(j) 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. At the inception of each hedge the company determines whether it will or will not apply hedge accounting.

When applying hedge accounting, 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 recognized in the period in which they have been terminated or cease to be effective.

(k) Property, plant and equipment:

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 their estimated useful lives at the following rates:

Asset class	Estimated useful life
Ship hulls	40 years
Ship propulsion and utility systems	20 to 30 years
Marine structures	20 to 40 years
Buildings	20 to 40 years
Equipment and other	3 to 20 years

(l) Intangible assets:
The costs of acquired computer software and licenses as well as internally developed computer software and website are capitalized. These intangible assets are valued at their acquisition cost plus direct overhead and financing costs, less amortization. Intangible assets are amortized on a straight-line basis over their estimated useful lives of 3 to 5 years.

(m) 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.

(n) Revenue recognition:
Tariff revenue is recognized when transportation is provided. The value of pre-sold fare media is included in the balance sheets as deferred revenue. Ferry service fees are recorded when service is provided.

(o) Pension and other employee future benefit plans:
Defined contribution plan accounting is applied to the Company's multi-employer defined benefit pension and long-term disability plans. These multi-employer plans are administered by external parties and the Company does not have sufficient 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 per cent 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 was 7.1 years as at March 31, 2007, the date of the most recent actuarial valuation.

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.

(p) 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 sale, the economic life of capital assets and the corresponding periods of amortization, the recoverability of capital assets, the valuation of employee future benefits, and provisions for contingencies. Actual results could differ from these estimates.

(q) 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.

The provision of vehicle and passenger ferry services is an exempt supply under the *Excise Tax Act* for GST purposes.

(r) 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 period in which they arise.

(s) Debt transaction costs:

Legal and financing costs incurred for long-term debt arranged for are capitalized. Once the debt is issued these costs are reclassified from deferred costs to long-term debt which is measured using the effective interest rate method.

(t) Asset retirement obligations:

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

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.

The Company's long-lived assets include certain vessels which contain undetermined amounts of asbestos. Under certain circumstances the Company may be required to handle and dispose of the asbestos in a manner required by regulations. It is the Company's intention to sell decommissioned vessels into world markets for continued use in providing commercial ferry service. Under these circumstances asbestos remediation would become the responsibility of the new owner.

No amount has been recorded for asset retirement obligations relating to these assets as it is not possible to make a reasonable estimate of the fair value of any such liability due to the indeterminate magnitude, likelihood or financial impact, if any, of this issue.

(u) Interest rate support:

The Company receives interest rate support from the Government of Canada for eligible new Canadian built vessels or major refurbishment of vessels. Amounts receivable in regard to capitalized interest are recognized as a reduction of capitalized interest upon completion of the project. Amounts receivable in regard to post-completion debt service costs are recognized as a reduction to interest expense.

(v) Comprehensive income:

The Company has not recognized any adjustments through other comprehensive income for the years ended March 31, 2010 and 2009.

(w) Comparative figures:

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

2. LOANS:

As at March 31	2010	2009
5.74% Senior Secured Bonds, Series 04-1, due May 2014 (effective interest rate 5.92%) (a)	**$ 250,000**	$ 250,000
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (effective interest rate 6.41%) (a)	**250,000**	250,000
5.02% Senior Secured Bonds, Series 07-1, due March 2037 (effective interest rate 5.06%) (a)	**250,000**	250,000
5.58% Senior Secured Bonds, Series 08-1, due January 2038 (effective interest rate 5.62%) (a)	**200,000**	200,000
6.21% Senior Secured Bonds, Series 08-2, due December 2013 (effective interest rate 6.33%) (a)	**140,000**	140,000
12 Year Loan, maturing March 2020 (b)		
Tranche A (effective interest rate 5.17%)	**75,000**	82,500
Tranche B (floating interest rate of CAD LIBOR plus 30 bps)	**15,000**	7,500
12 Year Loan, maturing June 2020 (b)		
Tranche A (effective interest rate 5.18%)	**76,875**	84,375
Tranche B (floating interest rate of CAD LIBOR plus 30 bps)	**13,125**	5,625
2.95% Loan, maturing January 2021(effective interest rate 3.08%) (c)	**99,000**	108,000
	1,369,000	1,378,000
Less: Deferred financing costs and unamortized bond discounts	**(11,817)**	(12,761)
Current portion	**(9,000)**	(9,000)
	$ 1,348,183	$ 1,356,239

Principal repayments due in the next five years are:

Year ended	
2011	$ 9,000
2012	22,125
2013	24,000
2014	164,000
2015	274,000
Thereafter	875,875
	$ 1,369,000

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.

The Company has issued five bond series of obligation bonds under the master trust indenture and entered into a credit facility agreement. In addition, the Company has entered into loan agreements which provided $288 million to partially finance the Company's purchase of two Super 'C' class vessels and one northern vessel. These funds were released to coincide with the conditional acceptance of the vessels in February 2008, May 2008 and January 2009.

(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. The following table shows the semi-annual interest payment dates for the obligation bonds each year through to maturity.

Bonds	Interest payment dates	
Series 04–1	May 27	November 27
Series 04–4	April 13	October 13
Series 07–1	March 20	September 20
Series 08–1	January 11	July 11
Series 08–2	December 19	June 19

(b) 12 Year Loans:

Proceeds of $90.0 million were received in each of February 2008 and May 2008 for the partial financing of the purchase of the *Coastal Inspiration* and the *Coastal Celebration* to coincide with conditional acceptance of these vessels from the shipyard. Quarterly payments are due in March, June, September and December each year of the term of the loans.

These loan agreements defer the principal payments for the first three years to a second tranche on which interest only (at floating rates) is paid quarterly and the principal is paid at the end of the term. These floating rates can change from time to time, depending upon Standard & Poor's rating of the Company.

(c) 2.95% Loan:
Proceeds of $108.0 million were received in January 2009 and applied toward the purchase of the *Northern Expedition* to coincide with conditional acceptance from the shipyard. Equal semi-annual principal payments plus interest are due in January and July each year of the 12 year term of the loan.

(d) Credit facility:
The Company has a credit facility with a syndicate of Canadian banks, secured by pledged bonds. This revolving facility, in the amount of $155.0 million, matures May 12, 2013. Draws on this facility totalled $nil as at March 31, 2010 (2009: $18.0 million), and are shown as short-term debt at their discounted value. Interest expensed during the year ended March 31, 2010, was $0.1 million (2009: $0.5 million). In addition, letters of credit outstanding against this facility at March 31, 2010, totalled $0.3 million (2009: $0.2 million).

(e) Debt service reserves:
The Company is required to maintain debt service reserves for the Series 04-1, 04-4, 07-1, 08-1 and 08-2 bonds equal to not less than six months forecasted debt service, to be increased under certain conditions. Further debt service reserves are required to be maintained for the 4.98% and 2.95% loans equal to the first six months of debt service.

As at March 31, 2010, debt service reserves of $37.2 million were held in short-term investments and have been classified as restricted cash equivalents and short-term investments on the balance sheet (2009: $37.2 million held in cash and cash equivalents).

3. FINANCIAL INSTRUMENTS:

The carrying and fair values of the Company's financial instruments are as follows:

	2010		2009	
As at March 31	**Carrying Value**	**Approx Fair Value**	Carrying Value	Approx Fair Value
Available for sale[1]				
Cash	**$ 1,617**	**$ 1,617**	$ 3,910	$ 3,910
Held for trading[2]				
Other cash equivalents	**8,991**	**8,991**	6,494	6,494
Restricted short-term investments	**37,240**	**37,240**	–	–
Derivative assets	–	–	–	–
Derivative liabilities	–	–	923	923
Held-to-maturity[3]				
Investments with maturities < 3 months	–	–	1,998	1,998
Restricted cash equivalents	–	–	37,240	37,240
Other short-term investments	**7,678**	**7,678**	153	153
Loans and receivables[3]				
Accounts receivable	**17,707**	**17,707**	13,181	13,181
Other financial liabilities[3]				
Accounts payable and accrued liabilities	**38,884**	**38,884**	41,825	41,825
Short-term debt	–	–	17,956	17,956
Interest payable on long-term debt	**18,319**	**18,319**	18,395	18,395
Accrued employee costs	**48,644**	**48,644**	51,923	51,923
Long-term debt, including current portion[4,5]	**1,357,183**	**1,458,074**	1,365,239	1,344,065
Other long-term liabilities	**172**	**172**	153	153

1 Measured at fair value with revaluation gains and losses included in other comprehensive income until the asset is removed from the balance sheet. Due to the nature of this financial instrument, carrying value approximates fair value.

2 Measured at fair value with all gains and losses included in net earnings in the period in which they arise. Fair values for the derivative liabilities have been estimated using period-end market rates. These fair values approximate the amount that the Company would pay to settle the contract at March 31.

3 Measured at amortized cost. Due to the nature of these financial instruments and/or short-term maturity of these financial instruments, carrying value approximates amortized fair value except as noted.

4 Carrying value is measured at amortized cost using the effective interest rate method.

5 Fair value is calculated by discounting the future cash flows of each debt issue at the estimated yield to maturity for the same or similar issues at March 31, 2010, or by using available quoted market prices.

3. FINANCIAL INSTRUMENTS (continued):

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

At March 31, 2010, all available for sale and held for trading financial instruments are classified as level 1 in the fair value hierarchy with quoted prices in active markets.

During the year ended March 31, 2010, no profits resulting from the use of valuation techniques used to measure level 2 or 3 instruments in the fair value hierarchy (i.e. those with no active market price) have been recognized.

The Company may use derivative instruments to hedge its exposure to fluctuations in fuel prices and foreign currency exchange rates. The fair value of commodity derivatives reflects only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel. These fair values reflect the estimated amounts that the Company would receive or pay should the derivative contracts be terminated at the stated dates. Any gains or losses related to fuel commodity swaps are charged to the Company's deferred fuel cost accounts.

4. FINANCIAL RISK MANAGEMENT:

Exposure to credit risk, liquidity risk, and market risk arises in the normal course of the Company's business. The Company manages market risk arising from the volatility in foreign currency, interest rate, and fuel price exposures in part through the use of derivative financial instruments including forward contracts, swaps and options. The Company does not utilize derivative financial instruments for trading or speculative purposes. At the inception of each hedge the Company determines whether it will or will not apply hedge accounting. No hedges have been designated under Section 3865 – "*Hedges*" at March 31, 2010 and 2009.

(a) Credit risk:

Credit risk is the risk that a third party to a financial instrument might fail to meet its obligations under the terms of the financial instrument. For cash and cash equivalents, short-term investments, and accounts receivable the Company's credit risk is limited to the carrying value on the balance sheet. Management does not believe that the Company is subject to any significant concentration of credit risk.

The Company limits its exposure to credit risk on cash and cash equivalents and short-term investments by investing in liquid securities with high credit-quality counter-parties, placing limits on tenor of investment instruments and instituting maximum investment values per counter-party.

Accounts receivable by source are as follows:

March 31, 2010		
Trade customers and miscellaneous	39.4%	$ 6,978
Federal and Provincial governments	59.4%	10,510
Counter-parties	1.2%	219
Total	100.0%	$ 17,707

Accounts receivable from trade customers are primarily due from commercial customers and transportation operators. Credit risk is reduced by a large and diversified customer base and is managed through the review of third party credit reports on customers both before extending credit and during the business relationship. The Company manages its exposure to credit risk associated with all customers through the monitoring of aging of receivables, by collecting deposits from and adjusting credit terms for higher-risk customers and customers who are not on a pre-authorized payment plan. Amounts due from tickets sold to passengers through the use of major credit cards are settled shortly after sale and are classified as cash and cash equivalents on the balance sheet.

Accounts receivable from trade customers are generally due in 30 days. At March 31, 2010, 93% of trade receivables are current. At March 31, 2010, the provision for impairment of credit losses was $0.1 million (2009: $0.3 million) and reflects management's estimate of uncollectible receivables from trade customers based on past experience and analysis of customer accounts.

Amounts due from the Government of Canada and the Province of British Columbia (the "Province") are considered low credit risk.

The Company is exposed to credit risk in the event that a counter-party in a derivative contract defaults on its obligation, including fuel commodity swaps and foreign exchange forward contracts. The Company manages the credit exposure related to financial instruments by dealing with high credit-quality institutions, in accordance with established credit-approval practices, and by an ongoing review of its exposure to counter-parties. Counter-party credit rating and exposures are monitored by management on an ongoing basis, and are subject to approved credit limits. The counter-parties with which the Company has significant derivative transactions must be rated single A or higher. The Company does not expect any counter-parties to default on their obligations.

4. FINANCIAL RISK MANAGEMENT (continued):

(b) Liquidity risk:

Liquidity risk is the risk that an entity will not be able to meet its obligations associated with its financial liabilities. The Company's financial position could be adversely affected if it fails to arrange sufficient and cost-effective financing to fund, among other things, capital expenditures and the repayment of maturing debt. The ability to arrange sufficient and cost-effective financing is subject to numerous factors, including the results of operations and financial position of the Company, conditions in the capital and bank credit markets, ratings assigned by rating agencies and general economic conditions.

The Company manages liquidity risk through daily monitoring of cash balances, the use of long-term forecasting models and the maintenance of debt service reserves (note 2). The Company targets a strong investment-grade credit rating to maintain capital market access at reasonable interest rates. As at March 31, 2010, the Company's credit ratings were as follows:

	DBRS	Standard & Poor's
British Columbia Ferry Services Inc.:		
Senior secured long-term debt	A (March 31, 2009: A low)	A+ (March 31, 2009: A-)

The following is an analysis of the contractual maturities of the Company's financial liabilities as at March 31, 2010.

Financial liabilities	< 1 year	2-3 years	4-5 years	> 5 years	Total
Accounts payable and accrued liabilities	$ 38,884	$ –	$ –	$ –	$ 38,884
Interest payable on long-term debt	18,319	–	–	–	18,319
Accrued employee costs	48,644	–	–	–	48,644
Obligations under capital lease, including current portion	398	139	–	–	537
Long-term debt, including current portion (excluding deferred costs)[1]	9,000	46,125	438,000	875,875	1,369,000
Other long-term liabilities	–	172	–	–	172
	$ 115,245	$ 46,436	$ 438,000	$ 875,875	$ 1,475,556

1 Carrying value at March 31, 2010, is net of unamortized deferred financing costs of $11.8 million.

(c) Market risk:

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates, foreign currency prices or fuel prices.

Interest rate risk:

The Company is exposed to interest rate risk associated with short-term borrowings and floating rate debt. The Company's cash equivalents and short-term investments include fixed rate instruments with maturities of 185 days or less. Accordingly, the Company has exposure to interest rate movement that occurs beyond the term of the maturity of the fixed rate investments. The Company's credit facility and the second tranche of each of the two 4.98% long-term loans are at variable rates and are subject to interest rate risk. To manage this risk, the Company maintains between 70% and 100% of its debt portfolio in fixed rate debt, in aggregate. Additionally, the Company may enter into interest rate agreements to manage its exposure on debt instruments. As at March 31, 2010, the Company has no interest rate agreements in place to offset interest rate risk and had approximately two per cent of total debt in variable rate instruments. A 50 basis point change in interest rates would not have had a significant effect on earnings for the twelve months ended March 31, 2010.

Foreign currency price risk:

The Company is exposed to risk from foreign currency prices on financial instruments, such as accounts payable and future purchase commitments denominated in currencies other than the Canadian dollar. To manage exposure on future purchase commitments, the Company reviews foreign currency denominated commitments and hedges through derivative instruments as necessary. As at March 31, 2010, the Company has no foreign currency forward contracts (2009: nil). A 10 per cent change in foreign exchange rates would not have had a significant effect on earnings for the twelve months ended March 31, 2010.

Fuel price risk:

The Company is exposed to risks associated with changes in the market price of marine diesel fuel. The Company may manage its exposure to 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. Fuel price hedging instruments are used solely for the purpose of reducing fuel price risk, not for generating trading profits. Gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs. Pursuant to the Company's Commodity Risk Management Policy, the term of the contracts is not to extend beyond March 31, 2012. This policy limits hedging, to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period to March 31, 2011, and to a maximum of 90% of anticipated monthly fuel consumption for the 12 month period thereafter to March 31, 2012.

The Company is also allowed by regulatory order to use deferred fuel cost accounts to mitigate the impact of changes in fuel price on its earnings. Any differences between the per litre cost of fuel purchased and consumed (including hedge gains or losses) and the per litre cost of fuel included in the determination of price caps for the second performance term (note 6) are:

i) for those routes comprising the Northern Route Group;

   a. one-half of the first 5 cents per litre of difference is recorded in expense for the period with the remaining one-half of the first 5 cents per litre of difference recorded in deferral accounts for recovery or settlement through future tariffs to customers (note 6(a)), and

   b. any difference beyond 5 cents per litre is recorded in accounts receivable or payable for subsequent recovery from or payment to the Province, and

ii) for all other routes;

   a. one-half of the first 5 cents per litre of difference is recorded in expense for the period with all remaining differences per litre recorded in deferral accounts for recovery or settlement through future tariffs to customers (note 6(a)).

As a result of the use of deferred fuel cost accounts, the maximum effect on earnings from a change in fuel prices would be approximately $3.0 million.

During the year ended March 31, 2010, the amounts payable to the Province in relation to fuel cost differences totalled $1.3 million (2009: $2.4 million recoverable from the Province).

5. CAPITAL MANAGEMENT:

The Company's principal business of ferry transportation requires ongoing access to capital in order to fund operations, satisfy outstanding long-term debt obligations and fulfill future capital asset acquisition obligations. In order to ensure capital market access is maintained, the Company targets maintaining strong investment grade credit ratings (note 4(b)).

The capital structure of the Company is presented in the following table:

	March 31, 2010		March 31, 2009	
	$	**%**	$	%
Aggregate borrowings[1]	**1,524,537**	**83.04**	1,534,078	83.01
Shareholders' equity[2]	**311,281**	**16.96**	313,876	16.99
Total capital	**1,835,818**	**100.00**	1,847,954	100.00

1 Includes long-term debt, including current portion, credit facility (drawn and undrawn) and short-term borrowings.
2 Excludes undesignated subsidiaries, PMV and Global.

The Company has covenants restricting the issuance of additional debt, distributions to shareholders, and guarantees and investments. Incurrence of additional debt and distributions are restricted when aggregate borrowings exceed 85 per cent of the Company's total capital, while guarantees and investments are restricted at 75 per cent. Debt service coverage (earnings before interest, taxes, depreciation, amortization, and rent) must be at least 1.5 times the debt service cost and the Company is required to maintain debt service reserves (notes 2 and 4). In addition to these restrictions and requirements, there are other covenants contained in the Master Trust Indenture (May 2004) available at www.SEDAR.com. The Company was in compliance with all of its covenants throughout the years ended March 31, 2010 and 2009.

6. FINANCIAL STATEMENT EFFECT OF RATE REGULATION:

The Company is regulated by the Commissioner to ensure that tariffs are fair and reasonable and to monitor service levels. Under the terms of the Act, the tariffs the Company charges its customers are subject to price caps. The Commissioner may, under certain circumstances, allow increases in price caps over the set levels. The Commissioner has set price caps for the four year term through March 31, 2012 (the "second performance term"), and will establish the price caps to apply for each subsequent term.

The accounting for regulated operations of the Company differs from non-regulated businesses following GAAP. The Company records assets and liabilities that result from the regulated price cap setting process that would not be recorded under GAAP for non-regulated entities. Regulatory assets generally represent incurred costs that have been deferred because they are probable of future recovery in tariffs. Regulatory liabilities represent obligations to customers which will be settled through future tariff reductions. Management continually assesses whether the regulatory assets are probable of future recovery by considering factors such as applicable regulatory changes and believes the existing regulatory assets are probable of recovery. This determination reflects the current regulatory climate and is subject to change in the future. If future recovery of costs ceases to be probable, asset write-offs would be required to be recognized in the current period earnings at that time.

If the Company was not a rate-regulated entity and did not record regulatory assets and liabilities, net earnings for the year ended March 31, 2010, would have been $13.2 million higher (2009: $21.5 million lower) as detailed below:

As at March 31		2010		2009
Impact of regulatory accounts on net earnings				
First performance term accounts:				
Deferred fuel costs (a)	$	**(4,625)**	$	(4,625)
Performance term submission costs (b)		**(150)**		(150)
Second performance term accounts:				
Deferred fuel costs (a)		**(11,321)**		8,733
Performance term submission costs (b)		**84**		–
Hedge gains (losses) – vessel construction contracts (c)		**–**		16,833
Tariffs in excess of price cap (d)		**2,858**		700
Total (decrease) increase in net earnings	$	**(13,154)**	$	21,491

6. FINANCIAL STATEMENT EFFECT OF RATE REGULATION (continued):

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

As at March 31		2010		2009
Regulatory accounts				
First performance term accounts:				
Balance at March 31, 2008:				
Deferred fuel costs (a)	$	**18,501**	$	18,501
Performance term submission costs (b)		**600**		600
		19,101		19,101
Accumulated amortization		**(9,550)**		(4,775)
		9,551		14,326
Current portion (asset)		**(4,775)**		(4,775)
Long-term portion of first performance term accounts		**4,776**		9,551
Second performance term accounts:				
Deferred fuel costs (a)				
Balance – beginning of year		**1,213**		(4,826)
Fuel costs deferred (including realized hedge gains and losses)		**(16,082)**		26,761
Rebates granted		**6,298**		494
Surcharges collected		**–**		(17,025)
Fuel price risk payments to (recoveries from) the Province (note 4 (c))		**1,273**		(2,429)
Other payments from the Province		**(1,620)**		(1,684)
Interest payable		**(267)**		(78)
Balance – end of year		**(9,185)**		1,213
Unrealized fuel hedge losses (gains) (a)		**–**		923
Performance term submission costs (b)		**84**		–
Long-term portion of second performance term accounts		**(9,101)**		2,136
Total long-term regulatory (liabilities) assets	$	**(4,325)**	$	11,687
Regulatory liabilities – current				
Tariffs in excess of price cap (d) – current	$	**–**	$	2,858

(a) Deferred fuel costs:

As prescribed by regulatory order, the Company defers differences between actual fuel costs and approved fuel costs which were used to develop the regulated price caps. The difference between the approved fuel costs and the actual fuel costs (including fuel hedge gains and losses) is deferred for settlement in future tariffs. Also prescribed by regulatory order, the Company collects fuel surcharges or provides fuel rebates from time to time which are applied against deferred fuel cost account balances and has included interest in the amount to be recovered from or returned to customers.

The Commissioner has considered $18.5 million of unrecovered deferred fuel costs in the determination of the price caps set for the second performance term beginning April 1, 2008, and it is expected that recovery will occur over this four year period. Accordingly, this $18.5 million will be amortized to expense on a straight-line basis over the term. The difference between the balances in the deferred fuel cost accounts at March 31, 2008 and this $18.5 million, a $6.6 million credit, forms the opening balances of the fuel cost deferral accounts for the second performance term.

During the year ended March 31, 2010, the Province agreed to pay $1.6 million, to be applied against the balance of deferred fuel costs (2009: $1.7 million).

During the year ended March 31, 2010, the Company recognized $4.6 million in amortization expense for deferred fuel costs (2009: $4.6 million).

It is expected that the recovery or settlement period of balances in the second performance term deferred fuel cost accounts will be the remaining period of the term ending March 31, 2012.

Unrealized hedge gains or losses result from the use of forward contracts to fix the price of future fuel purchases and are valued on a mark-to-market basis as at the balance sheet date. Section 3855 "*Financial Instruments – Recognition and Measurement*" requires that these financial instruments be valued at fair value and recognized in the consolidated financial statements.

(b) Performance term submission costs:

The Commissioner has authorized the Company to defer costs of representation associated with the second and third performance terms. The Commissioner has considered, or will consider, these costs in the determination of the price caps set for the four years beginning April 1, 2008, and for the four years beginning April 1, 2012. The Commissioner has not included an allowance for a return on investment for the second performance term submission costs. The recovery periods will be the four year period of the second performance term, commencing April 1, 2008 and the four year period of the third performance term, commencing April 1, 2012.

(c) Hedge gains or losses – vessel construction contracts:

The Company defers gains or losses on financial derivative instruments which have been entered into to manage market risk against fluctuations in the Canadian dollar equivalent of vessel construction contracts denominated in foreign currencies. The intent and effect of these transactions is to provide greater certainty of the cost of the related new vessel acquisitions. The total cost of these assets, including hedge gains or losses, has been determined by the Commissioner to be reasonable and will be taken into account in the determination of price caps set for the periods following the entry of these assets into service. It is expected that the settlement or recovery period of hedge gains or losses is five to forty years. The Company did not have any such hedge gains or losses related to vessel construction contracts during the twelve months ended March 31, 2010

(d) Tariffs in excess of price cap:

The Act contains provisions which ensure that if tariffs charged by the Company exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. At March 31, 2010, tariffs charged to customers on all route groups were below established price caps. At March 31, 2009, tariffs charged to customers on the Major Route Group exceeded the price cap by $2.9 million.

7. PROPERTY, PLANT AND EQUIPMENT:

March 31, 2010	**Cost**	**Accumulated amortization**	**Net book value**
Property, plant and equipment			
Vessels	**$ 1,772,870**	**$ 554,304**	**$ 1,218,566**
Berths, buildings and equipment	**91,957**	**51,722**	**40,235**
Berths, buildings and equipment under capital lease	**598,154**	**256,822**	**341,332**
Land	**1,406**	**–**	**1,406**
Construction-in-progress	**42,530**	**–**	**42,530**
	$ 2,506,917	**$ 862,848**	**$ 1,644,069**

March 31, 2009	Cost	Accumulated amortization	Net book value
Property, plant and equipment			
Vessels	$ 1,568,702	$ 533,714	$ 1,034,988
Berths, buildings and equipment	76,962	50,081	26,881
Berths, buildings and equipment under capital lease	586,149	240,967	345,182
Land	1,406	–	1,406
Construction-in-progress	275,119	–	275,119
	$ 2,508,338	$ 824,762	$ 1,683,576

Capitalized financing costs during construction for property, plant and equipment and intangible assets for the year ended March 31, 2010, totalled $2.8 million (2009: $14.3 million). Amortization expense for assets under capital lease for the year ended March 31, 2010, totalled $18.3 million (2009: $16.2 million).

In addition to the construction-in-progress referenced above, the contractual commitments at March 31, 2010 for capital assets to be constructed, totalled $25.6 million (2009: $11.9 million).

During the year ended March 31, 2010, the Company disposed of a surplus parcel of land adjacent to its ship repair facility in Richmond, B.C. and a gain of $1.8 million was recognized.

The Government of Canada, through the Marine Security Contribution Program, has agreed to provide funding to help offset the costs of improving security at certain of our terminals. The Company expects to receive a total of $9.1 million under this program. This amount has been recorded as a reduction of property, plant and equipment during the year ended March 31, 2010 (2009: nil).

During the year ended March 31, 2010, the Company received $0.9 million (2009: $0.7 million) of rental income earned from buildings held for leasing purposes. These buildings have a cost and accumulated amortization of $13.5 million and $1.3 million respectively, as at March 31, 2010.

8. INTANGIBLE ASSETS:

March 31, 2010		**Cost**		**Accumulated amortization**		**Net book value**
Intangible assets subject to amortization						
Acquired software and licenses	$	**28,812**	$	**16,810**	$	**12,002**
Internally developed software and website		**22,531**		**14,831**		**7,700**
Work in progress		**6,704**		**–**		**6,704**
	$	**58,047**	$	**31,641**	$	**26,406**

March 31, 2009		Cost		Accumulated amortization		Net book value
Intangible assets subject to amortization						
Acquired software and licenses	$	28,949	$	23,562	$	5,387
Internally developed software and website		20,864		12,768		8,096
Work in progress		6,383		–		6,383
	$	56,196	$	36,330	$	19,866

There was no impairment of intangible assets during the year ended March 31, 2010, or the year ended March 31, 2009.

Included in the cost of intangible assets as at March 31, 2010, is $0.7 million of unamortized training costs (2009: $0.7 million). If the Company was not a regulated entity, these training costs would be expensed in the period incurred.

During the year ended March 31, 2010, intangible assets totalling $10.2 million (2009: $4.3 million) were acquired and $2.4 million (2009: $6.2 million) were internally developed. During this same period intangible assets with a cost and accumulated amortization of $11.0 million were retired (2009: $nil). Amortization expense for the year ended March 31, 2010 totalled $6.3 million (2009: $5.8 million).

9. ASSETS HELD FOR SALE:

During the year ended March 31, 2010, in accordance with the Company's business plan to upgrade or replace aging assets, the *Queen of Prince Rupert* and the *Queen of Vancouver* were decommissioned. The *Queen of Prince Rupert* is held for sale as at March 31, 2010. This vessel and its related spare parts and inventories was written down by $1.4 million to reflect estimated fair values less costs to sell. The *Queen of Vancouver* and the *Queen of Saanich* (decommissioned during the year ended March 31, 2009) were sold during the year ended March 31, 2010, resulting in a loss on disposal of $1.5 million.

10. 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.

Since April 1, 2003, the Company has entered into various agreements with BCTFA to add lands to the existing terminal leases. During the year ended March 31, 2010, the cost of lands added to the terminal leases totalled $nil (2009: $5.1 million).

11. 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.

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 multi-employer 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.

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, 2010, consisting of cash contributed by the Company to its multi-employer 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 $25.5 million (2009: $23.4 million).

(c) Defined benefit plans:

All of the Company's defined benefit plans, except its multi-employer plans, are currently unfunded. The most recent actuarial valuation of the retirement bonus and death benefit plans is as at March 31, 2007. A plan amendment at December 31, 2007 restricts exempt employees from joining the retirement bonus and death benefit plans. This has resulted in a negative past service cost which is being amortized over the average remaining service period of the active employee group covered by the plans commencing January 1, 2008. The most recent actuarial valuations of the WCB obligation and the Sick Bank obligation are as at March 31, 2006 and March 31, 2001, respectively.

Other benefit plans	2010	2009
Accrued benefit obligations		
Balance, beginning of year	$ **14,104**	$ 15,079
Current service cost	**527**	511
Interest cost	**636**	673
Benefits paid	**(2,011)**	(2,155)
Actuarial gains	**(35)**	(4)
Balance, end of year	$ **13,221**	$ 14,104

11. ACCRUED EMPLOYEE FUTURE BENEFITS (continued):

(c) Defined benefit plans (continued):

Other benefit plans	2010	2009
Reconciliation of funded status of the benefit plans to the amounts recorded in the financial statements		
Fair value of plan assets	$ –	$ –
Accrued benefit obligation	13,221	14,104
Funded status of plans – deficit	(13,221)	(14,104)
Unamortized net actuarial loss	2,273	2,443
Unamortized plan amendment – past service cost	(982)	(1,186)
Accrued benefit liability	(11,930)	(12,847)
Current portion of accrued employee future benefits	800	800
Accrued employee future benefits	$ (11,130)	$ (12,047)

Other benefit plans	2010	2009
Elements of defined benefit costs recognized in the year		
Current service cost, net of employee contributions	527	511
Interest cost	636	673
Actuarial losses	135	202
Plan amendments	(204)	(204)
Defined benefit costs recognized	$ 1,094	$ 1,182

Significant assumptions

The significant assumptions used are as follows (weighted average):	2010	2009
Accrued benefit obligation as of March 31:		
Discount rate	5.1%	5.1%
Rate of compensation increase	2.0%	2.0%
Annual employee retention rate	92.0%	92.0%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%
Benefit cost for years ended March 31:		
Discount rate	5.1%	5.1%
Rate of compensation increase	2.0%	2.0%
Annual employee retention rate	92.0%	92.0%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%

(d) Multi-employer plans:

The total cost recognized for the Company's multi-employer plans is as follows:	2010	2009
Public Service Pension Plan contributions (i)	$ 18,907	$ 18,289
Long-term disability plan contributions	4,626	2,966
Long-term disability plan amortization of surplus (ii)	64	64
	$ 23,597	$ 21,319

i) The March 31, 2008 actuarial valuation report for the Public Service Pension Plan was received by the Public Service Pension Board of Trustees on December 3, 2008. This report indicated that the pension fund has a surplus of $487 million. Under the terms of the plan's joint trust agreement, plan members and employers share in any increase or decrease in contribution rates. The plan trustees have increased the member and employer contribution rates to the basic account from 7.63% to 7.78% of pensionable earnings effective April 1, 2009, primarily due to changes in the investment return and salary increase assumptions. The contribution rates to the inflation adjustment account remain unchanged for members and employers at 1.5% and 2.5% respectively. The next valuation will be as at March 31, 2011.

ii) Contribution rates for the long-term disability plan are actuarially determined every three years as a percentage of covered payroll. The most recent valuation, as at March 31, 2008, determined a fund deficit. To address this deficit the employer contribution rate was increased from 1.81% to 2.87% of covered payroll effective April 1, 2009, and further increased to 3.09% of covered payroll effective April 1, 2010. The next scheduled valuation will be as at March 31, 2011.

12. OBLIGATIONS UNDER CAPITAL LEASE:

The Company has entered into lease agreements with terms of three or four years for computer equipment and for a ten year term for a training facility. During the year ended March 31, 2010, the Company did not add any leased computer equipment to capital assets (2009: $0.4 million).

Year ended		
Future minimum lease payments:		
2011	$	449
2012		154
2013		12
2014		–
Executory costs and imputed interest included in payments (5.62% – 6.33%)		(78)
		537
Current portion of capital lease liability		(398)
	$	139

For the year ended March 31, 2010, $0.1 million of interest paid on capital leases is included in interest expense (2009: $0.1 million).

13. 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.

(b) Issued and outstanding:

	2010		2009	
As at March 31	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

(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.

14. FARE REDUCTION AND SERVICE RESTORATION AGREEMENT:

During the year ended March 31, 2009, the Company entered into an agreement with the Province under which the Province paid the Company $1.2 million to reimburse the costs of providing certain sailings from mid-October 2008 through March 31, 2009. This $1.2 million has been recorded as a reduction of operations expenses for the fiscal year ended March 31, 2009.

In addition, the Province paid the Company $19.6 million to allow a 33 per cent reduction on fares for all routes during the months of December 2008 and January 2009, and on the Prince Rupert to Skidegate route during February 2009. This $19.6 million has been recorded as tariff revenue for the fiscal year ended March 31, 2009.

15. FERRY SERVICE FEES:

The Company 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 agreement was amended on June 30, 2007 and March 31, 2008 to, among other things, establish the ferry service levels and the fees for the provision of such service for the second performance term ending March 31, 2012.

16. FEDERAL-PROVINCIAL SUBSIDY AGREEMENT:

The Company receives revenue provided to the Province 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.

17. INTEREST RATE SUPPORT:

During the year ended March 31, 2010, the Government of Canada agreed to provide $1.6 million in the form of interest rate support to the Company for major refurbishment of two vessels (2009: $10.7 million for major refurbishment of one vessel and construction of another). During the year ended March 31, 2010, $4.7 million of these amounts have been recorded as a reduction of interest expense (2009: $2.4 million) and $0.6 million as a reduction of capitalized interest (2009: $3.6 million).

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

18. OTHER COMMITMENTS:

(a) Operating lease agreements:

The Company has entered into operating leases for certain building spaces, land and equipment. Lease payments charged to expense during the year ended March 31, 2010 were $1.5 million (2009: $1.2 million).

Future minimum lease payments, reflecting early termination of an existing office space lease as described in (b) below, are as follows:

Year ended	
2011	$ 1,326
2012	928
2013	730
2014	462
2015	258
	$ 3,704

(b) Capital lease agreements:

During the year ended March 31, 2009, the Company signed agreements which constitute a capital lease for space in a new downtown Victoria, BC head office building. The lease is expected to take effect in September 2010 following the completion of construction of the new building and will result in the termination of an existing office space lease.

The initial term of the new building lease is for fifteen years, with four renewal options of five years each. The Company's wholly-owned subsidiary, Pacific Marine Leasing Inc., has agreed to advance up to $25 million to the developer of the new head office property for a term of fifteen years, secured by a second mortgage of the property. Incidental to the loan, the Company was granted an option to purchase up to fifty per cent of the owner's equity interest in the new building at a maximum price of $25 million. The purchase option expires at the end of the loan term.

Additionally, the Company has agreed to sell the current head office building located at 1112 Fort Street, Victoria, BC for approximately $11 million. Both the commencement of the new office lease and the sale of the existing head office building are subject to the construction of the new head office building being completed no later than May 31, 2011.

Future minimum lease payments are as follows:

Year ended		
2011		1,736
2012		2,976
2013		2,976
2014		2,976
2015		2,976
Thereafter		34,798
	$	48,438

19. RELATED PARTY TRANSACTIONS:

In accordance with the Act, the Company is responsible for paying any expenses that are incurred by the Authority without charge. During the year ended March 31, 2010, the Company paid $1,130 (2009: $1,789) of such expenses.

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

20. 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.

21. SUPPLEMENTAL CASH FLOW INFORMATION:

Years ended March 31			**2010**		2009
(a)	**Changes in non-cash operating working capital:**				
	Change in working capital				
	Accounts receivable	$	**(4,526)**	$	1,282
	Prepaid expenses		**1,319**		(847)
	Inventories		**(1,205)**		220
	Accounts payable and accrued liabilities		**(2,941)**		(49,438)
	Interest payable on long-term debt		**(76)**		2,677
	Accrued employee costs		**(3,279)**		(1,290)
	Deferred revenue		**614**		301
	Regulatory liabilities		**(2,858)**		(700)
	Change in non-cash working capital		**(12,952)**		(47,795)
	Change attributable to capital asset acquisitions		**3,484**		41,012
	Change in non-cash operating working capital	$	**(9,468)**	$	(6,783)
(b)	**Cash paid during the year for interest**	$	**74,043**	$	63,291
(c)	**Non-cash transactions:**				
	Capital assets acquired under capital lease	$	**–**	$	444

22. SUBSEQUENT EVENT:

On April 29, 2010, the Province introduced legislation, *Bill 20 – Miscellaneous Statutes Amendment Act (No.3)*, 2010, to amend several statutes, including the Act. The proposed amendments include changes to the governance and regulatory framework within which the Company operates.

The proposed governance changes broaden the mandate of the Authority to include responsibility for the compensation plans of the Company's directors and certain executive officers and a requirement that effective September 30, 2010, a director of the Authority cannot also be a director of the Company. The proposed amendments to the regulatory framework expand the responsibilities of the Commissioner to include consideration of the interests of ferry users and regulation of reservation fees. These amendments also require the Commissioner to determine whether the Company has an unfair competitive advantage in providing transportation services.

Corporate Directory

British Columbia Ferry Services Inc.

BOARD OF DIRECTORS
(Effective April 1, 2010)

Donald P. Hayes
Chair

Christopher C. Gardner

David L. Hahn

Elizabeth J. Harrison, QC

Holly A. Haston-Grant

Brian G. Kenning

Gordon R. Larkin

A. Daniel Miller

Jane L. Peverett

Stephen E. Smith

Wayne H. Stoilen

Graham M. Wilson

BOARD OF DIRECTORS
(Effective April 1, 2009 – March 31, 2010)

Elizabeth J. Harrison, QC
Chair

Mark L. Cullen

Christopher C. Gardner

David L. Hahn

Holly A. Haston-Grant

Donald P. Hayes

Brian G. Kenning

Gordon R. Larkin

A. Daniel Miller

Jane L. Peverett

Stephen E. Smith

Wayne H. Stoilen

Graham M. Wilson

Corporate Directory

SENIOR OFFICERS OF THE COMPANY
(Effective April 1, 2010)

David L. Hahn
President & Chief Executive Officer

Robert P. Clarke
Executive Vice President & Chief Financial Officer

Michael J. Corrigan
Executive Vice President & Chief Operating Officer

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

OFFICERS OF THE COMPANY
(Effective April 1, 2010)

Janet E. Carson
Vice President, Marketing & Travel Services

Mark F. Collins
Vice President, Engineering

Geoffrey H. Dickson
Vice President, Catering & Retail Operations

L. Blaine Ellis
Vice President, Employee Relations

M. Alana Gallagher
Treasurer

Cynthia M. Lukaitis
Vice President & Corporate Secretary

Captain D.W. James Marshall
Vice President, Fleet Operations & Training

Mark S. Stefanson
Vice President, Public Affairs

Corrine E. Storey
Vice President, Terminal Operations

Pierre Vorster (effective April 19, 2010)
Vice President & Chief Information Officer

A Message from the Chair

The B.C. Ferry Authority is an independent, no-share corporation that holds the single issued voting share of British Columbia Ferry Services Inc. The Authority appoints the Board of Directors of British Columbia Ferry Services Inc.

The B.C. Ferry Authority is governed by the *Coastal Ferry Act*, which establishes a process for the appointment of directors to ensure broad regional representation. In accordance with the Act, the Authority has a nine-member Board of Directors comprised of individuals with a wide range of experience.

Four directors are appointed from nominations received from four appointment areas, comprised of 14 coastal regional districts. In addition, one director is appointed from nominations from the union representing the employees of British Columbia Ferry Services Inc., two directors are appointed from the community-at-large and two additional directors are appointed by the provincial government.

The Board adheres to the highest corporate governance standards in its deliberations.

DONALD P. HAYES
Chair

The B.C. Ferry Authority (the "Authority") is established and governed by the *Coastal Ferry Act* (the "Act"). The Authority is a corporation without share capital which owns the single issued voting share of the operating company, British Columbia Ferry Services Inc. ("BCF"). The Province of British Columbia is the holder of all of the preferred shares of BCF, but has no voting interest in either the Authority or BCF. The Authority appoints the Board of Directors of BCF.

The Authority has adopted high standards of public and stakeholder accountability that require the Authority's financial and operating performance, as well as its process for appointing qualified individuals to serve as directors, and the compensation of directors, to be open to public view.

Subsequent to fiscal year end, the Province introduced legislation amending the Act, which includes changes to the governance structure of the Authority and BCF. This is discussed further below.

Appointment of Directors

The composition of the Board of Directors of the Authority is set out in the Act and includes regional and stakeholder representation. Four directors are to be appointed by the Board from nominees of four Appointment Areas, composed of coastal regional districts, and one director is to be appointed from the nominees of the BC Ferry & Marine Workers' Union (the "BCFMWU"), the trade union representing the employees of BCF. The Board is also to include two directors appointed by the Province of British Columbia and two additional directors appointed by the Board from members of the community at large.

The Act requires that the terms of three directors of the Authority expire each year. Directors may serve on the Board for up to two consecutive terms (or three consecutive terms in the case of directors who served on the first Board of the Authority).

One director appointed from the nominees of the BCFMWU, as well as one director appointed from the community at large and one director appointed by the Province had terms expiring March 31, 2010. During the fiscal year, the Board sought and received nominations of qualified individuals to serve as directors from the BCFMWU. The nominations from the BCFMWU included the incumbent director who was selected and re-appointed to the Board effective April 1, 2010. Also, during the fiscal year, the Board selected and appointed a qualified individual from the community at large to serve on the Board effective April 1, 2010. The Board presently has one vacancy pending the appointment of a director by the Province.

In selecting individuals to serve as directors of the Authority, two primary objectives continued to guide the deliberations of the Board. The first objective was to ensure that the composition of the Board met the requirements of the Act and the second was to ensure that collectively, the Board included individuals with the skills and experience necessary to ensure the sound performance of the Authority and the effective interaction and operation of the Board. The specific criteria that guided the Board in its appointment process during the fiscal year are reflected in the Skills and Experience Profile adopted by the Authority and included as Schedule "A" to the General Bylaws of the Authority. The General Bylaws of the Authority are available for public view on the Authority's website: www.bcferryauthority.com. There were no amendments made to the General Bylaws during the fiscal year.

Meetings

The Board meets regularly to conduct its business. During the fiscal year, the Board and its Committees met on 15 occasions. This included the Annual General Meeting of the Authority held in accordance with Section 18 of the Act. A summary of the outcomes of the meetings of the Board and its Committees follows in Table 1.

Summary of Meetings

Date	Type	Outcomes
June 10, 2009	Audit & Finance Committee	• Financial statements of the Authority for the year ended March 31, 2009 recommended
June 11, 2009	Governance & Nominating Committee	*Nil*
June 11, 2009	Board of Directors	• Financial statements of the Authority for the year ended March 31, 2009 approved • 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. • 2008/09 annual report of the Authority approved
June 25, 2009	Annual General Meeting	• Annual General Meeting held pursuant to the *Coastal Ferry Act* (section 18)
August 20, 2009	Audit & Finance Committee	• Financial statements of the Authority for the three months ended June 30, 2009 recommended
August 20, 2009	Board of Directors	• Financial statements of the Authority for the three months ended June 30, 2009 approved
November 9, 2009	Board of Directors	*Nil*
November 18, 2009	Audit & Finance Committee	• Financial statements of the Authority for the six months ended September 30, 2009 recommended • 2009/10 terms of engagement for the external auditor approved • Amendments to the terms of reference of the Audit & Finance Committee recommended • Amendments to the Code of Business Conduct and Ethics of the Authority recommended • Amendments to the Corporate Disclosure and Securities Trading Policy of the Authority recommended • Committee meeting dates for 2012/13 approved
November 19, 2009	Governance & Nominating Committee	• Appointment of a director from nominees of the BCFMWU recommended • Amendments to the terms of reference of the Audit & Finance Committee recommended • Amendments to the terms of reference of the Governance & Nominating Committee recommended

Date	Type	Outcomes
November 19, 2009 (Continued)	Governance & Nominating Committee	• Amendments to the terms of reference of the Corporate Secretary recommended • Amendments to the Code of Business Conduct and Ethics of the Authority recommended • Amendments to the Corporate Disclosure and Securities Trading Policy of the Authority recommended • Committee meeting dates for 2012/13 approved
November 19, 2009	Board of Directors	• Financial statements of the Authority for the six months ended September 30, 2009 approved • Nominee of the BCFMWU appointed a director of the Authority effective April 1, 2010 • Amendments to the terms of reference of the Audit & Finance Committee approved • Amendments to the terms of reference of the Governance & Nominating Committee approved • Amendments to the terms of reference of the Corporate Secretary approved • Amendments to the Code of Business Conduct and Ethics of the Authority approved • Amendments to the Corporate Disclosure and Securities Trading Policy of the Authority approved • Board of Directors meeting dates for 2012/13 approved
February 26, 2010	Audit & Finance Committee	• Financial statements of the Authority for the nine months ended December 31, 2009 recommended
February 26, 2010	Board of Directors	• Financial statements of the Authority for the nine months ended December 31, 2009 approved
March 3, 2010	Audit & Finance Committee	• 2010/11 operating budget of the Authority recommended
March 4, 2010	Governance & Nominating Committee	*Nil*
March 4, 2010	Board of Directors	• 2010/11 operating budget of the Authority approved • Time and location of the next Annual General Meeting of the Authority confirmed

Director Remuneration & Expenses

Director Compensation

The compensation plan for directors of the Authority was established by the Board with the assistance of an independent third-party compensation expert. The plan was designed to provide compensation at or below the median of a comparator group of 17 companies. This group of companies included private-sector and public sector organizations in transportation, utilities and other industrial sectors, all of them having significant operations in Western Canada.

During the fiscal year, directors received fees consistent with best practices and the objective of keeping overall director compensation at or below the median of the comparator group. Each director of the Authority also served as a director of BCF during the fiscal year, however, only one fee was payable. Annual fees paid were $140,000 for the Chair of the Board and $48,000 for other directors. In addition, a $15,000 annual fee was paid to the Chair of the Audit & Finance Committee and a $10,000 annual fee was paid to the Chair of the Governance & Nominating Committee. Each member of each Committee, other than the Chair of the Committee, received an annual fee of $3,000. Meeting fees were $1,500 per day or $750 per day when the meeting was undertaken by teleconference and ran for two hours or less. Meeting fees were not payable to the Board Chair for participation in Committee meetings. Directors were also eligible for reimbursement of reasonable expenses incurred on Board-related business.

Table 2 sets out the amount each director of the Authority received in remuneration and expenses in respect of the fiscal year-ended March 31, 2010.

Director Remuneration & Expenses

Fiscal year ended March 31, 2010 ($)

Name	Remuneration (Fees Earned)[2,4]	Expenses Reimbursed[3]
Elizabeth J. Harrison[1]	**149,004**	**3,763**
Christopher G. Gardner	**68,250**	**216**
Holly A. Haston-Grant	**69,000**	**2,832**
Donald P. Hayes	**68,250**	**0**
Brian G. Kenning	**78,246**	**1,718**
Gordon R. Larkin	**67,500**	**175**
Jane L. Peverett	**67,500**	**429**
Stephen E. Smith	**68,250**	**3,074**
Graham M. Wilson	**80,250**	**2,643**

Notes:

1 Elizabeth J. Harrison was the Chair of the Board.

2 Fees are for service as a director of both the Authority and BCF.

3 Expenses are the amounts reimbursed to directors for expenses incurred by them on Authority and/or BCF Board related business.

4 There is a ferry travel pass program for directors and their eligible family members which only applies while the director serves on the Board of Directors. This program may generate a taxable benefit and taxable income related to this program is included in the fees earned.

Changes in Legislation

On June 3, 2010, the Province of British Columbia passed legislation – *Bill 20 Miscellaneous Statutes Amendment Act (No.3), 2010 (Bill 20)* to amend several statutes, including the Act. The amendments to the Act respond to the Comptroller General's Report on Review of Transportation Governance Models, released November 6, 2009, and include provisions that when brought into force, will change the governance and regulatory framework within which the Authority and BCF operate. The governance changes include broadening of the mandate of the Authority to include: responsibility for the compensation plan for the directors of BCF, the remuneration provided under such plan not to be greater than the remuneration that provincial public sector organizations in British Columbia provide to their directors; as well as responsibility for the compensation plan for certain executive officers of BCF, the remuneration provided under such plan not to be greater than provincial public sector employers in British Columbia provide to individuals who, in those organizations, perform similar services or hold similar positions to that BCF executive officer. Also included in *Bill 20* is the requirement that effective September 30, 2010, a director of the Authority cannot also be a director of BCF and the directors of BCF be replaced as of that date. Changes to the General Bylaws of the Authority and the Articles of BCF will be required should the legislative amendments be brought into force.

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, 2010 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, 2010 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

CHARTERED ACCOUNTANTS
Victoria, Canada

May 12, 2010

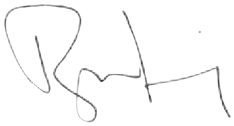
Statement of Financial Position (expressed in thousands)

As at March 31	2010	2009
Assets		
Investment in British Columbia Ferry Services Inc.	$ 235,479	$ 238,095
	$ 235,479	$ 238,095
Net Assets		
Invested in common share of British Columbia Ferry Services Inc.	$ 1	$ 1
Accumulated undistributed earnings of British Columbia Ferry Services Inc.	235,478	238,094
	$ 235,479	$ 238,095

See accompanying notes to financial statements.

On behalf of the Board:

Director, Donald P. Hayes



Director, Brian G. Kenning

Statement of Operations (expressed in thousands)

Years ended March 31	2010	2009
Revenue:		
Distributable (loss) earnings of British Columbia Ferry Services Inc. (note 2)	$ (2,616)	$ 2,991
Expenses:		
Administration	1	2
Recovery from British Columbia Ferry Services Inc. (note 3)	(1)	(2)
	–	–
Net (loss) earnings	$ (2,616)	$ 2,991

See accompanying notes to financial statements.

Statement of Changes in Net Assets (expressed in thousands)

Years ended March 31	2010			2009
	Invested in BCFSI	Undistributed Earnings of BCFSI	Total	Total
Beginning of year	$ 1	$ 238,094	$ 238,095	$ 235,104
Net (loss) earnings	–	(2,616)	(2,616)	2,991
End of year	$ 1	$ 235,478	$ 235,479	$ 238,095

See accompanying notes to financial statements.

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");
- 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 terms of three director positions expire each fiscal year.

The Authority's primary purpose is to hold the share of BCFSI, a company incorporated under the *Company Act* (British Columbia) by way of conversion on April 2, 2003, and which now validly exists under the *Business Corporations Act* (British Columbia). BCFSI's primary business is the provision of 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) Adoption of new accounting standards:

Financial Statement Presentation:
Effective April 1, 2009, the Authority adopted amendments that have been made to CICA Handbook Section 4400 – "*Financial Statement Presentation by Not-For-Profit Organizations*". The amendments clarify the reporting requirements for net assets and require not for profit organizations to apply the same standards as profit-oriented enterprises with respect to interim financial statements and statements of cash flows. The adoption of this guidance has not had any impact on the financial statements.

Financial Instruments:
In June 2009, the CICA issued amendments to Section 3862, "*Financial Instruments – Disclosures*", of the CICA Handbook. The amendments require additional disclosure about the fair value measurement of financial instruments and enhanced liquidity risk disclosures. The Authority did not hold any financial instruments at either March 31, 2010, or March 31, 2009. Accordingly, the adoption of this standard has not had any impact on the financial statements.

(c) Revenue recognition:

The Authority follows the deferral method of accounting for contributions. The Authority does not expect to receive endowment contributions.

(d) Taxes:

The Authority and BCFSI are exempt from federal and provincial income taxes.

(e) Statement of Cash Flows:

A statement of cash flows has not been included with these statements as it does not provide additional information.

(f) Comparative figures:

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

2. DISTRIBUTABLE (LOSS) EARNINGS OF BRITISH COLUMBIA FERRY SERVICES INC.:

The distributable (loss) 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		2010		2009
Net earnings and comprehensive income of BCFSI	$	**3,422**	$	9,029
Dividends paid on 8% cumulative preferred shares		**(6,038)**		(6,038)
	$	**(2,616)**	$	2,991

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:

As at March 31		2010		2009
Current assets	$	**102,861**	$	92,718
Capital and other assets		**1,704,112**		1,749,460
	$	**1,806,973**	$	1,842,178
Current liabilities	$	**132,068**	$	159,630
Accrued employee future benefits		**11,130**		12,047
Regulatory liabilities		**4,325**		–
Other long-term liabilities		**172**		153
Long-term debt and capital lease obligations		**1,348,322**		1,356,776
		1,496,017		1,528,606
Shareholders' equity				
Common share held by the Authority		**1**		1
Preferred shares (a)		**75,477**		75,477
Retained earnings		**235,478**		238,094
		310,956		313,572
	$	**1,806,973**	$	1,842,178

Years ended March 31		2010		2009
Revenue (including gains)	$	**732,449**	$	683,283
Expenses (including losses)		**729,027**		674,254
Net earnings and comprehensive income	$	**3,422**	$	9,029
Cash flows from operating	$	**121,297**	$	88,562
Cash flows from financing		**(33,535)**		339,269
Cash flows from investing		**(89,556)**		(531,758)

(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.

5. SUBSEQUENT EVENT:

On April 29, 2010, the Province introduced legislation, *Bill 20 – Miscellaneous Statutes Amendment Act (No.3), 2010*, to amend several statutes, including the Act.

The proposed amendments include governance changes that broaden the mandate of the Authority to include responsibility for the compensation plans of the directors and certain executive officers of BCFSI and a requirement that effective September 30, 2010, a director of the Authority cannot also be a director of BCFSI. These amendments also require the British Columbia Ferries Commissioner to issue an opinion annually on the performance of the Authority in carrying out its legislated responsibilities.

Corporate Directory

B.C. Ferry Authority Board of Directors
(Effective April 1, 2010)

Donald P. Hayes
Chair
(Southern Vancouver Island appointment area)

Christopher C. Gardner
(Province of British Columbia appointment)

Holly A. Haston-Grant
(Central Vancouver Island & Northern Georgia Strait appointment area)

Brian G. Kenning
(Southern Mainland appointment area)

Gordon R. Larkin
(Organized labour appointment)

A. Daniel Miller
(Community-at-large appointment)

Jane L. Peverett
(Community-at-large appointment)

Stephen E. Smith
(Northern Coastal & North Island appointment area)

Vacant
(Province of British Columbia appointment)

Officers
(Effective April 1, 2010)

Donald P. Hayes
Chair

Cynthia M. Lukaitis
Vice President & Corporate Secretary

Board of Directors
(Effective April 1, 2009 – March 31, 2010)

Elizabeth J. Harrison, Q.C.
Chair

Christopher C. Gardner

Holly A. Haston-Grant

Donald P. Hayes

Brian G. Kenning

Gordon R. Larkin

Jane L. Peverett

Stephen E. Smith

Graham M. Wilson

Officers
(Effective April 1, 2009 – March 31, 2010)

Elizabeth J. Harrison, Q.C.
Chair

Cynthia M. Lukaitis
Vice President & Corporate Secretary

BCFerries

Experience the difference™

BRITISH COLUMBIA FERRY SERVICES INC.
1112 Fort Street, Victoria, British Columbia V8V 4V2
www.bcferries.com | www.bcferryauthority.com