

# 2010/11 ANNUAL REPORTS



# BRITISH COLUMBIA FERRY SERVICES INC.

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# B.C. FERRY AUTHORITY

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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, fluctuating financial markets, demographics, tax changes, and the requirements of the Coastal Ferry Services Contract.

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

- our short and long-range business plans;
- traffic levels;
- our asset renewal programs for vessels and terminals;
- expectations of a net loss in 2012 and a return to profitability in 2013; and
- expectations of funding under the Infrastructure Stimulus Fund program.

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

A number of factors could cause actual events or results to differ materially from the results discussed in the forward looking statements. In evaluating these statements, prospective investors should specifically consider various factors including, but not limited to, the risks and uncertainties associated with traffic volume and tariff revenue risk, safety and security, asset risk, accident risk, tax risk, environmental risk, regulatory risk, labour disruption risk, limitations of vessel repair facilities, risk of default under material contracts and aboriginal land claims.

Actual results may differ materially from any forward looking statement. Although management believes that the forward looking statements contained in this 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 35 vessels. We are an essential transportation link that connects coastal communities and facilitates the movement of people, goods and services. In fiscal 2011, we carried 20.7 million passengers and 8.1 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 continuously improve 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 OF THE BOARD OF DIRECTORS



Over the past year, we reflect on some of the great accomplishments made, such as achieving the highest on-time performance record ever, at 89.1 per cent across the fleet. The all-important customer satisfaction rating is equally strong at 89 per cent for 2010.

On behalf of the Board of Directors of British Columbia Ferry Services Inc., I take this opportunity to thank the women and men of BC Ferries for consistently addressing the evolving expectations of our customers and contributing to the success of the Company in so many meaningful ways.

Over the past year, we reflect on some of the great accomplishments made, such as achieving the highest on-time performance record ever, at 89.1 per cent across the fleet. The all-important customer satisfaction rating is equally strong at 89 per cent for 2010. These achievements demonstrate employee engagement and a clear commitment to customer service.

On September 30, 2010, the membership of the Authority and BC Ferries' Boards was changed in response to the new requirements of the *Miscellaneous Statutes Amendment Act (No.3) – 2010*. I send a special thank you to outgoing Services Board members Christopher C. Gardner, A. Daniel Miller, Jane L. Peverett, and Stephen E. Smith and thank them for their years of valuable service. I also welcome new members Maureen V. Macarenko and P. Geoffrey Plant to the Services Board.

As we continue to transform and strengthen this celebrated marine transportation system, the Board remains focused on long-term stability and sustainability. We continue to build on the successful business model by constantly reinvesting in our ships and terminals.

Our priorities continue to concentrate on operating the service to a world-class safety standard, while delivering solid economic value for ferry users across the coast.

We recognize the challenges as well as great opportunities the upcoming year holds and we embrace the principles of strong management and leadership. As BC Ferries addresses current economic realities, the Company anticipates and prepares for a bright future.

DONALD P. HAYES,  
Chair of the Board of Directors  
British Columbia Ferry Services Inc.

# MESSAGE FROM THE PRESIDENT & CEO

As I reflect on the past year, I am pleased with the tremendous progress that we've made in the areas of customer service enhancements, employee initiatives and capital improvements.

I'm continuously impressed by the safety improvements we've made in all areas of the fleet through our SailSafe program; a joint initiative with the BC Ferry and Marine Workers' Union. Since the program's inception in 2007, we've seen a reduction in employee time loss injuries by nearly 50 per cent and days lost due to injuries by 40 per cent. This employee-driven undertaking, which enables front-line staff to identify potential safety concerns, has changed the safety culture at BC Ferries.

Last spring saw the opening of the BC Ferries Vacations Centre in downtown Vancouver across from the newly expanded Vancouver Convention Centre. At the time of opening we had approximately 20 unique vacation packages, and now have over 50 packages we've created with our tourism partners. We've exceeded our estimates for the first year in operation by generating over \$1.5 million in gross sales.

On October 1, 2010, the federal government announced it had granted BC Ferries remission of import duties and related GST of \$119.4 million on the four vessels built offshore. We know our customers are sensitive to rising fares and in cooperation with the provincial government we were able to apply these funds to an across-the-board fare reduction of two per cent on all fares on all routes. As a result of this decision by the federal government, these four major ships were delivered \$150 million under budget.

Additionally, we were able to bring forward several terminal projects when the Government of Canada approved stimulus funding, including an overhead walkway and ramp coatings at Horseshoe Bay; a foot passenger walkway at Campbell River; sewage pump ashore facilities; seismic upgrading of a transfer deck at Tsawwassen; and a waste water facility at Langdale.

On the capital investment side, we continued to invest in our ships and terminals to maintain the long-term safety and reliability of our assets. Major projects included the multi-year replacement and refurbishment of one of the major berths at the Tsawwassen terminal; life extension of the *Quadra Queen II*; and the first of two phases to life-extend the *Queen of Chilliwack*. It is also important to note that BC Ferries spends almost \$150 million a year in British Columbia on maintenance, refit and major capital projects. In fact, over the past five years, we've spent approximately half a billion dollars in the province on these important investments in our fleet.



The strong Canadian dollar is having a two-fold effect on discretionary ferry travel. Not only are fewer Americans coming to British Columbia for vacations, but the borders are full of Canadians heading to the United States where they can purchase the same consumer goods cheaper, with a stronger dollar.

The year ahead is going to be a challenging one for BC Ferries. We are planning to post a loss of approximately \$20 million in fiscal 2011/12. This loss is attributed to continued low traffic volumes as well as our commitment to fund on-going vessel maintenance and repair, maintain SailSafe initiatives and expand our safety management and training programs. Our strategy is to not repeat past practices of cutting capital expenditures and other important programs to the detriment of British Columbia's ferry service.

While we continue to be concerned about economic recovery and the effect high fuel prices has, not only on our operation, but our customers' travel patterns, we remain optimistic about the future. I am confident that BC Ferries will return to a profitable position next year with renewed enthusiasm. The strong foundation we continue to build upon today will serve our customers for many years to come.

A handwritten signature in dark ink, reading "David L. Hahn". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

DAVID L. HAHN,  
President & Chief Executive Officer  
British Columbia Ferry Services Inc.

# KEY ACCOMPLISHMENTS

## Improving the travel experience...

- Opened the BC Ferries Vacations Centre in the heart of downtown Vancouver. The 2,675-square foot centre is located directly across the street from the newly expanded Vancouver Convention Centre and provides BC Ferries with significant presence in this major tourism market.
- Offered fuel rebates of between 2 and 5 per cent on many of our routes for the majority of the year.
- Introduced "C Spa" services on the Spirit of British Columbia and the Spirit of Vancouver Island.
- Introduced a free wireless Internet service on all ships servicing the Tsawwassen – Swartz Bay route, as well as at these two major terminals. The service enables our customers to text, email and browse the Internet.
- Reached fleetwide on-time performance record of 89.1 per cent.
- Offered CoastSaver promotions on Tuesdays, Wednesdays and Thursdays from May 25 – July 29, 2010 and March 22 – 31, 2011 on the three major routes connecting Vancouver Island and the Lower Mainland. The popular \$39.95 passenger vehicle and driver fare was also available from December 29, 2010 – January 5, 2011.
- Introduced vehicle reservations on the Comox – Powell River route.
- Launched fifth season of the Coastal Naturalists educational programs on the Tsawwassen – Swartz Bay and Horseshoe Bay – Departure Bay routes.
- Expanded self-ticketing for foot passengers to the Horseshoe Bay terminal. The self-ticketing process is designed to simplify and speed up the foot passenger ticketing process.
- Launched the new Decadent Chocolate and Cheesecake Buffet Bar in the Pacific Buffets.
- Began using Twitter and Facebook as additional ways to communicate with our customers.
- Negotiated a new five-year contract with White Spot that allows BC Ferries access to complete full service menu items. The Monty Mushroom Burger, Lifestyle Chicken Burger, and Poutine were the first new items introduced.

## Investing in our vessels and terminals...

- Invested \$4.6 million in a new berthing structure and foot passenger waiting shelter at Quathiaski Cove on Quadra Island, and completed the \$2.7 million replacement of the wingwalls and two line dolphins at Campbell River.
- Completed the refurbishment of the *Quinsam* with a \$19 million extensive asset betterment project that prepares the 28-year-old Gabriola Island ferry for another 17 years of service.
- Introduced wireless hand-held point of sale systems at Heriot Bay on Quadra Island, Gravelly Bay on Denman Island and Lyall Harbour on Saturna Island to instantly process BC Ferries Experience Card transactions.
- Received approval from the Government of Canada for funding for several projects under the Infrastructure Stimulus Fund, including: installation of sewage pump ashore facilities at eight terminals; the concrete restoration and seismic upgrade of the transfer deck between Berths 3 and 4 at Tsawwassen; an overhead walkway and new ramp coatings for Berth 3 at Horseshoe Bay; a foot passenger walkway at Campbell River; and waste water facilities at Langdale and Swartz Bay. BC Ferries expects to receive approximately \$9.2 million of the total project budget of \$32 million.
- Completed the multi-year, \$32 million replacement and refurbishment of Berth 4 at Tsawwassen terminal, which saw the replacement of 13 dolphins, the port wingwall and the lower ramp.
- Commenced the first phase of a two-phased project to extend the life of the 33-year-old *Queen of Chilliwack*. The first phase of this \$15 million project includes new car deck watertight doors, propeller seals, new instrumentation, control systems and new lifesaving systems.
- Began implementation of a \$52 million pump ashore program to achieve zero overboard discharge of sewage from its vessels operating in terminals where shoreside treatment is available. The program involves major modifications and upgrades to 19 vessels and eight terminals.



# KEY ACCOMPLISHMENTS

- *Queen of Cumberland* and *Queen of Capilano* both underwent \$6 million combined refit and asset betterment projects that included extensive mechanical refits and drydocking; passenger accommodation upgrades; installation of new car deck deluge piping; and upgrades to the sewage treatment systems.
- Completed a \$15 million life extension project on the *Quadra Queen II* which prepares the 41-year-old vessel for another 20 years of service. The project included hull steel renewal, new propellers and bow thruster, new generators, new instrumentation and control systems, new wheelhouse structure, new lifesaving systems and new passenger accommodations.

## Building a better BC Ferries...

- Reduced employee time loss injuries by eight per cent through our SailSafe program, a joint initiative with the BC Ferry and Marine Workers' Union.
  - Participated in SAREX Nanaimo Harbour 2010, a multi-agency training exercise organized by the Canadian Coast Guard and the City of Nanaimo to test the coordinated response to a major maritime disaster.
  - Introduced B5 biodiesel to ships in all service areas where the product is available.
  - Scored an average of 89 per cent on Customer Satisfaction Surveys during 2010.
  - Expanded wet waste recycling to the ships operating on the Duke Point–Tsawwassen route.
- Led industry investors in supporting the British Columbia Institute of Technology (BCIT) Marine Campus' Simulator Renewal Initiative, which will result in the most modern and capable deck and engineering simulation training in North America. As part of this investment, finalized a five-year partnership agreement with BCIT. This new Simulation Centre will be a valuable employee training resource and, in concert with the partnership, will greatly assist in the ongoing development and training of our number one asset; our employees.
  - Commenced a Bridge Simulator Training project that will implement training simulators at three of our major terminals. This program will allow BC Ferries to provide low-risk, affordable and sustainable simulation training in individual and team skills for bridge personnel commencing in September 2011.
  - The Government of Canada granted BC Ferries request for duty remission on the four vessels it has built offshore. The \$119.4 million in import taxes and related GST was returned to BC Ferries and the funds went towards an across-the-board ferry fare reduction of about two per cent effective October 18, 2010. \$20.0 million of this amount has been allocated to upgrade key assets in the ship repair and maintenance business in British Columbia.
  - Relocated head office to a new building in downtown Victoria. This relocation consolidates BC Ferries head office functions, which were previously in several locations.
  - Sold our previous head office building for approximately \$11 million, resulting in a gain on the sale of \$9.3 million.
  - Launched a "Watt Now" Energy Conservation program.

# KEY ACCOMPLISHMENTS

## Connecting with the communities we serve...

- Celebrated BC Ferries' 50<sup>th</sup> Anniversary on June 15, 2010.
- Consulted regularly with our 12 Ferry Advisory Committees.
- Raised \$50,000 to help build Jeneece Place through the BC Ferries Media Charity Golf Classic held in June 2010. Over the past five years, this tournament has raised over \$250,000 to support children's programs.
- Raised another \$50,000 in September to donate to the First Tee Program of the Vancouver YMCA in September 2010.
- Donated a used 70-foot crane truck to help train students in Camosun College's Heavy Duty/Commercial Transport Mechanics program.
- Hosted the convocation ceremony for students of BCIT's Nautical Sciences and Marine Engineering program on the *Coastal Celebration*.
- Implemented emergency service to evacuate residents of the Bella Coola area who were cut-off from the highway due to flooding in the fall of 2010. These special sailings also assisted in supplying additional emergency supplies for the Central Coast communities hard hit by flooding and the closure of Highway #20.
- Pledged \$100,000 in employee contributions in the 2010 United Way Campaign.
- Sponsored the BC Bike Race.
- Sponsored the 52<sup>nd</sup> Annual All Native Basketball Tournament in Prince Rupert.
- 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.



# PROVINCIAL PAYMENTS & RECEIPTS

## British Columbia Ferry Services Inc.

### PROVINCIAL RECEIPTS & PAYMENTS

Fiscal 2004 through 2011

(\$ thousands)	2004	2005	2006	2007	2008	2009	2010	2011	Total
<b>Receipts</b>									
Ferry Transportation fees	91,817	91,833	91,849	90,953	103,801	103,294	125,599	125,150	824,296
Contracted Routes fee	1,747	1,724	1,700	1,700	1,700	1,939	1,849	1,855	14,214
Social Programs fee	12,317	13,414	14,674	15,967	17,248	19,252	22,060	24,018	138,950
Federal-Provincial subsidy	23,975	24,343	24,890	25,309	25,856	26,294	26,924	26,924	204,515
Other <sup>1</sup>				7,000	1,284	4,113	1,620	1,753	14,017
Other <sup>2</sup>						20,750			20,750
	129,856	131,314	133,113	140,929	149,889	175,642	178,052	179,700	1,216,742
<b>Payments</b>									
Debenture repayment <sup>3</sup>		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	6,038	48,304
Provincial Fuel tax adjustments	75			224	47				346
Fuel on northern routes <sup>4</sup>							1,273		1,273
	28,593	437,138	6,038	6,262	6,085	6,038	7,311	6,038	503,503

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 and \$196 over the set price on the northern routes reimbursed in fiscal 2009 and 2011, respectively, and in fiscal 2008, 2009, 2010 and 2011, a contribution equal to the transportation fee reduction related to import duties remission and related GST obtained on the *Northern Adventure* (\$1,284, \$1,684, \$1,620 and \$1,557 respectively).

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.

# KEY COST DRIVERS

When BC Ferries was established as an independent company on April 1, 2003 the major strategic issue facing the Company was the replacement of our aged assets, specifically vessels, terminals and information technology systems.

Over the past eight years there have been many accomplishments. In this time BC Ferries has brought into service seven new vessels, completed upgrades to twelve vessels, had significant marine structure replacements and terminal improvements, security upgrades and sewage pump-ashore and waste water treatments. This ongoing reinvestment in our assets is reflected in interest and amortization expenses, which have grown from \$68 million in 2004 to \$195 million projected for 2012, an increase of \$127 million.

There has been a 140% increase in fuel costs since fiscal 2004, as well as significant operating cost increases, such as insurance premiums, property taxes, utilities, benefits program rates, contractual labour costs, and regulated labour requirements.

Since 2003 BC Ferries has reduced our fuel consumption by over 3.7 million litres per year.

Major Cost Drivers Affecting Fares (\$ millions)	Fiscal 2004 Actual <sup>1</sup>	Fiscal 2012 Forecast
Operations Costs		
Labour	202	266
Fuel <sup>2</sup>	50	120
Materials, Supplies, Contracted services and other	33	41
Insurance <sup>3</sup> , property tax, utilities and credit card fees	10	24
Maintenance Expenses	84	94
Administration Expenses	32	36
Net Financing and Amortization <sup>4</sup>	68	195

BC Ferries will continue to focus on reducing expenditures wherever possible, while providing a safe, reliable and efficient marine transportation service.

1 The fiscal 2004 figures for Operations, Maintenance and Administration (OM&A) expenses have been adjusted from those figures previously reported to reflect classifications of expenses used in fiscal 2012. Total OM&A expenses for fiscal 2004 are identical to those previously reported.

2 Fuel reflects the total cost of fuel net of fuel price hedging gains or losses.

3 Insurance includes gains or losses from our subsidiary, BCF Captive Insurance Subsidiary Ltd.

4 Net Financing includes financing for the Kuper owned by our subsidiary, Pacific Marine Leasing Inc.

# MANAGEMENT'S DISCUSSION & ANALYSIS

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# MANAGEMENT'S DISCUSSION & ANALYSIS

## Management's Discussion and Analysis of Financial Condition and Results of Operations for the fiscal year ended March 31, 2011

**Dated May 19, 2011**

(except where otherwise indicated)

The following is our discussion and analysis of the financial condition and results of operations for British Columbia Ferry Services Inc. This discussion and analysis has been prepared based on information available at May 19, 2011, except where otherwise indicated. This should be read in conjunction with our audited consolidated financial statements and related notes for the years ended March 31, 2011 (fiscal 2011) and March 31, 2010 (fiscal 2010). These documents are available on SEDAR at [www.sedar.com](http://www.sedar.com) and on our Investor webpage at <http://www.bcferries.com/about/investors/index.html>.

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

### Business Overview

British Columbia Ferry Services Inc. is an independent company providing ferry services on the west coast of British Columbia. On June 15, 2010, we celebrated 50 years of service. Our service started with two vessels operating between Swartz Bay and Tsawwassen. Over the years we have grown to be one of the largest and most complex ferry systems in the world, providing frequent year-round transportation service on 25 routes, supported by 35 vessels and 47 terminals.

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

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

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

Significant events during or subsequent to fiscal 2011:

#### REGULATION

- On June 24, 2010, the *Miscellaneous Statutes Amendment Act (No.3), 2010* (Bill 20), was enacted except for certain sections which were brought into force effective October 1, 2010. Bill 20

amended several statutes, including the *Coastal Ferry Act* (the Act), changing the governance and regulatory framework within which we operate. (See "Corporate Structure – Amendments to the *Coastal Ferry Act*" below for more detail).

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

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

- On February 1, 2011, the Commissioner released his conditional approval of our customer complaints process, fulfilling a new requirement of the Act, as amended by Bill 20. (See "Corporate Structure – Amendments to the *Coastal Ferry Act*" below for more detail).
- On March 31, 2011, the Commissioner released his order establishing the preliminary price caps for performance term three covering the four years commencing April 1, 2012. (See "Corporate Structure – Economic Regulatory Environment" below for more detail).
- On May 19, 2011, the Province and the Commissioner announced a review of the Act to identify improvements which would better allow the Commissioner to balance the interests of ferry users with the financial sustainability of our Company. On June 2, 2011, the *Coastal Ferry Amendment Act, 2011* (Bill 14) was enacted. This legislation provides the Commissioner with the mandate to conduct the review of the Act and the timeline established for this purpose. (See "Corporate Structure – Economic Regulatory Environment" below for more detail).

#### OUR ASSETS

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

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

- On November 1, 2010, our former corporate office building was sold for \$11.0 million, resulting in a gain on sale of \$9.3 million.
- On December 14, 2010, the *Queen of Cumberland* returned to service after completion of a \$6 million combined refit and asset improvement project. The vessel underwent an extensive mechanical refit and dry-docking, a passenger accommodation upgrade, installation of new car deck deluge piping, and upgrades to the sewage system.
- On December 17, 2010, the *Queen of Nanaimo* returned to service after completion of a \$4 million asset betterment project that included steel renewal throughout the vessel and a new exhaust system.
- On March 24, 2011, the *Quadra Queen II* returned to service after completion of a \$15 million life extension project to prepare it for another 20 years of service.
- On March 31, 2011, the \$32 million multi-year project for replacement and refurbishment of berth 4 at Tsawwassen terminal was completed. The project replaced all 13 dolphins and the port wingwall. The lower ramp was replaced with a new multi-apron ramp with two-lane commercial vehicle capacity and the foundations and ramp supports were upgraded and a new hydraulic lift system installed.
- On April 19, 2011, the sale of the *Queen of Prince Rupert*, decommissioned in fiscal 2010, was completed. On May 1, 2011, the 55-year-old *Mill Bay* completed operations and was sold on the following day. There was no significant gain or loss arising from the disposition of these vessels.

## OTHER EVENTS

- On April 1, 2010, a fuel rebate of 2% of tariffs on average was implemented on our Major Routes at which time rebates of up to 5% of tariffs on average were in place on many of our other routes. On August 17, 2010, the fuel rebates on many of our other routes were reduced to 2% and on December 1, 2010, fuel rebates were removed completely due to the increasing cost of fuel. No rebates were in place on our Northern Routes during fiscal 2011. Due to the rising cost of fuel, on May 16, 2011, we announced the implementation of fuel surcharges effective June 1, 2011. These surcharges will be 2.5% on our Major Routes and 5% on many of our other routes.
- On May 11, 2010, our new Vacations Centre in downtown Vancouver officially opened to the public. The purpose of this facility is to assist us in attracting new customers to our

system and growing revenues. With the aid of an 11-metre long interactive media wall display, customers are able to view route maps, vessel schematics, and destination images to help them choose from a variety of travel package options.

- On May 26, 2010, we released the results of our 2009 Customer Satisfaction Tracking surveys, which indicated that 91% of customers surveyed reported being satisfied with their overall trip experience, up from 86% in the prior year and the highest overall level of customer satisfaction reported since we began these surveys in 2003.
- On July 1, 2010, the harmonized sales tax (HST) became effective, combining the existing 7% provincial sales tax with the 5% federal goods and services tax (GST) into a single tax of 12%. We expect this tax to add approximately \$5 to \$6 million annually to the cost of our operations. The HST has also increased the price to our customers of our food and certain retail offerings. Our vehicle and passenger tariffs are exempt from HST.
- On September 9, 2010, Mr. Vince Ready published his arbitration award to exclude certain senior shipboard positions that should be part of the management structure, and therefore excluded from the bargaining unit. Following discussion with the BC Ferry & Marine Workers' Union (the Union), we provided our transition plan to employees on December 1, 2010. We have planned a gradual, phased implementation of the newly excluded positions over an approximately five year time frame to ensure the optimum retention of current staff and the orderly placement and orientation of those transitioning into the new positions.
- Throughout September and October 2010, we relocated to our new corporate office building in downtown Victoria. These premises are being leased under agreements which constitute a capital lease. The initial term of the lease is 15 years, with renewal options for up to an additional 20 years. On November 1, 2010, we loaned the developer of our new corporate office building \$24.2 million for a term of 15 years, secured by a second mortgage on the property. We were granted an option to purchase up to 50% of the owner's equity interest in the new building at a price of \$24.2 million. Final adjustments were made on April 15, 2011, bringing the total amount of the loan and the purchase option to \$24.5 million. The purchase option expires at the end of the loan term. This relocation consolidated our head office functions, which were previously in several locations.
- On October 1, 2010, it was announced that our request for duty remission, amounting to \$119.4 million including related GST, on four vessels built in Germany had been granted by

# MANAGEMENT'S DISCUSSION & ANALYSIS

the Government of Canada. One of these vessels, the *Northern Expedition*, operates on our Northern Routes which are supported by ferry transportation fees paid by the Province pursuant to the Coastal Ferry Services Contract. An agreement with the Province stipulated that these fees would be reduced if we were successful in obtaining duty remission on the *Northern Expedition*. The Province has agreed to forego this fee reduction, amounting to approximately \$5.3 million for the balance of performance term two, which ends March 31, 2012.

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

## Corporate Structure

### COASTAL FERRY SERVICES CONTRACT

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

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

### ECONOMIC REGULATORY ENVIRONMENT

The office of the Commissioner was created under the Act, enacted by the Province on April 1, 2003. The Commissioner establishes price caps for designated ferry route groups for the purpose of regulating our tariffs. The Commissioner is also responsible for regulating the reduction of service, discontinuance of routes

and certain other matters. The Act requires the Commissioner to undertake regulation in accordance with several principles, including placing priority on the financial sustainability of ferry operators, encouraging ferry operators to adopt a commercial approach to ferry service delivery and moving over time to a greater reliance on a user pay system. In addition, the Commissioner is mandated to consider the interests of ferry users when establishing price caps.

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

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



# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

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

- establishes a price cap for the first year of the third performance term with an increase for each route group on April 1, 2012,

of 4.15% from the weighted average of the tariffs payable as at March 31, 2012, as determined in a manner approved by the Commissioner;

- provides for the Commissioner to undertake the usual price cap review proceedings for the balance of the review performance term, being the period from April 1, 2013 to March 31, 2016;
- prevents us from obtaining extraordinary price cap increases, and requires ministerial approval (as opposed to Commissioner approval) for the discontinuance of ferry services, until October 1, 2012; and
- requires the Commissioner to undertake a review of the Act and provide recommendations by January 24, 2012, to the B.C. Minister of Transportation and Infrastructure as to how the Act could be amended to allow the Commissioner to balance the interests of ferry users with the financial sustainability needs of our Company.

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

## AMENDMENTS TO THE COASTAL FERRY ACT

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

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

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

## Financial and Operational Overview

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

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

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

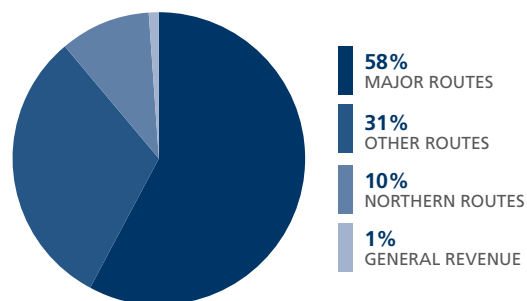
Vehicle and passenger traffic declined 1.6% and 1.4% respectively this fiscal year as compared to the prior year. The general decline in vehicle traffic was partially offset by an increase in drop trailer traffic. With this service, launched in March 2009, commercial customers on two of our Major Routes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

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

## Revenue

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



In fiscal 2011, the greatest portion of our revenues, 58%, was earned on our three Major Routes connecting Vancouver Island to Vancouver and the Lower Mainland. The revenue from the Northern Routes contributed 10% and Other Routes contributed 31%.

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

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

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

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

In fiscal 2009, a fare reduction agreement was made with the Province to provide \$19.6 million in funding to allow a 33% reduction on fares for all routes during the months of December 2008 and January 2009 and for our Prince Rupert-Skidegate route during February 2009.



# MANAGEMENT'S DISCUSSION & ANALYSIS

Fares were reduced and this \$19.6 million was recorded in tariff revenue. Although this fare reduction was expected to stimulate traffic, our service areas experienced three weeks of severe weather conditions which resulted in a 10% decrease in traffic in the month of December 2008.

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

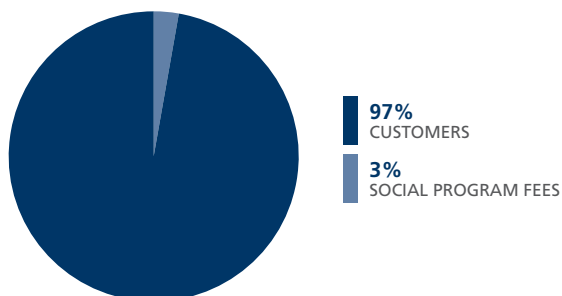
## YEAR TO YEAR COMPARISON OF REVENUES 2011–2010

### Major Routes

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

Our Major Routes consist of three regulated routes connecting Greater Vancouver with mid and southern Vancouver Island. Both vehicle traffic and passenger traffic decreased in fiscal 2011 from the prior year. The general decline in vehicle traffic was partially offset by a 57.7% or \$2.0 million increase in drop trailer traffic. Overall fiscal 2011 vehicle and passenger traffic was marginally higher, 0.2% and 0.1% respectively, than fiscal 2009.

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



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

# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

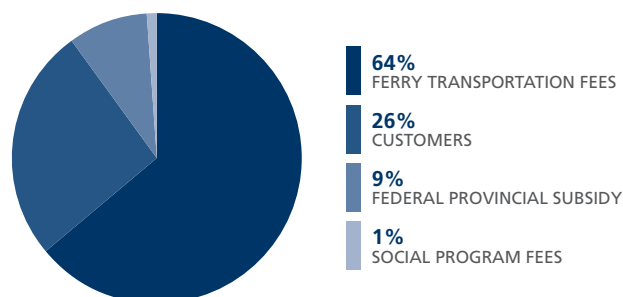
All vessels that provide service on our Major Routes have a gift shop and options for food service. Both food and gift shop sales decreased as a result of lower average spending per passenger and lower passenger traffic. The HST implemented July 1, 2010, increased the price to our customers of our food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

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

## Northern Routes

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

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



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

# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

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

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

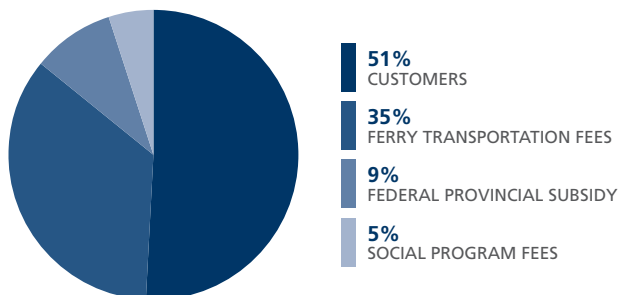
We receive ferry transportation fees for these routes under the Coastal Ferry Services Contract, which relate, in part, to the capital cost of the vessels serving these routes. The fees decrease as the vessel assets are amortized.

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

## Other Routes

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

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



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



# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

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

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

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

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

## YEAR TO YEAR COMPARISON OF REVENUES 2010–2009

### Major Routes

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

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

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

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

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

Other revenue increased mainly as a result of hostling<sup>1</sup> fees from our new drop trailer service for commercial customers.

<sup>1</sup> Loading and unloading of commercial trailers that are dropped off for transportation on a ferry route.

# MANAGEMENT'S DISCUSSION & ANALYSIS

## Northern Routes

Years ended March 31 (\$ thousands)	2010	2009	Increase	(Decrease)
<b>Direct Route Revenue</b>				
<i>Vehicle traffic (volume)</i>	31,139	31,739	(600)	(1.9%)
Vehicle tariff	8,006	8,253	(247)	(3.0%)
<i>Passenger traffic (volume)</i>	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%)
<b>Total Direct Route Revenue</b>	<b>19,663</b>	<b>19,351</b>	<b>312</b>	<b>1.6%</b>
<b>Indirect Route Revenue</b>				
Ferry transportation fees	47,590	25,283	22,307	88.2%
Federal-Provincial subsidy	6,660	6,505	155	2.4%
<b>Total Route Revenue</b>	<b>73,913</b>	<b>51,139</b>	<b>22,774</b>	<b>44.5%</b>

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

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

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

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

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

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

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

## Other Routes

Years ended March 31 (\$ thousands)	2010	2009	Increase	(Decrease)
<b>Direct Route Revenue</b>				
<i>Vehicle traffic (volume)</i>	4,484,535	4,402,295	82,240	1.9%
Vehicle tariff	63,646	57,638	6,008	10.4%
<i>Passenger traffic (volume)</i>	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%
<b>Total Direct Route Revenue</b>	<b>126,798</b>	<b>114,294</b>	<b>12,504</b>	<b>10.9%</b>
<b>Indirect Route Revenue</b>				
Ferry transportation fees	79,858	79,950	(92)	(0.1%)
Federal-Provincial subsidy	20,264	19,789	475	2.4%
<b>Total Route Revenue</b>	<b>226,920</b>	<b>214,033</b>	<b>12,887</b>	<b>6.0%</b>

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.

# MANAGEMENT'S DISCUSSION & ANALYSIS

## Expenses

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

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

## RESTRUCTURING

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

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



# MANAGEMENT'S DISCUSSION & ANALYSIS

## YEAR TO YEAR COMPARISON OF EXPENSES 2011–2010

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

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

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

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

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

Interest expenses increased \$4.5 million primarily due to:

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

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

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

## YEAR TO YEAR COMPARISON OF EXPENSES 2010–2009

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

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

These increases were partially offset by:

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

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

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

- \$4.4 million decrease in wages and benefits, including:
  - \$2.0 million additional restructuring costs incurred in fiscal 2009;
  - \$1.9 million reduction in fiscal 2010 reflecting the lower number of exempt positions from the restructuring;
  - \$0.5 million in reduced incentive compensation; and

# MANAGEMENT'S DISCUSSION & ANALYSIS

- \$2.5 million mainly due to transition costs incurred in fiscal 2009 to move IT systems support to an in-house model and reductions in discretionary expenditures.

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

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

Interest expenses increased \$17.5 million primarily due to:

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

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

## DEFERRED FUEL COST ACCOUNTS

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

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

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

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

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

Under an agreement reached during fiscal 2008, the Province has agreed to pay benefits which are applied to the deferred fuel cost accounts. These benefits, totalling \$1.6 million for each of fiscal 2011 and fiscal 2010, are equal to the amount by which annual ferry transportation fees payable by the Province were reduced as

# MANAGEMENT'S DISCUSSION & ANALYSIS

a result of the lower cost of the *Northern Adventure* due to remission and refund of import duties paid. These reductions in the deferred fuel cost accounts benefit our customers through reduced fuel surcharges or earlier fuel rebates.

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

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

All of the Commissioner's orders can be viewed at [www.bcferrycommission.com](http://www.bcferrycommission.com).

## Liquidity and Capital Resources

### LIQUIDITY AND CAPITAL RESOURCES

We fund our operations and capital acquisitions with cash flow generated from operations, as well as bank financing and debt issues. On October 1, 2010, it was announced that our request for duty remission for vessels built in Germany totalling \$119.4 million (including related GST) had been granted. These funds were received from the Government of Canada in December 2010.

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

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

### LONG-TERM DEBT

Our long-term debt is summarized below:

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

\* Floating rate as at March 31, 2011.

# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

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

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

## Terminal Leases

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

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

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

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

## Other Long-Term Liabilities

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

## SOURCES & USES OF CASH

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

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

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

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

- \$8.6 million in fuel rebates granted;
- \$0.3 million in fuel and interest costs deferred; and
- \$0.1 million in performance term three submission costs; partially offset by:
- \$1.5 million in other payments from the Province credited to deferred fuel accounts.



# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

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

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

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

Cash used in investing activities consisted of:

- \$122.2 million used to purchase capital assets (See "Investing in Our Capital Assets" below for detail of significant purchases);
- \$56.4 million used to purchase short-term investments; and
- \$24.2 million advanced to the developer of our new corporate office building; partially offset by:
- \$119.4 million received for remission of import duties and related GST;
- \$11.2 million in proceeds primarily from the sale of our former corporate office building; and
- \$0.2 million reduction in debt service reserve.

## Fourth Quarter Results

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

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

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

## REVENUE

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

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

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

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

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

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

## EXPENSES

Expenses are shown in the following table:

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

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

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

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

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

## Investing in our Capital Assets

### ASSETS ACQUIRED UNDER CAPITAL LEASE

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

The initial term of the lease is 15 years, with four renewal options of five years each. In November 2010, we advanced \$24.2 million to the developer of the property for a term of 15 years, secured by a second mortgage on the property. The loan agreement provides for interest equal to one-half of the net cash flow from the property, subject to minimum and maximum percentage rates of interest. Over the term of the loan, interest is expected to approximate the market rate when the loan was made. Incidental to the loan, we were granted an option to purchase up to 50% of the owner's equity interest in the new building at a price of \$24.2 million. Final adjustments were made on April 15, 2011, bringing the total amount of the loan and the purchase option to \$24.5 million. The purchase option expires at the end of the loan term.

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

### CAPITAL EXPENDITURES

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

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

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

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

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

### VESSEL UPGRADES AND MODIFICATIONS

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

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

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

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

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

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

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

## TERMINAL MARINE STRUCTURES

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

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



# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

## TERMINAL AND BUILDING UPGRADES AND EQUIPMENT

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

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

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

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

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

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

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

At nine terminals, mainly serving our Major and Northern Routes, we continued our multi-year project to upgrade security. This project primarily involves fencing, gating, lighting, access controls, and closed circuit television, as well as upgrades to foot passenger ticketing areas and baggage screening. We received \$3.2 million in the first quarter of fiscal 2011, bringing the total to \$9.1 million of federal funding through the Transport Canada Marine Security Contribution Program to help offset our costs of perimeter security, access control measures, and training.

## INFORMATION TECHNOLOGY

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

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

# MANAGEMENT’S DISCUSSION & ANALYSIS

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

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

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

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

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

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

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

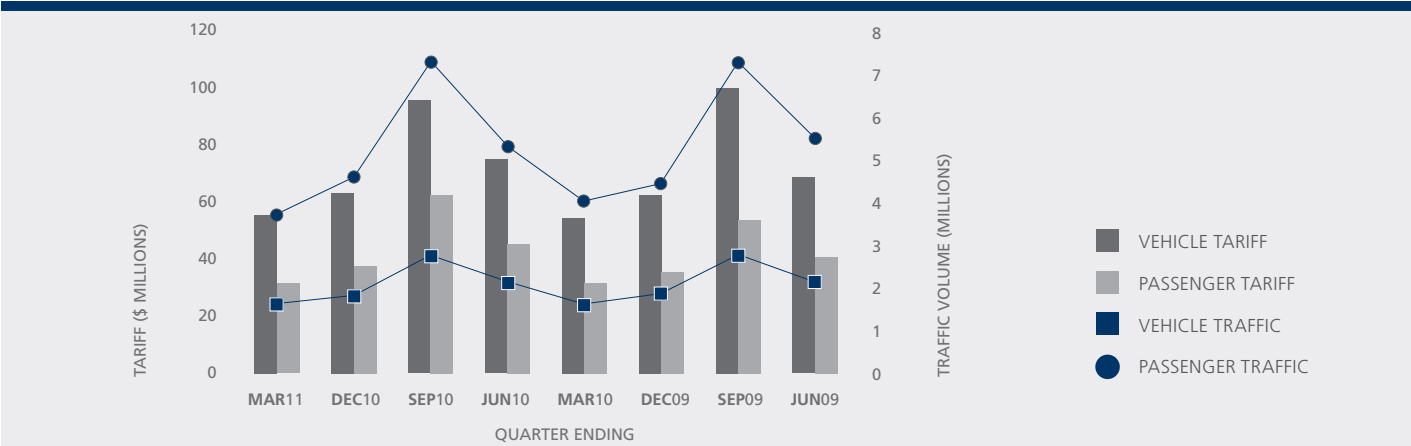
## Summary of Quarterly Results

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

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

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

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



# MANAGEMENT'S DISCUSSION & ANALYSIS

## Outlook

### TRAFFIC LEVELS

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

Our traffic levels have historically been relatively stable. However, during fiscal 2009, vehicle and passenger traffic were lower than the prior year by 5.2% and 4.9%, respectively. In fiscal 2009, the Canadian and world economies experienced turbulence in the financial markets and a recessionary period. British Columbia experienced fewer housing starts, reduced tourism, plant closures in the forest product industry, falling auto sales, dramatically higher vehicle fuel prices during the first part of the fiscal year, rising unemployment, and generally reduced consumer confidence. These and other declining economic conditions all negatively impacted our commercial and discretionary travel markets. The downturn in traffic in fiscal 2009 was at least partly due to these economic conditions.

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

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

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

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

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

### MARKET OPPORTUNITIES

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

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

## ASSET RENEWAL PROGRAM

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

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

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

## CABLE FERRY

In fiscal 2011, we completed our review of the feasibility of using cable ferry technology on one of our shortest routes. We determined that using a cable ferry is both technically and financially feasible. Cable ferry technology uses small engines in combination with drive and guide cables to move the vessel. Not only do cable ferries have a lower capital cost than conventional ferries, but a reduction in operating costs would also be expected. We are in the process of seeking regulatory and environmental approvals that are required before such a service could be implemented. Safety, reliability and quality of service will continue to be important considerations in the overall assessment of this concept. This initiative is part of our ongoing efforts to identify and pursue opportunities that have the potential to enhance our effectiveness in delivering safe, reliable, and quality ferry service.

## ALTERNATIVE SERVICE PROVIDERS

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

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

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

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

## FINANCIAL OUTLOOK

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

We are currently forecasting a net loss estimated to be in the range of \$20 million for fiscal 2012, largely driven by significantly lower traffic levels than those included in setting our performance term two price caps. Despite the loss, we have no plans to reduce our refit and maintenance programs, training and safety programs or capital programs. Although lower traffic levels are the major

# MANAGEMENT'S DISCUSSION & ANALYSIS

driver, other contributing factors to this loss are such items as the HST, Transport Canada requirements and freedom of information overhead expenses and other costs associated with Bill 20. We expect to return to profitability in fiscal 2013, the first year of performance term three.

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

## Financial Risks and Financial Instruments

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

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

### CREDIT RISK

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

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

### LIQUIDITY RISK

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

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

### MARKET RISK

#### Interest Rate

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

#### Foreign Currency

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

#### Fuel Price

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

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

High levels of fuel pricing could translate into significant fuel surcharges and result in unprecedented total tariff levels. There is uncertainty of the impact on future ferry traffic levels if fuel



# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

## Derivatives

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

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

## Non-Derivative Financial Instruments

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

(\$ millions)	2011		2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial Assets</b>				
Cash and cash equivalents	33.3	33.3	10.6	10.6
Restricted short-term investments	37.0	37.0	37.2	37.2
Other short-term investments	64.1	64.1	7.7	7.7
Accounts receivable	20.6	20.6	18.8	18.8
Loan receivable	24.2	24.2	—	—
	179.2	179.2	74.3	74.3

(\$ millions)	2011		2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial Liabilities</b>				
Accounts payable and accrued liabilities	51.2	51.2	38.9	38.9
Short-term debt	3.9	3.9	—	—
Interest payable on long-term debt	18.3	18.3	18.3	18.3
Accrued employee costs	48.2	48.2	48.6	48.6
Long-term debt, including current portion	1,349.1	1,464.0	1,357.2	1,458.1
Other long-term liabilities	—	—	0.2	0.2
	1,470.7	1,585.6	1,463.2	1,564.1

# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

## Business Risk Management

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

We do not believe that material uncertainties exist in regards to our future. As part of our risk management strategies, we have considered many items such as profitability levels, cash generating potential, cash utilization requirements including debt repayment schedules and future capital expenditures, and working capital requirements. We have taken measures to allow us to weather the economic downturn and ensure a viable, profitable future.

### CUSTOMER DEMAND

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

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

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

### SECURITY

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

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

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

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

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

### SAFETY

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

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

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

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

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

management system including the introduction of an operational risk assessment and management process.

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

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

## PERFORMANCE RISK

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

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

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

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

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

## REGULATIONS – ENVIRONMENTAL

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

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

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

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

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

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

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

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

## ECONOMIC REGULATORY ENVIRONMENT

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

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

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

## REGULATIONS – OTHER

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

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

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

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

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

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

## ACCESS TO CAPITAL MARKETS

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

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

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

## VESSEL REPAIR FACILITIES

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

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

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

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

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

## LABOUR RELATIONS—COLLECTIVE AGREEMENT

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

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

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

## LABOUR RELATIONS—APPLICATION FOR EXCLUSIONS

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

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

## TAXES

We received an advance income tax ruling from Canada Revenue Agency (CRA) that, provided the facts and other statements set out therein are accurate, we are a "Tax Exempt Corporation" described in paragraph 149(1)(d.1) of the *Income Tax Act*. This ruling was subject to a proposed amendment to subsection 149(1.3) of the *Income Tax Act* announced by the Department of Finance

on December 20, 2002. The essential elements of this amendment were included in Bill C-10, which was cancelled when Parliament was dissolved before the 2008 federal election and then subsequently included in the July 16, 2010 draft *Income Tax Amendments Act*, 2010, which had not been introduced into Parliament prior to Parliament being dissolved before the 2011 federal election. There is no reason to believe that the proposed amendment to subsection 149(1.3) will not be reintroduced. We have received a non-binding opinion from CRA that subsection 149(1.3), if amended as proposed on December 20, 2002, will not cause us to cease to be a Tax Exempt Corporation. There can be no assurance that subsection 149 (1.3) of the *Income Tax Act* will be amended as proposed, or that we are and will continue to be a Tax Exempt Corporation.

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

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

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

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

## TREATY NEGOTIATIONS—ABORIGINAL RIGHTS AND TITLE

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



# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

## Accounting Practices

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

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

#### **Workers' Compensation Claims Liability**

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

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

#### **Public Service Pension Plan**

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

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

#### **Retirement Bonus Liability**

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

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

#### **Rate Regulation**

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

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

## **Amortization Expense**

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

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

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

## **Hedging Relationships**

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

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

## **Asset Retirement Obligations**

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

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

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

## **ADOPTION OF NEW ACCOUNTING STANDARDS**

No new accounting standards have been adopted for fiscal 2011.

## **FUTURE ACCOUNTING CHANGES**

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

- In 2006, the Canadian Accounting Standards Board (AcSB) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian generally accepted accounting principles with IFRS over an expected five year transitional period.

# MANAGEMENT'S DISCUSSION & ANALYSIS

Our changeover date for the conversion to IFRS was originally April 1, 2011. However, the AcSB has amended Part 1 of the CICA Handbook – Accounting to require:

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

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

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

Transition to IFRS will require the restatement for comparative purposes of amounts reported by us for the year prior to changeover date. We are continuing to assess the financial reporting impacts of the adoption of IFRS and are monitoring ongoing standards development as issued by the International Accounting Standards Board and the AcSB as well as regulatory developments as issued by the Canadian Securities Administrators, which may affect the timing, nature or disclosure relating to our adoption of IFRS.

The transition to IFRS may materially affect our reported financial position and results of operations. As our analysis is still underway, we are unable to fully determine the impact of IFRS on the future financial position and results of operations.

We commenced our IFRS transition project in 2007 and have established a formal project governance structure with regular

reporting. We have also engaged a quality assurance advisor to assist in the project.

Our IFRS transition project consists of three phases:

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

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

The following table includes elements of our IFRS transition plan and an assessment of progress towards achieving the key milestones which have been amended to reflect our election to defer our changeover to IFRS by one year, to April 1, 2012. We are working through a detailed IFRS transition plan and certain project activities and milestones could change. Further, changes in regulation or timing of standard development throughout the project could result in changes to the transition plan.

## Financial statement preparation

### KEY ACTIVITIES

- Identify differences in Canadian GAAP/IFRS accounting policies
- Select ongoing IFRS policies
- Develop financial statement format
- Select IFRS 1 exemptions for transition
- Quantify effects of change at April 1, 2011 (for fiscal 2012 comparative financial statements)

### MILESTONES

- Senior management review of policy decisions and illustrative IFRS financial statements and disclosures by June 30, 2011
- Audit & Finance Committee approval of policy decisions and IFRS financial statement format, in principle, by September 30, 2011
- IFRS 1 exemptions finalized and quantified by September 30, 2011
- Policies and procedures in place by March 31, 2012

### STATUS

- Scoping and diagnostic phase completed in fiscal 2009, with high-level review of the major differences between Canadian GAAP and IFRS
- Highest areas of impact identified; review prioritized; and in-depth analysis complete
- Accounting policy alternatives have been analyzed and recommendations made for key accounting policy decisions
- IFRS 1 exemptions reviewed and analyzed
- Preparation of illustrative financial statements and note disclosures complete
- Drafting of policies and procedures in progress

# MANAGEMENT’S DISCUSSION & ANALYSIS

## Information technology infrastructure

### KEY ACTIVITIES

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

### MILESTONES

- System configuration changes complete by March 31, 2010
- System reporting changes required to accommodate both current Canadian GAAP and IFRS complete by August 31, 2010
- Changes to budgeting and forecasting processes complete by June 30, 2011

### STATUS

- Detailed reporting requirements to accommodate the transition to IFRS identified and documented
- Overall system approach selected
- System configuration to accommodate both current Canadian GAAP and IFRS complete
- System changes to accommodate reporting requirements complete
- Review to determine effects on the project of one-year deferral of changeover and absence of standard on rate-regulation complete
- Changes to budgeting and forecasting processes in progress

## Training, education & communication

### KEY ACTIVITIES

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

### MILESTONES

- Topic-specific training for IFRS working committee complete prior to March 31, 2010
- Department-specific training completed by March 31, 2012
- Impacts of transition to IFRS communicated to external stakeholders by March 31, 2012

### STATUS

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

## Control environment

### KEY ACTIVITIES

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

### MILESTONES

- All internal control process descriptions updated by March 31, 2012
- Publish quantitative effects of conversion on April 1, 2011 opening balance sheet in December 31, 2011 MD&A

### STATUS

- Analysis of control issues in progress as part of the detailed implementation plan
- Review and update of process descriptions in progress
- Documentation of policies and procedures nearing completion

## Business policy assessment

### KEY ACTIVITIES

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

### MILESTONES

- Potential impact on compensation arrangements determined by December 31, 2011
- Impact on customer/supplier contracts determined by December 31, 2011
- Impact on financial covenants quantified by March 31, 2012

### STATUS

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

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

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

This project on rate-regulated activities has been closed. There are no further discussions planned for this project. The IASB plans to consult constituents in 2011 on whether issues relating to rate-regulated activities should be considered in a new project in its post-2011 agenda.

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

- **Property, plant and equipment:**
  - *Inspections and major overhauls:* The capitalization of inspections and major overhauls of our vessels is a significant change affecting us. A process to track these items has been finalized and necessary system configuration changes have been completed. We have defined and identified inspection and major overhaul items for each class of vessel and are in the process of quantifying them for reclassification at transition date. We are also currently working on internal reporting solutions.

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

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

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

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

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



# MANAGEMENT'S DISCUSSION & ANALYSIS

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

## Corporate Structure and Governance

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

## Forward Looking Statements

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

Forward looking statements included in this document include statements with respect to our: short-term and long-range business plans, and asset renewal programs for vessels and terminals; expectations regarding traffic levels, vacation package sales, and our lack of need to access capital markets for at least the next two years; expectations of a net loss in fiscal 2012, a return to profitability in 2013 and the impacts of the HST, certain Transport Canada requirements, and costs associated with Bill 20; estimates of funding under the Infrastructure Stimulus Fund program; and expectations regarding the impacts of IFRS. In some cases, forward looking statements can be identified by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue" or the negative of these terms or other comparable terminology. A number of factors could cause actual events or results to differ materially from the results discussed in the forward looking statements. In evaluating these statements,

prospective investors should specifically consider various factors including, but not limited to, the risks and uncertainties associated with traffic volume and tariff revenue risk, safety and security, asset risk, accident risk, tax risk, environmental risk, regulatory risk, labour disruption risk, limitations of vessel repair facilities, risk of default under material contracts and aboriginal land claims.

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

## Schedule A CORPORATE STRUCTURE AND GOVERNANCE

### Board of Directors

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

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

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

In the fiscal year ended March 31, 2011, the Province of British Columbia enacted legislation, the *Miscellaneous Statutes Amendment Act (No.3), 2010* (Bill 20), which amended several statutes, including the CFA. The amendments to the CFA responded

# MANAGEMENT’S DISCUSSION & ANALYSIS

to the Comptroller General’s Report on Review of Transportation Governance Models, released November 6, 2009, and included provisions that changed the governance framework within which BCFA and BCFS operate.

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

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

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

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

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

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

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

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

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

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

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

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

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

## DIRECTORSHIPS

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

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

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

## ORIENTATION AND CONTINUING EDUCATION

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

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

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

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

## ETHICAL BUSINESS CONDUCT

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

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

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

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

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

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

## NOMINATION OF DIRECTORS

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

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

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

## EXECUTIVE COMPENSATION

### **Future:**

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

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

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

### **Current:**

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

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

## DIRECTOR COMPENSATION

### **April 1, 2010 – September 30, 2010:**

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

### **Effective October 1, 2010:**

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

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

## PROTOCOL AGREEMENT

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

## BOARD COMMITTEES

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

### Audit & Finance Committee:

Members April 1, 2010 to September 30, 2010:

Chair: Brian G. Kenning

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

Members effective September 30, 2010:

Chair: Brian G. Kenning

Members: Elizabeth J. Harrison, P. Geoffrey Plant and Graham M. Wilson

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

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

- assess the qualifications and independence of the external auditors, and recommend to the Board the nominations of the external auditors and the compensation to be paid to the external auditors.

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

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

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

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

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

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

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

# MANAGEMENT'S DISCUSSION & ANALYSIS

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

**Safety, Health, Environment & Security Committee:**

Members April 1, 2010 to September 30, 2010:

Chair: Wayne H. Stoilen

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

Members effective September 30, 2010:

Chair: Wayne H. Stoilen

Members: Holly A. Haston-Grant and Maureen V. Macarenko

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

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

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

**Governance & Nominating Committee:**

Members April 1, 2010 to September 30, 2010:

Chair: A. Daniel Miller

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

Members effective September 30, 2010:

Chair: Elizabeth J. Harrison

Members: P. Geoffrey Plant and Wayne H. Stoilen

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

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

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



# MANAGEMENT'S DISCUSSION & ANALYSIS

## **Human Resources & Compensation Committee:**

Members April 1, 2010 to September 30, 2010:

Chair: Jane L. Peverett

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

Members effective September 30, 2010:

Chair: Graham M. Wilson

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

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

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

## **ASSESSMENTS**

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

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

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

# 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 & Finance Committee, oversees management's responsibilities for financial reporting and internal control. The Audit & 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 & 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  
June 7, 2011

# INDEPENDENT AUDITORS' REPORT

## To the Shareholders of British Columbia Ferry Services Inc.

We have audited the accompanying consolidated financial statements of British Columbia Ferry Services Inc., which comprise the consolidated balance sheets as at March 31, 2011 and March 31, 2010 and the consolidated statements of earnings, comprehensive income and retained earnings and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

## Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

## Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinions.

## Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of British Columbia Ferry Services Inc. as at March 31, 2011 and March 31, 2010, and its results of operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

The image shows a handwritten signature in white ink that reads "KPMG LLP". The signature is stylized, with the letters "KPMG" being larger and more prominent than "LLP".

CHARTERED ACCOUNTANTS

Victoria, Canada  
June 7, 2011

# CONSOLIDATED FINANCIAL STATEMENTS

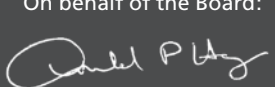
## British Columbia Ferry Services Inc.

CONSOLIDATED BALANCE SHEETS (EXPRESSED IN THOUSANDS)

As at March 31	2011	2010
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 33,335	\$ 10,608
Restricted short-term investments (note 2(e))	37,040	37,240
Other short-term investments	64,074	7,678
Accounts receivable (note 4(a))	20,619	18,832
Prepaid expenses	5,648	5,688
Inventories	19,957	18,040
Regulatory assets (note 6)	3,703	4,775
	184,376	102,861
Property, plant and equipment (note 7)	1,581,007	1,644,069
Intangible assets (note 8)	34,929	26,406
Assets held for sale (note 9)	–	200
Long-term loan receivable (note 12)	24,247	–
Long-term land lease (note 10)	32,979	33,437
	\$ 1,857,538	\$ 1,806,973
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 51,249	\$ 38,884
Short-term debt (note 2(d))	3,949	–
Interest payable on long-term debt	18,261	18,319
Accrued employee costs	48,194	48,644
Deferred revenue	15,596	16,023
Derivative liabilities (note 4(c))	23	–
Current portion of long-term debt (note 2)	22,125	9,000
Current portion of accrued employee future benefits (note 11)	1,200	800
Current portion of obligations under capital lease (note 12)	1,040	398
	161,637	132,068
Accrued employee future benefits (note 11)	10,907	11,130
Regulatory liabilities (note 6)	1,558	4,325
Long-term debt (note 2)	1,327,014	1,348,183
Obligations under capital lease (note 12)	47,723	139
Other long-term liabilities	–	172
	1,548,839	1,496,017
Shareholders' equity:		
Share capital (note 13)	75,478	75,478
Retained earnings	233,221	235,478
	308,699	310,956
Commitments (notes 7 and 17)		
Contingent liabilities (notes 1(s) and 19)		
	\$ 1,857,538	\$ 1,806,973

See accompanying notes to consolidated financial statements.

On behalf of the Board:



Donald P. Hayes, Director



Brian G. Kenning, Director

# CONSOLIDATED FINANCIAL STATEMENTS

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

Years ended March 31	2011	2010
Revenue:		
Tariffs	\$ 458,049	\$ 450,508
Ferry service fees (note 14)	151,023	149,507
Federal-Provincial Subsidy Agreement (note 15)	26,924	26,924
Retail	78,920	80,809
Other income	24,354	24,557
	739,270	732,305
Expenses:		
Operations	411,116	398,792
Maintenance	85,717	85,579
Administration	31,169	30,330
Cost of retail goods sold	29,659	30,127
Amortization	114,486	115,175
	672,147	660,003
Earnings from operations	67,123	72,302
Gain on foreign exchange	173	144
Interest expense (note 16)	(72,173)	(67,638)
Gain (loss) on disposal and impairment of capital assets (notes 7 and 9)	8,658	(1,386)
Net earnings	3,781	3,422
Other comprehensive income (note 1(u))	–	–
Net earnings and comprehensive income	3,781	3,422
Retained earnings, beginning of year	235,478	238,094
Preferred share dividend (note 13)	(6,038)	(6,038)
Retained earnings, end of year	\$ 233,221	\$ 235,478

See accompanying notes to consolidated financial statements.

# CONSOLIDATED FINANCIAL STATEMENTS

## CONSOLIDATED STATEMENTS OF CASH FLOWS (EXPRESSED IN THOUSANDS)

As at March 31	2011	2010
Cash provided by (used in):		
Operations:		
Net earnings	\$ 3,781	\$ 3,422
Items not involving cash:		
Amortization	114,486	115,175
Other non-cash items	(6,659)	1,854
Long-term regulatory costs deferred	(7,543)	10,314
Change in non-cash operating working capital (note 20)	2,765	(9,468)
	106,830	121,297
Financing:		
Dividends paid on preferred shares	(6,038)	(6,038)
Repayment of long-term debt	(9,000)	(9,000)
Proceeds from (repayment of) short-term loans	3,949	(17,956)
Repayment of capital lease obligations	(1,021)	(541)
	(12,110)	(33,535)
Investing:		
Proceeds from disposal of property, plant and equipment	11,181	2,135
Purchase of property, plant and equipment and intangible assets	(122,180)	(84,166)
Recovery of import duties and related taxes (note 7)	119,449	–
Reduction of restricted short-term investments	200	–
Advancement of long-term loan	(24,247)	–
Purchase of short-term investments	(56,396)	(7,525)
	(71,993)	(89,556)
Increase (decrease) in cash and cash equivalents	22,727	(1,794)
Cash and cash equivalents, beginning of year	10,608	12,402
Cash and cash equivalents, end of year	\$ 33,335	\$ 10,608

Supplemental cash flow information (note 20)

See accompanying notes to consolidated financial statements.



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## YEARS ENDED MARCH 31, 2011 AND 2010 (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.

On June 24, 2010, the Province enacted the *Miscellaneous Statutes Amendment Act* (No.3), 2010, (Bill 20), amending several statutes, including the Act. The amendments include changes to the governance and regulatory framework within which the Company operates.

Among other things, the Bill 20 amendments to the Act changed the mandate of the Authority to include: responsibility for the compensation plans of the Company's directors and certain executive officers; a requirement that effective September 30, 2010, a director of the Authority cannot also be a director of the Company; and subjected the records of the Company and the Authority to the *Freedom of Information and Protection of Privacy Act*. The amendments to the regulatory framework expanded the responsibilities of the Commissioner to include: consideration of the interests of ferry users, regulation of reservation fees, and regulation of ferry transportation services where the Commissioner determines the Company has an unfair competitive advantage.

## 1. SIGNIFICANT ACCOUNTING POLICIES:

### (a) Basis of presentation:

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles 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) Future accounting changes:

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

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

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

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

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

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

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

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

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The IASB has closed the current project on rate-regulated activities and plans to consult constituents in 2011 on whether issues relating to rate-regulated activities should be considered in a new project in its post-2011 agenda.

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

## **(c) 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.

## **(d) Cash and cash equivalents:**

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

## **(e) Short-term investments:**

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

## **(f) 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.

## **(g) 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 earnings 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 except for permanent impairment losses which are recognized in net earnings as incurred. 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,

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- 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).

## (h) Embedded derivatives:

As at March 31, 2011, the Company has no embedded derivatives that meet the requirements of Section 3855 which would require that they be separated from host contracts and valued separately at fair value.

## (i) 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.

## (j) 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 as follows:

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

## (k) Intangible assets:

The costs of acquired computer software, licenses and rights of use as well as internally developed computer software and websites are capitalized. These intangible assets are valued at their acquisition cost plus direct overhead and financing costs, less amortization. Computer software, licenses, and websites are amortized on a straight-line basis over their estimated useful lives of 3 to 7 years. Rights of use intangible assets are amortized on a straight-line basis over their estimated useful lives of 20 to 30 years.

## (l) 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 value. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

## (m) 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.

## (n) 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).

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 6.8 years as at March 31, 2010, 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.

## **(o) 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.

## **(p) 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/HST purposes.

## **(q) 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.

## **(r) Debt transaction costs:**

Legal and financing costs incurred for arranging long-term debt 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.

## **(s) 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.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## (t) 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.

## (u) Comprehensive income:

The Company has not recognized any adjustments through other comprehensive income for the years ended March 31, 2011 and 2010.

## (v) Comparative figures:

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

## 2. LOANS:

As at March 31

	2011	2010
<b>Long-term debt:</b>		
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%)	67,500	75,000
Tranche B (floating interest rate of 1.39% at March 31, 2011)	22,500	15,000
12 Year Loan, maturing June 2020 (b)		
Tranche A (effective interest rate 5.18%)	69,375	76,875
Tranche B (floating interest rate of 1.38% at March 31, 2011)	20,625	13,125
2.95% Loan, maturing January 2021 (effective interest rate 3.08%) (c)	90,000	99,000
	1,360,000	1,369,000
Less: Deferred financing costs and unamortized bond discounts	(10,861)	(11,817)
Current portion	(22,125)	(9,000)
	<b>\$1,327,014</b>	<b>\$1,348,183</b>

Principal repayments due in the next five years are:

### Year ended

2012	\$ 22,125
2013	24,000
2014	164,000
2015	274,000
2016	24,000
Thereafter	851,875
	<b>\$ 1,360,000</b>

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.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## (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 is paid in periods ranging from one to six months at the option of the Company, and the principal is paid at the end of the term. The interest rates on the second tranche are reset at floating rates of CAD LIBOR plus 30 bps, which will vary depending on the interest payment period.

## (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 \$3.9 million as at March 31, 2011 (2010: \$nil), and are shown as short-term debt. The interest rate on these borrowings was 3.0% at March 31, 2011. Interest expensed during the year ended March 31, 2011, was \$nil (2010: \$0.1 million). In addition, letters of credit outstanding against this facility at March 31, 2011 totalled \$0.2 million (2010: \$0.3 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 12 year loans and the 2.95% loans equal to not less than six months forecasted debt service, to be increased under certain conditions. As permitted under the terms of the 2.95% loan, during the year ended March 31, 2011, the Company withdrew \$0.2 million from the debt service reserves representing six months interest on the principal paid to date on this loan.

As at March 31, 2011, debt service reserves of \$37.0 million were held in short-term investments and have been classified as restricted short-term investments on the balance sheet (2010: \$37.2 million).



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 3. FINANCIAL INSTRUMENTS:

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

As at March 31	2011		2010	
	Carrying Value	Approx Fair Value	Carrying Value	Approx Fair Value
Available for sale <sup>1</sup>				
Cash	\$ 1,648	\$ 1,648	\$ 1,617	\$ 1,617
Held-for-trading <sup>2</sup>				
Other cash equivalents	137	137	8,991	8,991
Restricted short-term investments	37,040	37,040	37,240	37,240
Derivative liabilities	23	23	—	—
Held-to-maturity <sup>3</sup>				
Investments with maturities < 3 months	31,550	31,550	—	—
Other short-term investments	64,074	64,074	7,678	7,678
Loans and receivables <sup>3</sup>				
Accounts receivable	20,619	20,619	18,832	18,832
Loan receivable <sup>4</sup>	24,247	24,247	—	—
Other financial liabilities <sup>3</sup>				
Accounts payable and accrued liabilities	51,249	51,249	38,884	38,884
Short-term debt	3,949	3,949	—	—
Interest payable on long-term debt	18,261	18,261	18,319	18,319
Accrued employee costs	48,194	48,194	48,644	48,644
Long-term debt, including current portion <sup>5,6</sup>	1,349,139	1,463,954	1,357,183	1,458,074
Other long-term liabilities	—	—	172	172

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 fair value except as noted.

4 Measured at amortized cost. Carrying value approximates fair value as the rate of return is variable and is expected to return a market rate of interest.

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

6 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, 2011, or by using available quoted market prices.

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, 2011, 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, 2011, 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.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2011 and 2010.

**(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, 2011**

Trade customers and miscellaneous	42.5%	\$	8,767
Federal and Provincial governments	57.5%		11,852
Total	100.0%	\$	20,619

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, 2011, 99% of trade receivables are current. At March 31, 2011, the provision for impairment of credit losses was \$0.1 million (2010: \$0.1 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 investment parameters, 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.

**(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.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As at March 31, 2011 and 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	A+

The following is an analysis of the contractual maturities of the Company's financial liabilities as at March 31, 2011.

Financial liabilities	< 1 year	2-3 years	4-5 years	> 5 years	Total
Accounts payable and accrued liabilities	\$ 51,249	\$ –	\$ –	\$ –	\$ 51,249
Short-term debt	3,949	–	–	–	3,949
Interest payable on long-term debt	18,261	–	–	–	18,261
Accrued employee costs	48,194	–	–	–	48,194
Obligations under capital lease, including current portion	1,040	1,980	2,322	43,421	48,763
Long-term debt, including current portion (excluding deferred costs) <sup>1</sup>	22,125	188,000	298,000	851,875	1,360,000
	\$ 144,818	\$ 189,980	\$ 300,322	\$ 895,296	\$ 1,530,416

<sup>1</sup> Carrying value at March 31, 2011, is net of unamortized deferred financing costs of \$10.9 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 12 year 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, 2011, the Company has no interest rate agreements in place to offset interest rate risk and had approximately three 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, 2011.

### 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, 2011, the Company has foreign currency forward contracts of \$1.2 million (2010: \$nil). A 10 per cent change in foreign exchange rates would not have had a significant effect on earnings for the 12 months ended March 31, 2011.

### 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 hedging instruments with certain financial intermediaries in order to reduce price volatility and 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 Financial Risk Management Policy, the term of the contracts is not to extend beyond three years. This policy limits hedging, to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period; 90% of anticipated monthly fuel consumption for the 12 month period thereafter and to 85% of anticipated monthly fuel consumption for the remaining 12 month period.

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:

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- 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, 2011, the amounts receivable from the Province in relation to fuel cost differences totalled \$0.2 million (2010: \$1.3 million payable to 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, 2011		March 31, 2010	
	\$	%	\$	%
Aggregate borrowings <sup>1</sup>	1,563,763	83.50	1,524,537	83.04
Shareholders' equity <sup>2</sup>	309,020	16.50	311,281	16.96
Total capital	1,872,783	100.00	1,835,818	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 certain guarantees and certain investments may be restricted when aggregate borrowings exceed 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](http://www.SEDAR.com). The Company was in compliance with all of its covenants throughout the years ended March 31, 2011 and 2010.

## 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

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2011, would have been \$1.7 million lower (2010: \$13.1 million higher) as detailed below:

Year ended March 31	2011	2010
<b>Impact of regulatory accounts on net earnings</b>		
<b>First performance term accounts:</b>		
Deferred fuel costs (a)	\$ (4,625)	\$ (4,625)
Performance term submission costs (b)	(150)	(150)
<b>Second performance term accounts:</b>		
Deferred fuel costs (a)	7,393	(11,321)
Performance term submission costs (b)	148	84
Tariffs in excess of price cap (c)	(1,072)	2,858
Total increase (decrease) in net earnings resulting from regulatory accounts	\$ 1,694	\$ (13,154)
Unamortized training costs (note 8)	48	65
Total increase (decrease) in net earnings	\$ 1,742	\$ (13,089)

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	2011	2010
<b>Regulatory accounts</b>		
<b>First performance term accounts:</b>		
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	(14,326)	(9,550)
Total of first performance term accounts	4,775	9,551
<b>Second performance term accounts:</b>		
Deferred fuel costs (a)		
Balance – beginning of year	(9,185)	1,213
Fuel costs deferred (including realized hedge gains and losses)	849	(16,082)
Rebates granted	8,593	6,298
Fuel price risk (recoveries from) payments to the Province (note 4 (c))	(196)	1,273
Other payments from the Province	(1,556)	(1,620)
Interest payable	(295)	(267)
Balance – end of year	(1,790)	(9,185)
Tariffs in excess of price cap (c)	(1,072)	–
Performance term submission costs (b)	232	84
Total of second performance term accounts	(2,630)	(9,101)
Total regulatory assets	2,145	450
Current regulatory assets	3,703	4,775
Total long-term regulatory (liabilities)	\$ (1,558)	\$ (4,325)

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## (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, 2011, the Province agreed to pay \$1.6 million, to be applied against the balance of deferred fuel costs (2010: \$1.6 million).

During the year ended March 31, 2011, the Company recognized \$4.6 million in amortization expense for deferred fuel costs (2010: \$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.

## (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) 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, 2011, tariffs charged to customers on the Major Route Group exceeded the price cap by \$1.1 million. At March 31, 2010, tariffs charged to customers on all route groups were below established price caps.

## 7. PROPERTY, PLANT AND EQUIPMENT:

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

March 31, 2010	Cost	Accumulated amortization	Net book value
Vessels	\$ 1,773,172	\$ 554,313	\$ 1,218,859
Berths, buildings and equipment	86,483	51,461	35,022
Berths, buildings and equipment under capital lease	603,326	257,074	346,252
Land	1,406	—	1,406
Construction-in-progress	42,530	—	42,530
	\$ 2,506,917	\$ 862,848	\$ 1,644,069



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

During the year ended March 31, 2011, the Company received \$119.4 million of duty remission, including related GST from the Government of Canada, relating to the purchase of four vessels built in Germany. This amount was recorded as a reduction of the cost of these assets.

During the year ended March 31, 2011, the Company disposed of its former head office building located at 1112 Fort Street, Victoria for \$11.0 million, resulting in a gain on sale of \$9.3 million.

Capitalized financing costs during construction for property, plant and equipment for the year ended March 31, 2011, totalled \$2.5 million (2010: \$2.5 million). Amortization expense for assets under capital lease for the year ended March 31, 2011, totalled \$20.2 million (2010: \$18.3 million).

In addition to the construction-in-progress referenced above, the contractual commitments at March 31, 2011 for capital assets to be constructed, totalled \$48.7 million (2010: \$25.6 million).

The Government of Canada, through the Infrastructure Stimulus Program, has agreed to provide funding to help offset the costs of sewage and waste water treatment and other major projects at certain of our terminals. The Company expects to receive a total of \$9.2 million under this program. During the year ended March 31, 2011, \$6.1 million (2010: \$nil) of this amount has been recorded as a reduction of the cost of property, plant and equipment.

During the year ended March 31, 2011, the Company received \$0.8 million (2010: \$0.9 million) of rental income earned from buildings held for leasing purposes. These buildings have a cost and accumulated amortization of \$13.5 million and \$1.7 million respectively, as at March 31, 2011.

## 8. INTANGIBLE ASSETS:

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

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

There was no impairment of intangible assets during the year ended March 31, 2011, or the year ended March 31, 2010.

Capitalized financing costs during construction for intangible assets for the year ended March 31, 2011 totalled \$0.4 million (March 31, 2010: \$0.3 million).

Included in the cost of intangible assets as at March 31, 2011, is \$0.8 million of unamortized training costs (2010: \$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, 2011, intangible assets totalling \$11.8 million (2010: \$8.8 million) were acquired and \$2.1 million (2010: \$4.1 million) were internally developed. During this same period intangible assets with a cost and accumulated amortization of \$1.6 million were retired (2010: \$11.0 million). Amortization expense for the year ended March 31, 2011 totalled \$5.3 million (2010: \$6.3 million).

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 9. ASSETS HELD FOR SALE:

At March 31, 2011, the *Queen of Prince Rupert* is held for sale at a carrying value of \$nil. 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* was decommissioned. This vessel and its related spare parts and inventories was written down by \$1.4 million during the year ended March 31, 2010 and by a further \$0.2 million during the year ended March 31, 2011 to reflect estimated fair values less costs to sell.

## 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 80 years, being the initial 60 year lease period plus an additional 20 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 years ended March 31, 2011 and March 31, 2010, no new land costs were added to the terminal leases.

## 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, 2011, 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, \$25.8 million (2010: \$25.5 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, 2010. 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. As part of an implementation plan to assist with the transition of certain shipboard management to excluded positions, a further plan amendment has been made during the year ended March 31, 2011. This amendment allows bargaining unit employees transferring to excluded

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

positions to continue to be eligible for the retirement bonus, provided the transfer happens on or before December 31, 2013. 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	2011	2010
<b>Accrued benefit obligations</b>		
Balance, beginning of year	\$ 13,221	\$ 14,104
Current service cost	530	527
Interest cost	827	636
Benefits paid	(1,466)	(2,011)
Actuarial losses (gains)	50	(35)
Balance, end of year	\$ 13,162	\$ 13,221

Other benefit plans	2011	2010
<b>Reconciliation of funded status of the benefit plans to the amounts recorded in the financial statements</b>		
Fair value of plan assets	\$ –	\$ –
Accrued benefit obligation	13,162	13,221
Funded status of plans – deficit	(13,162)	(13,221)
Unamortized net actuarial loss	1,835	2,273
Unamortized plan amendment – past service cost	(780)	(982)
Accrued benefit liability	(12,107)	(11,930)
Current portion of accrued employee future benefits	1,200	800
Accrued employee future benefits	\$ (10,907)	\$ (11,130)

Other benefit plans	2011	2010
<b>Elements of defined benefit costs recognized in the year</b>		
Current service cost	530	527
Interest cost	827	636
Actuarial losses	488	135
Plan amendments	(202)	(204)
Defined benefit costs recognized	\$ 1,643	\$ 1,094

Significant assumptions

The significant assumptions used are as follows (weighted average):

	2011	2010
<b>Accrued benefit obligation as of March 31:</b>		
Discount rate	5.7%	5.1%
Rate of compensation increase	2.0%	2.0%
Annual employee retention rate	94.0%	92.0%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%
<b>Benefit cost for years ended March 31:</b>		
Discount rate	5.7%	5.1%
Rate of compensation increase	2.0%	2.0%
Annual employee retention rate	94.0%	92.0%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## (d) Multi-employer plans:

The total cost recognized for the Company's multi-employer plans is as follows:

	2011	2010
Public Service Pension Plan contributions (i)	\$ 19,230	\$ 18,907
Long-term disability plan contributions	5,068	4,626
Long-term disability plan amortization of surplus (ii)	64	64
	<b>\$ 24,362</b>	<b>\$ 23,597</b>

- 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 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 remained unchanged for members and employers at 1.5% and 2.5% respectively. The next valuation, expected to be received during the fiscal year ended March 31, 2012, 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, expected to be received during the fiscal year ended March 31, 2012, will be as at March 31, 2011.

## 12. HEAD OFFICE PROPERTY AND OTHER CAPITAL LEASES:

During the year ended March 31, 2011, agreements which constitute a capital lease for space in a new downtown Victoria, BC head office building took effect following the completion of construction of the new building. The initial term of the new building lease is for 15 years, with four renewal options of five years each. The lease agreement includes payment of building operating costs and property taxes based on the Company's proportion of total rentable area. In addition, 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, 2011, the Company did not add any leased computer equipment to capital assets (2010: \$nil).

### Loan and purchase option:

During the year ended March 31, 2011, the Company's wholly-owned subsidiary, Pacific Marine Leasing Inc., advanced \$24.2 million to the developer of the new head office property for a term of 15 years, secured by a second mortgage of the property. The loan agreement provides for interest equal to one-half of the net cash flow from the property, subject to minimum and maximum percentage rates of interest. Over the term of the loan, interest is expected to approximate the market rate when the loan was made. Incidental to the loan, the Company was granted an option to purchase up to 50 per cent of the owner's equity interest in the new building at a price of \$24.2 million. The purchase option expires at the end of the loan term.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Future minimum lease payments and obligations under the head office and other capital leases are as follows:

Year ended March 31	Head office lease				Other leases		
	Minimum lease payments	Executory costs	Imputed interest (5.04%)	Obligation	Minimum lease payments	Executory costs and imputed interest	Total obligations
2012	\$ 4,726	\$ 1,439	\$ 2,373	\$ 914	\$ 171	\$ 45	\$ 1,040
2013	4,726	1,439	2,327	960	77	65	972
2014	4,726	1,439	2,279	1,008	18	18	1,008
2015	4,726	1,439	2,228	1,059	—	—	1,059
2016	4,876	1,439	2,174	1,263	—	—	1,263
Thereafter	49,558	14,008	16,376	19,174	—	—	19,174
Purchase option	24,247	—	—	24,247	—	—	24,247
Total	\$ 97,585	\$ 21,203	\$ 27,757	\$ 48,625	\$ 266	\$ 128	\$ 48,763
Current portion				(914)			(1,040)
				\$ 47,711			\$ 47,723

## 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:

As at March 31,	2011		2010	
	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.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**14. 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 60 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.

**15. 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.

**16. INTEREST RATE SUPPORT:**

During the year ended March 31, 2011, the Government of Canada agreed to provide \$1.0 million in the form of interest rate support to the Company for major refurbishment of one vessel (2010: \$1.6 million for major refurbishment of two vessels). During the year ended March 31, 2011, \$0.5 million of these amounts have been recorded as a reduction of interest expense (2010: \$4.7 million, including \$4.1 million relating to agreements entered into during the year ended March 31, 2009) and \$0.1 million as a reduction of capitalized interest (2010: \$0.6 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.

**17. OTHER COMMITMENTS:**

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, 2011 were \$1.5 million (2010: \$1.5 million).

Future minimum lease payments are as follows:

Year ended	
2012	\$ 991
2013	726
2014	445
2015	282
	\$ 2,444

**18. 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, 2011, the Company paid \$71,361 (2010: \$1,130) 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.



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 19. 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 recognized in net earnings as determined.

## 20. SUPPLEMENTAL CASH FLOW INFORMATION:

Years ended March 31	2011	2010
(a) Changes in non-cash operating working capital:		
Change in working capital		
Accounts receivable	\$ (1,787)	\$ (5,651)
Prepaid expenses	40	2,444
Inventories	(1,917)	(1,205)
Regulatory assets	1,072	—
Accounts payable and accrued liabilities	12,365	(2,941)
Interest payable on long-term debt	(58)	(76)
Accrued employee costs	(450)	(3,279)
Deferred revenue	(427)	614
Regulatory liabilities	—	(2,858)
Employee future benefits	400	—
Change in non-cash working capital	9,238	(12,952)
Change attributable to capital asset acquisitions	(6,473)	3,484
Change in non-cash operating working capital	\$ 2,765	\$ (9,468)
(b) Cash paid during the year for interest	\$ 74,329	\$ 74,043
(c) Non-cash transactions:		
Capital assets acquired under capital lease	\$ 49,247	\$ —

# CORPORATE DIRECTORY

## British Columbia Ferry Services Inc.

### BOARD OF DIRECTORS

(effective September 30, 2010)

**Donald P. Hayes**  
Chair

**Elizabeth J. Harrison, QC**

**Holly A. Haston-Grant**

**Brian G. Kenning**

**Gordon R. Larkin**  
(effective November 26, 2010)

**Maureen V. Macarenko**

**P. Geoffrey Plant, QC**

**Wayne H. Stoilen**

**Graham M. Wilson**

### BOARD OF DIRECTORS

(effective April 1, 2010 – September 30, 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**

### SENIOR OFFICERS OF THE COMPANY

(effective April 1, 2011)

**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, 2011)

**Janet E. Carson**  
Vice President, Marketing & Travel Services

**Mark F. Collins**  
Vice President, Engineering

**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, Customer Services

**Pierre Vorster**  
Vice President & Chief Information Officer

# B.C. FERRY AUTHORITY 2010/11 ANNUAL REPORT

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# MESSAGE FROM THE CHAIR OF THE BOARD OF DIRECTORS



The board is committed to high standards of public and stakeholder accountability.

The past year has been one of change for B.C. Ferry Authority ("Authority").

During the year, amendments to the *Coastal Ferry Act* arising from *Miscellaneous Statutes Amendment Act (No.3) – 2010* ("Bill 20") changed the governance framework within which the Authority and its subsidiary, British Columbia Ferry Services Inc. ("BCFS"), operate.

In response to the requirements of Bill 20, the Authority amended the remuneration for the directors of the Authority and BCFS. As well, on September 30, 2010, the membership of the boards of the Authority and BCFS was changed.

On behalf of the board, I extend my thanks to outgoing Authority board members Donald Hayes, Christopher Gardner, Holly Haston-Grant, Brian Kenning and Gordon Larkin, and

thank them for their years of valuable service. I also welcome Bohdan Bodnar, Rod Dewar, Tom Harris and John Radosevic to the Authority board and recognize the experience and expertise they bring.

The board is committed to high standards of public and stakeholder accountability that require the Authority's financial and operating performance, as well as its processes for appointing and remunerating directors of the Authority and BCFS, and its processes for remunerating future executives of BCFS to be open to public view.

The board looks forward to executing its mandate over the next year.

JANE L. PEVERETT  
Chair of the Board of Directors  
B.C. Ferry Authority

# B.C. FERRY AUTHORITY 2010/11 ANNUAL REPORT

The B.C. Ferry Authority (the "Authority" or "BCFA") 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. (the "Company" or "BCFS"). The Province of British Columbia is the holder of all of the preferred shares of BCFS, and has no voting interest in either the Authority or BCFS.

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

Among other things, Bill 20 changed the mandate of the Authority to include responsibility for approving compensation plans for the directors of BCFS, as well as certain future members of executive management of BCFS. Bill 20 required that the Authority establish a BCFS directors' compensation plan by September 30, 2010, the remuneration provided under such plan to be consistent with the remuneration that organizations in Canada that are of a similar size and scope to BCFS provide to their directors, and not to be greater than the remuneration that provincial public sector organizations in British Columbia provide to their directors. Also effective that date, Bill 20 required that the directors of BCFS be replaced and further stipulated that an officer of the Company, including the President & Chief Executive Officer, cannot be a director of BCFA or BCFS, and an individual cannot serve simultaneously as a director of BCFA and BCFS.

In accordance with the provisions of Bill 20, the Authority replaced the directors of the Company on September 30, 2010. BCFA elected eight directors to the board of BCFS effective that date. A ninth director was elected effective November 26, 2010. The President & CEO of BCFS ceased to be a director of the Company on September 30, 2010.

On September 15, 2010, the Authority approved and established a compensation plan for the directors of BCFS. The plan is available for public view on the Authority's website: [www.bcferryauthority.com](http://www.bcferryauthority.com). Remuneration for directors of BCFS was amended and set effective October 1, 2010, in accordance with the approved directors' compensation plan. During the fiscal year, there were no current members of executive management of BCFS to whom an executive compensation plan under the Act, as amended by Bill 20, would apply and, as a consequence, no such plan was required or in effect as at March 31, 2010.

Bill 20 required that the remuneration for directors of the Authority appointed after the Bill's first reading be set in an amount and manner consistent with provincial public sector organizations. In response, the Authority amended the remuneration framework for its directors. While Bill 20 allowed for existing directors of the Authority to retain their (higher) baseline remuneration until the completion of their term of office, the Authority determined that the new remuneration framework would apply to all directors effective October 1, 2011.

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

The Authority has adopted high standards of public and stakeholder accountability that require the Authority's financial and operating performance, as well as its processes for appointing and remunerating directors of the Authority and BCFS, and its processes for remunerating future senior executives of BCFS to be open to public view.

## Appointment of BCFA 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 BCFS. 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.

During the fiscal year, the Authority sought and received nominations of qualified individuals to fill four vacancies on the board. Directors were appointed from the nominees of the BCFMWU and the appointment areas of Southern Mainland, Southern Vancouver Island, and Central Vancouver Island & Northern Georgia Strait. At April 1, 2011, the board had two vacancies pending appointments 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 skills and experience profile adopted by the Authority guided

# B.C. FERRY AUTHORITY

## 2010/11 ANNUAL REPORT

the board in its appointment process during the fiscal year. The board amended the profile in the fiscal year to align the key skills and experience criteria with those directly related to mandate, role and responsibilities of the Authority as set out in the Act, as amended by Bill 20. The current profile is attached as Schedule “A” to the general bylaws of the Authority.

### General Bylaws

The general bylaws of the Authority are available for public view on the Authority’s website. Table 1 sets out the amendments made to the general bylaws during the fiscal year. The amendments were occasioned primarily by Bill 20, and served to ensure that the general bylaws are consistent with the Act, as amended by Bill 20.

TABLE 1  
**Amendments to General Bylaws**  
Fiscal year ended March 31, 2011

Part	Amendments
1.1	<b>Definitions</b> – various new terms defined to reflect amendments made elsewhere in the bylaws.
4.2	<b>Directors Number and Powers</b> – amendment to reflect the requirement that a director must be a Qualified Authority Candidate, as that term is defined in the Act, as amended by Bill 20.
4.11	<b>Conflict of Interest</b> – amendment to eliminate the requirement that the conflict of interest policy for directors be consistent with that of BCFS.
4.12 – 4.13	<b>Remuneration and Expenses</b> – amendment to clarify the eligibility of a director for reimbursement of expenses incurred on Authority business and to reflect compliance with section 14 of the Act, as amended by Bill 20, respecting the amount and manner of remuneration payable to a director.
6.2	<b>Audit Committee</b> – amendment to permit, rather than require, the establishment of an Audit Committee.
11.1 – 11.2	<b>Directors of BCFS</b> – amendment to reflect compliance with section 21.1 of the Act, as amended by Bill 20, respecting matters related to the election of BCFS directors.
11.3 – 11.8	<b>Remuneration of Directors of BCFS</b> – amendment to reflect compliance with section 21.2 of the Act, as amended by Bill 20, respecting matters related to the remuneration of BCFS directors.
11.9 – 11.13	<b>Remuneration of Executives of BCFS</b> – amendment to reflect compliance with section 21.4 of the Act, as amended by Bill 20, respecting matters related to the remuneration of future BCFS executives.
Schedule A	<b>Skills and Experience Profile</b> – amendment to the description of the statutory qualifications for a director to reflect the requirements of the Act, as amended by Bill 20, and to the key skills and experience criteria to focus on those directly related to mandate, role and responsibilities of the Authority.

### Meetings

The board meets regularly to conduct its business. During the fiscal year, the board and its committees met on 14 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 is provided in Table 2.



# B.C. FERRY AUTHORITY

## 2010/11 ANNUAL REPORT

**TABLE 2**

**Summary of Meeting Outcomes<sup>1</sup>**

Fiscal year ended March 31, 2011

Date	Type	Outcomes
June 9, 2010 June 10, 2010 June 10, 2010	Audit & Finance Committee Governance & Nominating Committee Board of Directors	<ul style="list-style-type: none"> <li>Financial statements of the Authority for the year ended March 31, 2010 approved.</li> <li>Amendments to the corporate disclosure and securities trading policy of the Authority approved.</li> <li>Officer appointment of the former board Chair rescinded.</li> <li>Corporate Secretary authorized to execute the shareholder's unanimous consent resolutions pertaining to the setting of the annual reference date, the acceptance of the financial statements, the appointment of the Auditor and the postponement of the election of the British Columbia Ferry Services Inc. directors to September 30, 2010.</li> <li>2009/10 annual report of the Authority approved.</li> <li>Skills and experience profile for British Columbia Ferry Services Inc. approved.</li> </ul>
June 22, 2010 June 23, 2010	Governance & Nominating Committee Board of Directors	<ul style="list-style-type: none"> <li>No resolutions passed.</li> </ul>
August 17, 2010 August 18, 2010 August 18, 2010	Audit & Finance Committee Governance & Nominating Committee Board of Directors	<ul style="list-style-type: none"> <li>Financial statements of the Authority for the three months ended June 30, 2010 approved.</li> <li>Protocol agreement with British Columbia Ferry Services Inc. approved for execution effective October 1, 2010.</li> <li>Changes in remuneration of Authority directors effective October 1, 2010 approved.</li> <li>Amendments to the general bylaws of the Authority, including the skills and experience profile approved.</li> <li>British Columbia Ferry Services Inc. executive compensation plan conditionally approved.</li> <li>British Columbia Ferry Services Inc. directors' compensation plan conditionally approved and remuneration set effective October 1, 2010.</li> <li>Amended skills and experience profile of British Columbia Ferry Services Inc. approved.</li> <li>Corporate Secretary designated to attend and vote at the annual general meeting of British Columbia Ferry Services Inc. on September 30, 2010 to: confirm that effective at the termination of the meeting the existing directors cease to hold their respective offices; decrease the size of the board to 9; and, elect new directors.</li> <li>Appointment of the existing board Chair as an officer rescinded effective at the termination of the annual general meeting of British Columbia Ferry Services Inc. on September 30, 2010.</li> <li>Registered office address and the records office address for the Authority changed.</li> </ul>

<sup>1</sup> Meeting outcomes are resolutions passed by the board and/or its committees.

# B.C. FERRY AUTHORITY

## 2010/11 ANNUAL REPORT

Date	Type	Outcomes
August 18, 2010	Annual General Meeting	<ul style="list-style-type: none"> <li>• Annual general meeting of the Authority held.</li> </ul>
September 15, 2010	Board of Directors	<ul style="list-style-type: none"> <li>• British Columbia Ferry Services Inc. directors' compensation plan approved and remuneration set effective October 1, 2010.</li> <li>• British Columbia Ferry Services Inc. executive compensation plan approved.</li> <li>• Amended Articles of British Columbia Ferry Services Inc. approved subject to the approval of the Province as holder of the preferred shares.</li> <li>• Board Chair elected effective the termination of the annual general meeting of British Columbia Ferry Services Inc. on September 30, 2010.</li> <li>• Direction to the Corporate Secretary to vote at the annual general meeting of British Columbia Ferry Services Inc. on September 30, 2010 amended.</li> </ul>
November 26, 2010	Board of Directors	<ul style="list-style-type: none"> <li>• 2010/11 terms of engagement for the external auditor approved.</li> <li>• Time and location of the next annual general meeting of the Authority confirmed.</li> <li>• Direction to the Corporate Secretary to vote at the annual general meeting of British Columbia Ferry Services Inc. on September 30, 2010 amended.</li> </ul>
December 10, 2010	Board of Directors	<ul style="list-style-type: none"> <li>• Director appointed from nominees of the BCFMWU.</li> </ul>
January 28, 2011	Board of Directors	<ul style="list-style-type: none"> <li>• Amended Articles of British Columbia Ferry Services Inc. approved subject to the approval of the Province as holder of the preferred shares.</li> <li>• British Columbia Ferry Services Inc. executive compensation plan rescinded.</li> </ul>
February 25, 2011	Board of Directors	<ul style="list-style-type: none"> <li>• 2011/12 operating budget of the Authority approved.</li> <li>• Directors appointed from nominees of the Southern Mainland, Southern Vancouver Island and Central Vancouver Island &amp; Northern Georgia Strait appointment areas.</li> </ul>

## Director Remuneration

**April 1, 2010 – September 30, 2010**

The remuneration framework for directors of the Authority in effect April 1, 2010, was established by the board with the assistance of an independent third-party compensation expert. The board sought to provide remuneration at or below the median of a comparator group of 16 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.

The remuneration provided at the commencement of the fiscal year reflected the dual role of the directors at that time, as members of both the board of the Authority and the board of BCFS. Fees payable on an annual basis were \$140,000 for the Chair of the board and \$48,000 for other directors. In addition, a \$15,000 annual fee was payable to the Chair of the Audit & Finance Committee and a \$10,000 annual fee was payable to the Chair of the Governance & Nominating Committee. Each member of each committee, other than the Chair of the committee, was eligible for an annual fee of \$3,000. The fee structure for directors was changed effective October 1, 2010, and directors received a pro-rated portion of the annual fees payable as set out above, based on the six months of the fiscal year that the structure was in effect.

# B.C. FERRY AUTHORITY 2010/11 ANNUAL REPORT

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.

Ferry passes for complimentary vehicle and personal travel on BCFS' vessels were provided to directors and eligible members of their respective families.

Directors were also eligible for reimbursement of reasonable expenses incurred on board-related business.

The amount each BCFA director received for remuneration and expenses in the period April 1, 2010 through September 30, 2010 is set out in Table 3. The remuneration and expenses were for dual service as a director of the Authority and a director of BCFS.

**TABLE 3**

**Director Remuneration & Expenses  
For Dual Service as a Director of BCFA and BCFS  
April 1, 2010 – September 30, 2010**

Director	April 1, 2010 – September 30, 2010 <sup>1</sup>	
	Remuneration <sup>2,3</sup>	Expenses Reimbursed
Jane L. Peverett	\$ 44,375	1,040
Christopher G. Gardner	\$ 39,157	Nil
Holly A. Haston-Grant	\$ 38,231	469
Donald P. Hayes <sup>4</sup>	\$ 79,729	325
Brian G. Kenning	\$ 45,250	567
Gordon R. Larkin	\$ 40,203	Nil
A. Daniel Miller	\$ 42,042	1,671
Stephen E. Smith	\$ 40,977	Nil

**NOTES:**

- For the period April 1, 2010 to September 30, 2010, remuneration and expenses reimbursed are for dual service as a director of BCFA and a director of BCFS.
- Remuneration includes retainers, per diem fees and taxable income from the ferry travel pass program (see note 3).
- There is a ferry travel pass program for directors and their eligible family members which provides for complimentary travel on BCFS vessels. The program only applies while the director serves on the board. This program may generate a taxable benefit for the director.
- Donald P. Hayes served as Chair of the board of BCFA and Chair of the board of BCFS for the period April 1, 2010 to September 30, 2010.

**October 1, 2010 – March 31, 2011**

Bill 20 required that remuneration for directors appointed to BCFA after the date of first reading of Bill 20 be set in an amount and manner consistent with provincial public sector organizations. Existing directors were entitled under the provisions of Bill 20 to continue to receive their (higher) baseline remuneration until the completion of their term of office. However, the board broadened the application of the director remuneration provisions of Bill 20 to include existing as well as new directors of BCFA and, effective October 1, 2010, the remuneration for all BCFA directors was set in the amount and manner as outlined in Table 4.

**TABLE 4**

**BCFA Director Remuneration Framework  
effective October 1, 2010**

<b>Annual Retainers</b>	
Board Chair Retainer	\$ 25,000
Board Member Retainers:	
Base Retainer (all directors excluding board Chair)	\$ 6,250
Committee Chair Retainer	\$ 2,000
Committee Member Retainer	\$ 750
<b>Per Diem Fees</b>	
Board Member Fees	Up to
(all directors excluding board Chair)	\$ 1,200 per day
<b>Ferry Travel Pass</b>	
Ferry pass for directors and eligible members of their respective immediate families, for complimentary vehicle and personal travel on BCFS' vessels.	

The amount each BCFA director received for remuneration and expenses in the period October 1, 2010 through March 31, 2011, is set out in Table 5.

# B.C. FERRY AUTHORITY 2010/11 ANNUAL REPORT

**TABLE 5**

**BCFA Director Remuneration & Expenses**

October 1, 2010 – March 31, 2011

Director	October 1, 2010 – March 31, 2011	
	Remuneration <sup>2,3</sup>	Expenses Reimbursed
Jane L. Peverett <sup>3</sup>	\$ 13,859	687
Bohdan I. Bodnar <sup>6</sup>	\$ 1,200	Nil
Roderick D. Dewar <sup>6</sup>	\$ 1,200	Nil
Christopher G. Gardner	\$ 4,325	Nil
Thomas W. Harris <sup>6</sup>	\$ 1,200	Nil
Gordon R. Larkin <sup>4</sup>	\$ 1,704	Nil
A. Daniel Miller	\$ 11,294	874
John Radosevic <sup>5</sup>	\$ 9,710	860
Stephen E. Smith	\$ 7,179	2,793

**NOTES:**

- 1 Remuneration includes retainers, per diem fees and taxable income from the ferry travel pass program (see note 2).
- 2 There is a ferry travel pass program for directors and their eligible family members which provides for complimentary travel on BCFS vessels. The program only applies while the director serves on the board. This program may generate a taxable benefit for the director.
- 3 Jane L. Peverett served as Chair of the board of BCFA for the period September 30, 2010 to March 31, 2011.
- 4 Gordon R. Larkin resigned and ceased to be a director of BCFA effective November 26, 2010.
- 5 John Radosevic was appointed a director of BCFA effective December 10, 2010.
- 6 Bohdan I. Bodnar, Roderick D. Dewar, and Thomas W. Harris were appointed directors of BCFA effective April 1, 2011. Remuneration during the period October 1, 2010 – March 31, 2011 was for attendance at a one-day board orientation session in March 2011.

# INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of B.C. Ferry Authority, which comprise the statement of financial position as at March 31, 2011 and the statements of operations and changes in net assets for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

## Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

## Auditors' Responsibility

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 comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audit is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of B.C. Ferry Authority as at March 31, 2011, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

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

**Chartered Accountants**

Victoria, Canada  
June 7, 2011

# FINANCIAL STATEMENTS OF B.C. FERRY AUTHORITY


## Statement of Financial Position (expressed in thousands)

As at March 31

	2011	2010
<b>Assets</b>		
Investment in British Columbia Ferry Services Inc.	\$ 233,222	\$ 235,479
	\$ 233,222	\$ 235,479
<b>Net Assets</b>		
Invested in common share of British Columbia Ferry Services Inc.	\$ 1	\$ 1
Accumulated undistributed earnings of British Columbia Ferry Services Inc.	233,221	235,478
	\$ 233,222	\$ 235,479

See accompanying notes to financial statements.

On behalf of the Board:

  
Jane L. Peverett, Director

  
A. Daniel Miller, Director

## Statement of Operations (expressed in thousands)

As at March 31

	2011	2010
<b>Revenue:</b>		
Distributable loss of British Columbia Ferry Services Inc. (note 2)	\$ (2,257)	\$ (2,616)
<b>Expenses:</b>		
Administration	71	1
Recovery from British Columbia Ferry Services Inc. (note 3)	(71)	(1)
	–	–
Net loss	\$ (2,257)	\$ (2,616)

See accompanying notes to financial statements.

## Statement of Changes in Net Assets (expressed in thousands)

	2011			2010
Years Ended March 31	Invested in BCFS	Undistributed Earnings of BCFS	Total	Total
Beginning of year	\$ 1	\$ 235,478	\$ 235,479	\$ 238,095
Net loss	–	(2,257)	(2,257)	(2,616)
End of year	\$ 1	\$ 233,221	\$ 233,222	\$ 235,479

See accompanying notes to financial statements.



# 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. ("BCFS");
- 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 BCFS, 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). BCFS'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 BCFS common share. The Act provides that upon a sale of the common share of BCFS 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.

On June 24, 2010, the Province enacted the *Miscellaneous Statutes Amendment Act (No.3), 2010*, (Bill 20), amending several statutes, including the Act. Among other things, the amendments changed the mandate of the Authority to include responsibility for the compensation plans of the directors and certain executive officers of BCFS and a requirement that effective September 30, 2010, a director of the Authority cannot also be a director of BCFS. 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.

## 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, BCFS, is accounted for by the equity method. Under the equity method the original cost of the investment is adjusted for the Authority's share of post-acquisition earnings or losses less dividends.

### (b) Revenue recognition:

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

### (c) Taxes:

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

### (d) Statement of Cash Flows:

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

## 2. DISTRIBUTABLE LOSS OF BRITISH COLUMBIA FERRY SERVICES INC.:

The distributable loss of BCFS consists 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

	2011	2010
Net earnings and comprehensive income of BCFS	\$ 3,781	\$ 3,422
Dividends paid on 8% cumulative preferred shares	(6,038)	(6,038)
	\$ (2,257)	\$ (2,616)

# NOTES TO FINANCIAL STATEMENTS

## 3. RECOVERY FROM BRITISH COLUMBIA FERRY SERVICES INC.:

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

## 4. SUBSIDIARY SUPPLEMENTAL INFORMATION:

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

As at March 31	2011	2010
<b>Assets:</b>		
Current assets	\$ 184,376	\$ 102,861
Capital and other assets	1,673,162	1,704,112
	<b>\$ 1,857,538</b>	<b>\$ 1,806,973</b>
<b>Liabilities:</b>		
Current liabilities	\$ 161,637	\$ 132,068
Accrued employee future benefits	10,907	11,130
Regulatory liabilities	1,558	4,325
Other long-term liabilities	–	172
Long-term debt and capital lease obligations	1,374,737	1,348,322
	<b>1,548,839</b>	<b>1,496,017</b>
<b>Shareholders' equity:</b>		
Common share held by the Authority	1	1
Preferred shares (a)	75,477	75,477
Retained earnings	233,221	235,478
	<b>308,699</b>	<b>310,956</b>
	<b>\$ 1,857,538</b>	<b>\$ 1,806,973</b>
<b>Years ended March 31</b>	<b>2011</b>	<b>2010</b>
Revenue (including gains)	\$ 748,101	\$ 732,449
Expenses (including losses)	744,320	729,027
Net earnings and comprehensive income	<b>\$ 3,781</b>	<b>\$ 3,422</b>
Cash flows from operating	\$ 106,830	\$ 121,297
Cash flows from financing	(12,110)	(33,535)
Cash flows from investing	(71,993)	(89,556)

- (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 BCFS's ability to issue share capital and to declare dividends.

## B.C. Ferry Authority

### BOARD OF DIRECTORS

(Effective April 1, 2011)

**Jane L. Peverett**

(Community-at-large)

**Bohdan I. Bodnar**

(Southern Mainland appointment area)

**Roderick D. Dewar**

(Southern Vancouver Island appointment area)

**Thomas W. Harris**

(Central Vancouver Island & Northern Georgia Strait appointment area)

**A. Daniel Miller**

(Community-at-large)

**John Radosevic**

(Organized labour)

**Stephen E. Smith**

(Northern Coastal & North Island appointment area)

**Vacant**

(Province of British Columbia)

**Vacant**

(Province of British Columbia)

### OFFICERS

(Effective April 1, 2011)

**Jane L. Peverett**

Chair

**Cynthia M. Lukaitis**

Vice President & Corporate Secretary

### BOARD OF DIRECTORS

(April 1, 2010 – March 31, 2011)

**Jane L. Peverett**

**Christopher C. Gardner**

**Holly A. Haston - Grant**

(resigned effective September 30, 2010)

**Donald P. Hayes**

(resigned effective September 30, 2010)

**Brian G. Kenning**

(resigned effective September 30, 2010)

**Gordon R. Larkin**

(resigned effective November 26, 2010)

**A. Daniel Miller**

**John Radosevic**

(appointed effective December 10, 2010)

**Stephen E. Smith**

### OFFICERS

(April 1, 2010 – March 31, 2011)

**Donald P. Hayes**

(April 1, 2010 – September 30, 2010)

Chair

**Jane L. Peverett**

(September 30, 2010 – March 31, 2011)

Chair

**Cynthia M. Lukaitis**

Vice President & Corporate Secretary



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