

No securities regulatory authority has expressed an opinion about these securities and it is an offence to claim otherwise. This prospectus constitutes a public offering of these securities only in those jurisdictions where they may be lawfully offered for sale and therein only by persons permitted to sell such securities. The securities being offered hereby have not been and will not be registered under the United States Securities Act of 1933, as amended, and, subject to certain exceptions, may not be offered or sold in the United States. See "Plan of Distribution".

PROSPECTUS

Initial Public Offering

May 19, 2004



BRITISH COLUMBIA FERRY SERVICES INC.

\$250,000,000

5.74% Senior Secured Bonds, Series 04-1, due May 27, 2014

The 5.74% Senior Secured Bonds, Series 04-1 (the "Series 04-1 Bonds") being offered hereby are being issued by British Columbia Ferry Services Inc. ("BC Ferries") pursuant to BC Ferries' Capital Markets Platform. The net proceeds from the sale of the Series 04-1 Bonds will be used primarily to repay a portion of the indebtedness which is owing by BC Ferries to the Province of British Columbia (the "Province") and to fund reserves required in connection with the Series 04-1 Bonds. Interest on the Series 04-1 Bonds will be payable semi-annually on May 27 and November 27 of each year until maturity, commencing November 27, 2004. The Series 04-1 Bonds will generally rank *pari passu* with all present and future indebtedness of BC Ferries secured pursuant to the Indenture, including bonds or other debt instruments issued, and bank indebtedness outstanding, at the time of the completion of the offering or in the future. See "Capital Markets Platform".

The interest rate, offering price and redemption features of the Series 04-1 Bonds have been determined by negotiation between BC Ferries and the Underwriters.

See "Risk Factors" for a discussion of certain factors which should be considered by prospective purchasers of the Series 04-1 Bonds. There is no market through which the Series 04-1 Bonds may be sold and purchasers may not be able to resell Series 04-1 Bonds purchased under this prospectus.

In the opinion of counsel, the Series 04-1 Bonds will, when issued, qualify for investment under certain statutes as set forth under "Eligibility for Investment".

Price: 99.947% per Series 04-1 Bond

	Price to Public	Underwriters' Fee	Net Proceeds to BC Ferries ⁽¹⁾
Per \$1,000 principal amount of Series 04-1 Bonds	\$999.47	\$7.50	\$991.97
Total offering	\$249,867,500	\$1,875,000	\$247,992,500

(1) Before deducting expenses of the offering payable by BC Ferries estimated at approximately \$1,200,000 which, together with the Underwriters' fee, will be paid by BC Ferries out of the proceeds of the offering.

The effective yield to maturity on the Series 04-1 Bonds is 5.747% per annum.

CIBC World Markets Inc., BMO Nesbitt Burns Inc., RBC Dominion Securities Inc. and TD Securites Inc. (collectively, the "Underwriters"), as principals, conditionally offer the Series 04-1 Bonds, subject to prior sale, if, as and when issued by BC Ferries and accepted by the Underwriters in accordance with the conditions contained in the underwriting agreement referred to under "Plan of Distribution" and subject to the approval of all legal matters on behalf of BC Ferries by McCarthy Tétraut LLP and on behalf of the Underwriters by Farris, Vaughan, Wills & Murphy. CIBC World Markets Inc., BMO Nesbitt Burns Inc., RBC Dominion Securities Inc. and TD Securites Inc. are affiliates of Canadian chartered banks which have agreed to make certain credit facilities available to BC Ferries. See "Capital Markets Platform — Credit Facility". **Accordingly, BC Ferries may be considered to be a "connected issuer" of CIBC World Markets Inc., BMO Nesbitt Burns Inc., RBC Dominion Securities Inc. and TD Securities Inc. within the meaning of applicable Canadian securities legislation.** See "Plan of Distribution".

The Underwriters may over-allot or effect transactions which stabilize or maintain the market price of the Series 04-1 Bonds at levels other than those which otherwise might prevail on the open market. See "Plan of Distribution".

Subscriptions for the Series 04-1 Bonds will be received subject to rejection or allotment in whole or in part and the Underwriters reserve the right to close the subscription books at any time without notice. It is expected that the Series 04-1 Bonds will be ready for delivery in book-entry form only through the facilities of The Canadian Depository for Securities Limited in Vancouver on the closing, which is expected to occur on or about May 27, 2004, but not later than June 25, 2004.



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- Customer focused marine transportation system;
 - One of the largest ferry operators in the world;
 - 44 year operating history; and
 - Regulated to ensure financial stability.

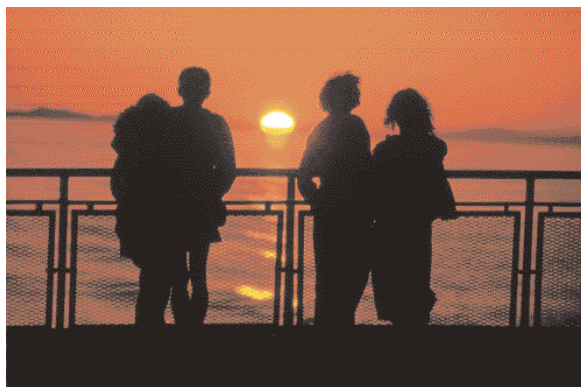


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PROSPECTUS SUMMARY

The following is a summary only and is qualified in its entirety by, and should be read in conjunction with, the more detailed information and financial and operating data appearing elsewhere in this prospectus. All references to dollars in this prospectus are to Canadian dollars unless otherwise indicated.

BC Ferries

BC Ferries operates a large and complex coastal ferry transportation system that provides vehicle and passenger transportation and related services in the coastal waters of British Columbia pursuant to a long term services contract with the Province. It is one of the largest ferry operators in the world based on passengers transported annually and based on transportation infrastructure. During the 2003/04 fiscal year, BC Ferries carried 21.4 million passengers and 8.3 million vehicles, generating \$533.7 million in revenue. The ferry service provided by BC Ferries is an integral part of British Columbia's coastal transportation system and has been designated by the Province as an essential service for purposes of the *Labour Relations Code* (British Columbia), necessary for the protection of the health, safety and welfare of the residents of British Columbia.

BC Ferries provides frequent year-round ferry transportation services on 25 routes, supported by 35 vessels and 47 terminals, connecting ports of call throughout coastal British Columbia, including connections between the Lower Mainland of British Columbia (encompassing Greater Vancouver and surrounding areas) and Vancouver Island. BC Ferries also manages nine other remote routes through contracts with eight independent operators. BC Ferries' service area stretches along the coast of British Columbia from Prince Rupert in the north to Victoria in the south with routes classified in three categories: Major Routes, Northern Routes and Other Routes. Approximately 76% of BC Ferries' revenue from tolls, catering and other sources (excluding revenues from government, interest income and income from subsidiaries) in the 2003/04 fiscal year was generated on its Major Routes.

While BC Ferries' core business is the provision of ferry transportation services, it also operates significant ancillary businesses in connection with its transportation services, including food and beverage services, reservation services, retail gift shops, vending machines and parking facilities.

BC Ferries was formerly called British Columbia Ferry Corporation. It was converted from a Crown corporation owned by the Province into an independent company under the *Company Act* (British Columbia) on April 2, 2003. The single voting common share of BC Ferries is held by the B.C. Ferry Authority (the "BCFA"), a non-share capital corporation established under the *Coastal Ferry Act* (British Columbia). The Board of Directors of BC Ferries is appointed by the BCFA. The Province owns cumulative preferred shares of BC Ferries in the amount of \$75.5 million and a debenture for \$427.7 million issued by BC Ferries, but has no voting interest in either the BCFA or BC Ferries. See "British Columbia Ferry Services Inc."

The Province enacted the Coastal Ferry Act on April 1, 2003. Under the Coastal Ferry Act, the office of the British Columbia Ferries Commissioner (the "Commissioner") was created. The Commissioner regulates price caps for designated ferry route groups, the reduction of service, discontinuance of routes and certain other matters. The Coastal Ferry Act requires the Commissioner to undertake regulation in accordance with several principles, including placing priority on the financial sustainability of ferry operators, encouraging ferry operators to adopt a commercial approach to ferry service delivery and moving over time to a greater reliance on a user pay system.

BC Ferries has entered into two key contracts relating to its provision of ferry services:

- the Coastal Ferry Services Contract with the Province, which has a term of 60 years commencing April 1, 2003 and which sets out the core ferry transportation services that BC Ferries must provide and the service fees payable by the Province for such services. These service fees include ferry transportation fees, social program reimbursements and unregulated route fees. See "Coastal Ferry Services Contract — Service Fees"; and
- the Master Agreement with the Province, through its Crown corporation the BC Transportation Financing Authority ("BCTFA"), pursuant to which BC Ferries has leased ferry terminal properties from

BCTFA under prepaid leases for a 60 year term commencing April 1, 2003 and has been granted exclusive rights and obligations to use and develop those properties.

BC Ferries' large existing fleet of vessels and terminal infrastructure provide the company a significant competitive advantage. In order to maintain this competitive advantage and to provide sufficient capacity in the future, BC Ferries plans to embark on a major capital improvement program. Over the next decade, BC Ferries has planned capital expenditures of approximately \$1.9 billion. Approximately 75% of these planned expenditures are related to new vessel acquisition, vessel upgrades and component replacement, with the balance allocated to terminals and other projects. These capital expenditures are expected to be funded approximately equally by internal cash flow generation and borrowings. See "Capital Markets Platform".

As an important transportation service, BC Ferries enjoys a very strong core demand. The requirement for commerce and social interaction between the large populations living and working on Vancouver Island and in Greater Vancouver and surrounding areas, and the popularity of both of these locations as tourist destinations, are the foundation for the demand for coastal transportation services. Over the past 16 years, passenger traffic on BC Ferries' system has grown 25.6%, due largely to the growth in population of Greater Vancouver and Vancouver Island over the same period. BC Ferries has carried over 20 million passengers and 7.5 million vehicles in each of the past five fiscal years ending with the 2003/04 fiscal year. During this five year period, vehicle traffic has grown at a compound annual growth rate of 1.2% per annum while passenger traffic has been relatively flat. Revenues have steadily increased, supported by growth in provincial contributions, at a compound annual growth rate of approximately 6.0%.

Improvement in the British Columbia economy, increasing personal disposable income and population growth in key markets are expected to contribute to further growth in ferry traffic in the near term. Toll increases beyond the anticipated rate of inflation are expected to moderate that growth but contribute to profitability.

See "Business of BC Ferries".

The Offering

Issue:	5.74% Senior Secured Bonds, Series 04-1.
Aggregate Principal Amount:	\$250,000,000.
Date of Issuance:	May 27, 2004.
Maturity Date:	May 27, 2014.
Price per Bond:	\$999.47 per \$1,000 principal amount of Series 04-1 Bonds.
Interest Rate:	5.74%.
Interest Payment Dates:	May 27 and November 27 of each year until maturity, commencing November 27, 2004.
Ratings:	Dominion Bond Rating Service Limited — A (low). Standard & Poor's Ratings Services — A-.
Redemption:	The Series 04-1 Bonds will be redeemable in whole or in part at the option of BC Ferries at any time at the greater of the face amount of the Series 04-1 Bonds to be redeemed and the Canada Yield Price, in each case plus accrued interest thereon. See "Details of the Offering — Redemption".
Security and Ranking:	The Series 04-1 Bonds will be direct obligations of BC Ferries generally ranking <i>pari passu</i> with all other indebtedness issued under the Indenture, secured principally by: (i) a first mortgage and charge on each vessel owned by BC Ferries or any Designated Subsidiary; (ii) an unregistered first mortgage and charge on the leasehold or ownership interests of BC Ferries or any Designated Subsidiary in all terminals; (iii) a security interest over all present and future personal property of BC Ferries and each Designated Subsidiary including all book debts and sources of revenue, all assets held in the Debt Service Reserve Fund and all material contracts; (iv) a floating charge on all present and future right and title to all real property interests and personal property not charged under the security described above now owned or later acquired by BC Ferries or a Designated Subsidiary; and (v) a guarantee from each Designated Subsidiary that is so designated from time to time. See "Capital Markets Platform — Indenture".
Key Covenants:	<p>The Indenture and the Supplemental Indenture under which the Series 04-1 Bonds will be issued will, among other things, restrict the ability of BC Ferries and its Designated Subsidiaries to:</p> <ul style="list-style-type: none">• incur liens;• dispose of assets to any entity which is not BC Ferries or a Designated Subsidiary other than specified assets;• enter into sale/leaseback or lease/leaseback transactions unless BC Ferries is able to meet certain financial tests for the incurrence of additional indebtedness;• terminate or amend material contracts unless such termination or amendment cannot be expected to materially adversely affect the interest of the Bondholders or the security in respect of the Series 04-1 Bonds, or the ability of BC Ferries to operate its business;• make distributions unless the Debt Service Reserve Fund is fully funded and certain financial tests are met;

- create guarantees or make investments unless the aggregate of all such guarantees and investments is less than 10% of shareholders' equity of BC Ferries, BC Ferries meets certain financial tests or two rating agencies confirm that the proposed guarantee or investment will not adversely impact BC Ferries' ratings; and
- issue additional indebtedness unless certain financial tests are met.

These covenants are subject to important qualifications and limitations. See "Capital Markets Platform — Indenture" and "Details of the Offering — Covenants".

Debt Service Reserve Fund:

The Indenture and each Supplemental Indenture will require BC Ferries to establish a segregated fund, designated as the "Debt Service Reserve Fund", comprised of Series Reserve Accounts for each series of Obligation Bonds with a term of one year or more, into which BC Ferries shall cause to be deposited an amount equal to not less than six months debt service requirements in respect of such series of Bonds. Each Series Reserve Account is to be funded at the time of the issuance of such series of Bonds. Money in a Series Reserve Account will be used to pay principal, interest and other amounts due in respect of the applicable series of Bonds at the direction of BC Ferries or to the extent such payments have not been made when due.

Use of Proceeds:

The net proceeds from the sale of the Series 04-1 Bonds offered hereby are estimated to be \$246.8 million, after deducting the Underwriters' fee and the expenses of the offering payable by BC Ferries, estimated to be approximately \$1.2 million. Such net proceeds, together with drawings of \$200 million under the Credit Facility, will be used as follows: approximately \$431.2 million to repay indebtedness and accrued interest owed to the Province; approximately \$9.8 million to fund the initial deposits required to be made to the Debt Service Reserve Fund maintained by BC Ferries pursuant to the Indenture and the Supplemental Indentures authorizing the Series 04-1 Bonds and the Pledged Bonds issued to the lenders under the Credit Facility; and the balance for general corporate purposes. See "Use of Proceeds" and "Capital Market Platform — Credit Facility".

Risk Factors:

An investment in the Series 04-1 Bonds is subject to a number of risk factors. Prospective purchasers should consider all of the information set forth in this prospectus, including the discussion under "Risk Factors".

Selected Consolidated Financial and Operating Information

The following selected consolidated financial and operating information has been derived from and should be read in conjunction with the historical consolidated financial statements and other historical information of BC Ferries contained elsewhere in this prospectus.

	Years ended March 31,		
	2004	2003	2002
	(in thousands)		
Revenue			
Tolls	\$323,023	\$315,618	\$305,710
Ferry service fees ⁽¹⁾	105,806	—	—
Federal-Provincial Subsidy Agreement ⁽²⁾	23,975	23,377	22,953
Retail	63,206	61,762	60,374
Other income	17,721	14,866	12,329
Motor fuel tax subsidy	—	74,243	71,706
Total revenue	<u>533,731</u>	<u>489,866</u>	<u>473,072</u>
Expenses			
Operations, maintenance, administration	411,046	397,759	384,846
Cost of retail goods sold	23,298	22,046	22,479
Amortization	47,355	44,050	46,056
Total expenses	<u>481,699</u>	<u>463,855</u>	<u>453,381</u>
Earnings from operations	52,032	26,011	19,691
Gain on foreign exchange	190	150	176
Interest expense	(22,672)	(1,364)	(1,757)
Loss on disposal and write-down of capital assets	(1,565)	(412)	(732)
Earnings before the following	27,985	24,385	17,378
Loss on disposal of high speed ferries	—	(53,107)	—
Provision for write-down of high speed ferries	—	—	(40,000)
Net earnings (loss)	<u>\$ 27,985</u>	<u>\$ (28,722)</u>	<u>\$ (22,622)</u>
	Years ended March 31,		
	2004	2003	2002
	(in thousands)		
Operating Information (unaudited)			
Number of passengers	21,367	21,624	21,246
Number of vehicles	8,292	8,321	8,106

(1) These are service fees paid by the Province to BC Ferries pursuant to the Coastal Ferry Services Contract.

(2) This is a subsidy provided by the Government of Canada pursuant to an agreement between the Province and the Government of Canada. See “Coastal Ferry Services Contract — Entitlement to Federal Subsidy”.

GLOSSARY OF CERTAIN TERMS

In this prospectus, unless otherwise indicated or the context otherwise requires:

“**Acknowledgement Agreement**” means the acknowledgement agreement referred to under “Capital Markets Platform — Acknowledgement Agreement”;

“**automobile equivalents**” or “**AEQ**” mean a standard traffic unit used by BC Ferries to measure capacity of its vessels based upon the length and height of a vehicle (for example, a typical passenger automobile is equal to one AEQ; overweight vehicles are each 1.5 AEQ; commercial vehicles, buses and trucks are between 2.5 and 3.75 AEQ);

“**BCFA**” means the B.C. Ferry Authority, a non-share capital corporation established under the Coastal Ferry Act and the sole voting shareholder of BC Ferries;

“**BCFC**” means British Columbia Ferry Corporation, the name of BC Ferries prior to its conversion under the *Company Act* (British Columbia);

“**BC Ferries**” means British Columbia Ferry Services Inc.;

“**BCFMWU**” means the British Columbia Ferry and Marine Workers’ Union, the union which represents BC Ferries’ unionized employees;

“**BCTFA**” means the BC Transportation Financing Authority, a British Columbia Crown corporation which owns terminal properties leased to BC Ferries;

“**CRA**” means the Canada Customs and Revenue Agency (the name of which is to be changed to the Canada Revenue Agency);

“**Coastal Ferry Act**” means the *Coastal Ferry Act* (British Columbia), the statute which establishes the regulatory regime under which BC Ferries currently operates;

“**Coastal Ferry Services Contract**” means the 60 year services contract commencing April 1, 2003 between BC Ferries and the Province which sets out the core ferry transportation services to be provided by BC Ferries and the service fees payable by the Province for such services;

“**Commissioner**” means the British Columbia Ferries Commissioner, the independent regulator appointed under the Coastal Ferry Act to regulate core ferry services and tariffs in British Columbia;

“**DPMI**” means Deas Pacific Marine Inc., a wholly owned subsidiary of BC Ferries;

“**fiscal year**” means, in respect of BC Ferries, the period from April 1 to March 31;

“**FTE**” means full-time equivalent, which is calculated by dividing actual labour hours worked by the standard hours in a work year per employee;

“**Major Routes**” means the following three routes that connect Vancouver Island to the Lower Mainland of British Columbia: Swartz Bay – Tsawwassen, Duke Point – Tsawwassen and Departure Bay – Horseshoe Bay;

“**Master Agreement**” means the master agreement between BC Ferries, the Province and the BCTFA in respect of terminal properties leased to BC Ferries;

“**Northern Routes**” means BC Ferries’ mid and north coast routes that connect British Columbia’s north coast and the Queen Charlotte Islands: Prince Rupert – Port Hardy and Prince Rupert – Skidegate;

“**Other Routes**” means all of BC Ferries’ routes other than Major Routes and Northern Routes, which consist primarily of routes that connect the Gulf Islands and several other island or rural communities to either Vancouver Island or the Lower Mainland;

“**Province**” means the Province of British Columbia;

“**Series 04-1 Bonds**” means the 5.74% senior secured bonds of BC Ferries offered hereby;

“**Tax Act**” means the *Income Tax Act* (Canada);

“**Terminal Leases**” means the 60 year net leases commencing April 1, 2003 pursuant to which the BCTFA has leased terminal properties to BC Ferries; and

“**Transportation Fee**” means the portion of the service fees payable by the Province to BC Ferries pursuant to the Coastal Ferry Services Contract in consideration of BC Ferries providing an agreed level of service on the Northern Routes and Other Routes.

FORWARD LOOKING STATEMENTS

This prospectus contains certain “forward looking statements”. These statements relate to future events or future performance and reflect management’s expectations regarding BC Ferries’ growth, results of operations, performance, business prospects and opportunities and industry performance and trends. These forward looking statements reflect management’s current internal projections, expectations or beliefs and are based on information currently available to management. In some cases, forward looking statements can be identified by terminology such as “may”, “will”, “should”, “expect”, “plan”, “anticipate”, “believe”, “estimate”, “predict”, “potential”, “continue” or the negative of these terms or other comparable terminology. A number of factors could cause actual events or results to differ materially from the results discussed in the forward looking statements. In evaluating these statements, prospective investors should specifically consider various factors, including, but not limited to, the risks and uncertainties discussed under “Risk Factors” and elsewhere in this prospectus. Actual results may differ materially from any forward looking statement. Although management believes that the forward looking statements contained in this prospectus 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 prospectus, and BC Ferries assumes no obligation to update or revise them to reflect new events or circumstances.

BRITISH COLUMBIA FERRY SERVICES INC.

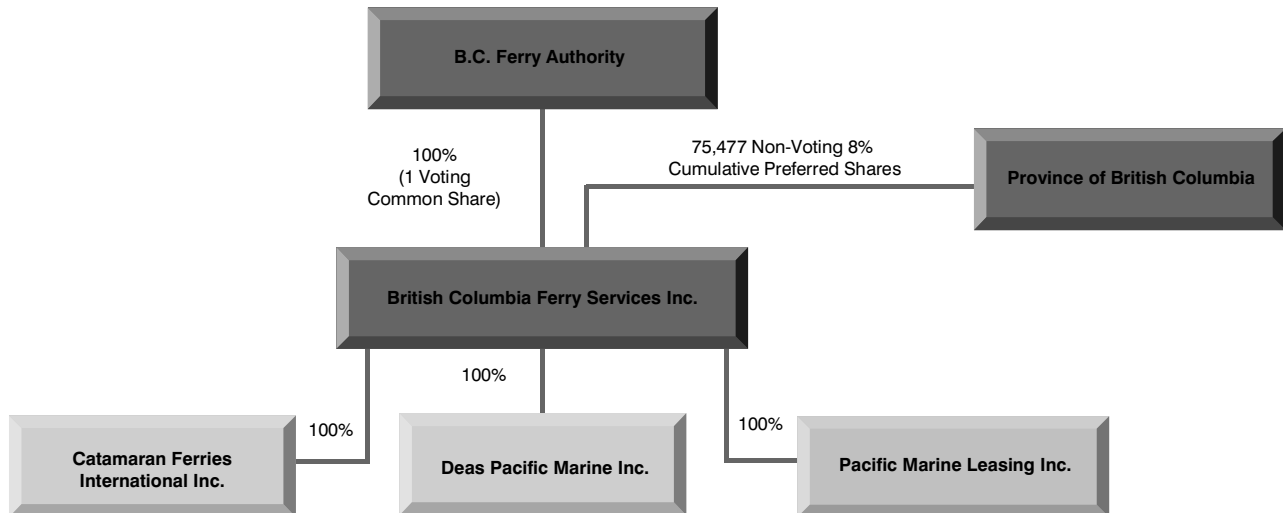
Incorporation and Corporate Structure

The Province first commenced operation of a vehicle and passenger ferry service between Vancouver and Vancouver Island in 1960. In 1977, a Crown corporation called British Columbia Ferry Corporation (“BCFC”) was established to assume the operation of that service. On April 2, 2003, BCFC was converted into an independent company under the *Company Act* (British Columbia) and renamed British Columbia Ferry Services Inc.

Voting ownership of BC Ferries is held by the BCFA, a non-share capital corporation established under the Coastal Ferry Act. The BCFA holds the single voting common share in BC Ferries and appoints BC Ferries’ Board of Directors. The BCFA has its own Board of Directors composed of nine directors, of whom two are appointed by the Province pursuant to the Coastal Ferry Act. The Province owns 75,477 non-voting 8% cumulative preferred shares of BC Ferries (each with a par value of \$1,000) and a secured debenture in the principal amount of \$427.7 million issued by BC Ferries, but has no voting interest in either the BCFA or BC Ferries. The preferred shares owned by the Province are convertible into common shares of BC Ferries on a one-for-one basis, at the election of the holder of the preferred shares, if the one voting common share owned by the BCFA is at any time sold, transferred or otherwise disposed of. See “Share and Loan Capital”. In addition, the Province, through the BCTFA, owns the land and structures comprising most of the terminals operated by BC Ferries, but leased them to BC Ferries for a 60 year term commencing on April 1, 2003.

Deas Pacific Marine Inc. (“DPMI”), a wholly owned subsidiary of BC Ferries, was incorporated on June 17, 2003 under the *Company Act* (British Columbia) to conduct a portion of BC Ferries’ maintenance and refit operations. BC Ferries has two other wholly owned subsidiaries, Catamaran Ferries International Inc. which is an inactive company expected to be wound up within the next 12 months, and Pacific Marine Leasing Inc. which is an inactive company formed for the purpose of acquiring and leasing capital assets to BC Ferries or third party operators under contract to BC Ferries.

The following diagram illustrates BC Ferries’ corporate and ownership structure:



The principal business address and registered office of BC Ferries is 1112 Fort Street, Victoria, British Columbia, Canada V8V 4V2.

BC Ferries has received an advance income tax ruling from CRA that it is a “tax exempt corporation” for purposes of the *Income Tax Act* (Canada) (the “Tax Act”). BC Ferries has also received a non-binding opinion from CRA that proposed amendments to the Tax Act will not affect BC Ferries’ tax-exempt status.

History and Development

BC Ferries and its predecessors have operated a ferry system on the British Columbia coast since the 1960s. Throughout the period from the 1960s to the 1990s, the Province expanded its operations through acquisitions of other ferry operators, expansion of routes and construction and upgrade of vessels and terminals. BC Ferries is now one of the largest ferry operators in the world based on passengers transported annually and based on transportation infrastructure.

In the late 1990s, BC Ferries initiated a strategy to increase ancillary revenues by obtaining its first corporate sponsors, AGFA Film and Coca Cola, and by entering into its first branded partnership by partnering with White Spot restaurants to provide branded food services on several of its vessels.

On April 1, 2003, BC Ferries entered into the Coastal Ferry Services Contract with the Province for the provision of ferry services and the Province brought into force the Coastal Ferry Act which established the regulatory regime under which BC Ferries currently operates.

Strategy

BC Ferries intends to increase its annual operating income and enhance profitability by executing the following strategies:

Implement comprehensive strategic plan. BC Ferries has adopted a strategic plan with the following objectives:

- ensure a safe, secure and environmentally responsible marine transportation system;
- promote a company-wide commitment to customer service;
- foster a highly motivated, committed and flexible workforce;
- establish pro-active and constructive relationships with community and government;
- respond to and develop market demand to increase revenue; and
- maximize shareholder value.

The strategic plan also establishes short and long term performance targets for each of the objectives. The strategic plan is intended to be reviewed annually and updated every three to five years to address new opportunities and challenges.

Increase revenues. BC Ferries has three primary revenue sources — ferry tolls, ancillary/retail revenues and service fees from the Province. With average annual tolls capped and the majority of service fees fixed, BC Ferries can increase revenue by increasing traffic levels and expanding ancillary/retail revenues, both on-board vessels and at the terminals. BC Ferries plans to increase traffic and revenue by incorporating demand management techniques such as variable pricing (peak/off-peak pricing) and expanded reservations. Joint marketing initiatives with tour operators and tourism associations will be explored with a view to increasing traffic and revenue from new markets. In addition, BC Ferries is continuing to evaluate strategic business opportunities and partnerships for new food service and retail products to increase choice and quality, with resulting increases in ancillary revenue.

Reduce costs. BC Ferries is obligated under the Coastal Ferry Act to seek additional or alternative service providers to provide ferry services on its designated routes, under contract, franchise agreement or otherwise, in an effort to reduce the costs of providing those services. BC Ferries' objective will be to foster efficiencies through competitive processes and performance targeting. Further savings are expected to result from ongoing cost reduction initiatives. Specifically, BC Ferries' capital expenditure plan is expected to reduce operating costs by replacing disproportionately aged assets, thereby reducing maintenance costs while enhancing capacity and reliability and providing new revenue opportunities.

Alternative service delivery. A significant change reflected in the new model for ferry services is the transformation of BC Ferries from that of the sole provider of services to that of service integrator. The Coastal Ferry Act states that ferry operators are to be encouraged to seek additional or alternative service providers on

designated ferry routes through fair and open competitive processes. As a service integrator, BC Ferries is obligated to test the market in an effort to reduce the costs of providing those services. BC Ferries' future success lies in its ability to provide safe and reliable service that is commercially focused and competitive. Costs relative to third party service providers will be a key consideration in assessing alternative service delivery options.

BUSINESS OF BC FERRIES

Overview

BC Ferries operates a large and complex coastal ferry transportation system that provides vehicle and passenger transportation and related services in the coastal waters of British Columbia. It is one of the largest ferry operators in the world based on passengers transported annually and based on transportation infrastructure. During the 2003/04 fiscal year, BC Ferries carried 21.4 million passengers and 8.3 million vehicles, generating \$533.7 million in revenue, including federal and provincial subsidies.

BC Ferries provides frequent year-round ferry transportation services on 25 routes, supported by 35 vessels and 47 terminals, connecting ports of call throughout coastal British Columbia, including connections between the Lower Mainland and Vancouver Island. BC Ferries also manages nine other remote routes through contracts with eight independent operators. BC Ferries transports an average of 58,500 passengers and 22,700 vehicles on more than 500 sailings per day.

While BC Ferries' core business is the provision of ferry transportation services, it also operates significant ancillary businesses in connection with its transportation services, including food and beverage services, reservation services, retail gift shops, vending machines and parking facilities.

Regulatory Environment

BC Ferries is regulated under the Coastal Ferry Act, which provides for the restructuring of BCFC, the creation of the BCFA, the contracting by the Province for the operation of ferries on specified routes, the establishment of the new ferry system and the office of the independent Commissioner and the regulation of ferry operators on an ongoing basis through the office of the Commissioner.

The Coastal Ferry Act requires the Commissioner to regulate operators providing core ferry services pursuant to service contracts with the Province. BC Ferries is currently the only ferry operator regulated under the Coastal Ferry Act. The Coastal Ferry Act requires the Commissioner to undertake regulation in accordance with certain principles, including placing priority on the financial sustainability of ferry operators. The Commissioner is not authorized to regulate ferry operators in relation to ancillary services (for example, catering and retail concessions, reservations and parking).

In regulating BC Ferries under the Coastal Ferry Act, the Commissioner is primarily responsible for:

- regulating tariffs that may be charged for core ferry services by setting caps on the average tolls charged for each route group identified in the Coastal Ferry Services Contract for each performance term after the first performance term;
- authorizing extraordinary price cap increases in relation to a route group in certain extraordinary circumstances, including the deployment of a new vessel, an extraordinary increase in the price of any non-controllable input (such as fuel), an unanticipated and extraordinary change in traffic levels or the introduction of any new regulation that imposes an unexpected and significant additional cost burden;
- authorizing the reduction of service on a designated route below the core ferry services required for that route if the Commissioner is of the opinion that it is for a temporary period and for an extraordinary situation; and
- authorizing the discontinuance of service on a designated route.

In assessing an application by BC Ferries for authorization relating to setting price caps, extraordinary price cap increases and the discontinuance of service, the Commissioner must consider principles specific to each type of authorization as set out in the Coastal Ferry Act.

Under the Coastal Ferry Act, BC Ferries must not, except as permitted by the Coastal Ferry Services Contract, reduce service on a designated route below the core ferry services required for that route unless BC Ferries first obtains the authorization of the Commissioner. BC Ferries has the freedom to set individual tolls within each route group, provided the average toll does not exceed the capped level. This will assist BC Ferries in maximizing revenues by utilizing innovative pricing strategies to optimize traffic volumes and ferry utilization (for example, by seasonal or time of day fare differences).

See “Regulation” for a more detailed summary of the Coastal Ferry Act.

Major Contracts

Coastal Ferry Services Contract

The Coastal Ferry Act authorizes the Province to enter into contracts for the operation of ferries on specified ferry routes. BC Ferries entered into the Coastal Ferry Services Contract with the Province on April 1, 2003 relating to the provision of ferry services for a 60 year term. Among other things, the contract establishes the routes to be operated, the service levels to be met by BC Ferries (subject to an allowance for short term or temporary service disruptions) and the service fees to be paid by the Province for the provision of such services, and provides for certain provincial social program reimbursements.

Performance Terms

The first performance term under the Coastal Ferry Services Contract is the five year period from April 1, 2003 to March 31, 2008. Each subsequent performance term will be four years.

Core Service Levels

For the first two years of the first performance term of the Coastal Ferry Services Contract, the core service levels for each designated route are the number of trips and number of hours during which home port departures occur, as specified in the 2002/03 published schedule for that route. Core service levels for the last three years of the first performance term allow for more scheduling flexibility, as long as adequate capacity is provided to carry the previous year’s traffic and the required total annual round trips are provided. Core service levels in relation to a designated ferry route may not be adjusted before April 1, 2005, but may be adjusted after that date by mutual agreement between the Province and BC Ferries if such adjustments result in improved schedules, customer service or operational efficiency. Core service levels are required to be reviewed and may be adjusted for each subsequent performance term. The Coastal Ferry Services Contract also permits core service levels to be adjusted by mutual agreement upon deployment of a new vessel which enhances capacity on a designated route.

Service Fees

The Coastal Ferry Services Contract requires the Province to pay service fees to BC Ferries for the provision of services. These fees consist of ferry transportation fees for Other Routes and Northern Routes, social program reimbursement payments and unregulated route fees. These fees are estimated to total approximately \$106 million per annum for the first performance term. Service fees are required to be reviewed and may be altered for subsequent performance terms. The Coastal Ferry Services Contract also provides that the Province will continue to make available to BC Ferries the proceeds of a federal subsidy pursuant to the Canada / British Columbia Coastal Ferry Subsidy Agreement dated April 18, 1977. The subsidy agreement is terminable only by the joint agreement of the Province and the Government of Canada. For the 2003/04 fiscal year this federal subsidy was \$24.0 million.

Renewal of Term

The Coastal Ferry Services Contract is renewable for an additional 60 year term if mutually agreed. If the Province elects not to contract with BC Ferries for the provision of ferry services on a designated route after the expiry of the initial 60 year term of the Coastal Ferry Services Contract, BC Ferries has the right to require

the Province to purchase surplus vessels that were used on that route for net book value, subject to certain conditions.

Vessel Purchase Options

If a vessel becomes surplus to BC Ferries' requirements as a result of a route discontinuance authorized by the Commissioner, BC Ferries has an option to require the Province to purchase that surplus vessel for net book value, provided that BC Ferries has used all reasonable commercial efforts to redeploy the surplus vessel. The Province has an option to purchase a vessel (free and clear of all liens) for net book value if the vessel is no longer needed and BC Ferries wishes to dispose of it. Subject to the terms of the Acknowledgement Agreement, the Province also has the option to purchase each of the vessels owned or leased by BC Ferries and used to provide services under the Coastal Ferry Services Contract upon the occurrence of an event of default under the Coastal Ferry Services Contract by BC Ferries.

Other

The Coastal Ferry Services Contract also contains other provisions dealing with public accountability, indemnities, insurance and remedies for default.

See "Coastal Ferry Services Contract" for a more detailed summary of the Coastal Ferry Services Contract.

Master Agreement and Terminal Leases

BC Ferries and the BCTFA entered into a Master Agreement effective March 31, 2003 as a part of the restructuring of BC Ferries. This agreement acknowledges the transfer of ownership of 43 terminals from BC Ferries to the BCTFA pursuant to the Coastal Ferry Act. As consideration for the transfer, the BCTFA issued a \$330.6 million promissory note to BC Ferries. In addition, BCTFA leased the terminals to BC Ferries pursuant to individual 60 year net leases (the "Terminal Leases"), commencing April 1, 2003. Under the Terminal Leases, control of the 43 terminals has been transferred to BC Ferries and BC Ferries has responsibility for maintaining, developing and managing the terminals at its cost. BC Ferries will retain ownership of any leasehold improvements until termination. BC Ferries has pre-paid the lease payments under the Terminal Leases for the full 60 year term by surrendering the promissory note issued to it by the BCTFA.

If BC Ferries fails to meet its obligations under a Terminal Lease, or upon an event of default under the Coastal Ferry Services Contract by BC Ferries, the BCTFA may at its option re-enter and take possession of the ferry terminal properties (including leasehold improvements) and at its option terminate the lease, subject to the terms of the Acknowledgement Agreement. In addition, BC Ferries has a right to terminate a Terminal Lease in certain circumstances where BC Ferries has been authorized by the Commissioner to discontinue a route.

See "Terminal Leases" for a more detailed summary of the Master Agreement and the Terminal Leases.

Demand

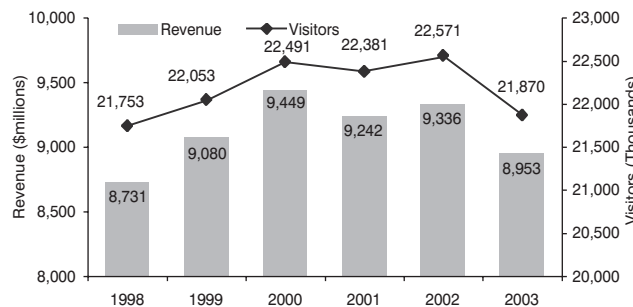
The economic and demographic environment of coastal British Columbia provides strong demand for coastal transportation services. The requirement for commerce and social interaction between the large populations living and working on Vancouver Island and in Greater Vancouver and the surrounding areas, and the popularity of both of those locations as tourist destinations, are the foundation for the demand for coastal transportation services.

According to BC Stats, the central statistical agency of the Province, British Columbia's population was approximately 4.1 million in 2003, and is expected to grow 32% by 2030, reaching a population of 5.4 million. Population growth is expected to be driven largely by migration into the Province. According to BC Stats, the Lower Mainland and Victoria are expected to benefit disproportionately due to their greater employment prospects as metropolitan centres.

According to Tourism British Columbia, the confluence of major events that occurred during 2003, including the onset of the Iraq war, the appearance of SARS and the impact of severe forest fires in the British Columbia interior, led to the largest decline in visitor volume since 1987. Tourism British Columbia anticipates

that these events will have a diminished impact on visitor volume during 2004 and onwards. Approximately 1.4 million overseas travelers (down 11% from the previous year) and 4.9 million visitors from the United States (down 7.7% from the previous year) visited British Columbia in 2003. The remaining 15.5 million visitors in 2003 (down 3.0% from the previous year) were visitors from other parts of Canada or visitors from within British Columbia making overnight visits to other points in British Columbia. The decrease in visitors led to overall tourism revenue and visitor volume declining by 4.2% and 3.2%, respectively, in 2003. Tourism creates seasonal demand for ferry services, with ridership increasing during the summer months. The majority of tourists on BC Ferries' routes use the Major and Northern Routes. The following chart shows tourism visits to British Columbia and resulting revenue for the six year period ended December 31, 2003:

BC Tourism Revenue and Visitor Volume



Source: BC Ministry of Management Services "Tourism Industry Monitor".

Other key variables that affect demand for ferry services in British Columbia are real disposable income, the level of commercial and industrial activity in coastal British Columbia and toll levels. Improvement in the British Columbia economy, increasing disposable income resulting in part from reduced personal taxation and population growth in key markets are expected to contribute to growth in ferry traffic in the near term. Toll increases beyond the rate of inflation are expected to moderate that growth but contribute to profitability.

Price Elasticity of Demand

As an important transportation service, BC Ferries enjoys a strong core demand. Changes to toll levels impact the level of demand as customers react to price changes. BC Ferries conducts ongoing market research into the sensitivity of customers to price changes, expressed in terms of price elasticity of demand.

A comprehensive study of elasticity of demand for BC Ferries was conducted in 1998. The results are calibrated each year in internal forecasting models. In 2003, BC Ferries commissioned a follow-up study by Transportation Economics & Management System, Inc. to evaluate the accuracy of the price elasticity of demand on its Major Routes. The study confirmed the results of the 1998 study with respect to the Major Routes.

Demand on Northern and Other Routes is relatively more inelastic (less sensitive to price changes) than demand on Major Routes because those customers make a much higher proportion of non-discretionary trips (for commuting and shopping for example) and there are fewer alternatives for travel to and from the communities served by those routes.

The following table shows the estimated elasticities and changes to toll revenue for real toll increases of 10% on BC Ferries' routes.

	Major Routes ⁽¹⁾	Northern and Other Routes ⁽¹⁾
Elasticity — “In Vehicle” Trips	-0.70	-0.25
Elasticity — “On Foot” Trips	-0.48	-0.19
Toll Revenue Impact in Following 12 Months ⁽²⁾	+6.3%	+8.7%

(1) Price elasticity measures the responsiveness of travelers to changes in toll levels. Since demand typically decreases as toll levels increase, the ratio is negative. For example, a ratio of -0.70 illustrates that a real toll increase of 10% would result in a 7% decrease in demand.

(2) Revenue impacts assume an “across-the-board” toll increase. Anticipates a delay in customer response to toll increases. Additional revenue impact will occur over time.

Recent market research indicates that the application of appropriate price optimization measures, including peak/off-peak pricing, and revenue yield analysis would permit BC Ferries to realize greater revenue increases than indicated above. BC Ferries now has the ability to price in this manner.

Service Area

BC Ferries' service area stretches from Prince Rupert in northern British Columbia to Victoria in southern British Columbia, with routes classified by BC Ferries in three categories:

Major Routes. The Major Routes connect Vancouver Island to the Lower Mainland of British Columbia through BC Ferries' five major terminals: Tsawwassen, Swartz Bay, Horseshoe Bay, Duke Point and Departure Bay. Approximately 76% of BC Ferries' revenue (excluding revenues from government, interest income and income from subsidiaries) for the 2003/04 fiscal year was generated on the Major Routes. The Province does not pay ferry transportation service fees pursuant to the Coastal Ferry Services Contract in respect of the Major Routes. Travel times on Major Routes generally vary between 90 and 120 minutes.

Northern Routes. The Northern Routes provide ferry service to the Province's mid and north coast and the Queen Charlotte Islands. Approximately 4% of BC Ferries' revenue (excluding revenues from government, interest income and income from subsidiaries) for the 2003/04 fiscal year was generated on the Northern Routes. Northern Routes qualify for ferry transportation service fees from the Province pursuant to the Coastal Ferry Services Contract. Travel times on Northern Routes are generally from seven to 21 hours.

Other Routes. The Other Routes consist primarily of routes that connect the Gulf Islands and several other island or rural communities to either Vancouver Island or the Lower Mainland. Approximately 20% of BC Ferries' revenue (excluding revenues from government, interest income and income from subsidiaries) for the 2003/04 fiscal year was generated on the Other Routes. These routes qualify for ferry transportation service fees from the Province pursuant to the Coastal Ferry Services Contract. Travel times on the Other Routes generally vary between 10 and 75 minutes, with the majority of crossing times between 20 and 50 minutes.

Eight independent operators provide ferry services to remote coastal communities on BC Ferries' nine contracted routes, which account for less than 1% of BC Ferries' revenue.

Fleet

Description of Vessels

BC Ferries' fleet consists of 35 vessels, including 33 vessels which it owns and two vessels, the Queen of Surrey and the Queen of Oak Bay, which it operates under prepaid capital leases. BC Ferries will acquire, for nominal consideration, title to these two vessels on January 1, 2006 and January 1, 2007, respectively. BC Ferries also owns two other small vessels, the MV Nicola and the MV Garibaldi II, which it charters to third parties.

As illustrated in the table below, BC Ferries' 35 vessels differ significantly in terms of size, characteristics and class. Vessel capacity ranges from 138 to 2,100 passengers and from 16 to 470 automobile equivalents. The "S" Class twin vessels, Spirit of British Columbia and Spirit of Vancouver Island, are the largest vessels operated by BC Ferries.

Classes of Vessels Operated by BC Ferries			
Class	Number of Vessels	AEQ Capacity	Passenger and Crew Capacity
"S" Class	2	470	2,100
"V" Class	3	338 - 376	1,656 - 1,708
"C" Class	5	295 - 362	1,200 - 1,500
Burnaby Class	2	192	1,216
Cumberland Class	2	85 - 127	462
Century Class	1	100	600
Northern Vessels	3	80 - 115	400 - 700
Other (Vehicle Capacity greater than 125)	2	138 - 286	950 - 1,340
Other (Vehicle Capacity 51 to 125)	5	70	330 - 400
Other (Vehicle Capacity 0 to 50)	9	16 - 50	138 - 400

(1) The MV Nimpkish (16 AEQ capacity) is not currently operating as part of the BC Ferries' fleet on a day-to-day basis and is not included above.

Maintenance

BC Ferries has implemented a comprehensive asset management strategy to ensure that the lifecycle and related costs of its assets, including vessels, are monitored and analyzed on an ongoing basis. All vessels are maintained to the standards regulated by Transport Canada, classification societies and other regulatory agencies. BC Ferries utilizes an internally developed vessel condition assessment program as a means of ensuring that all vessels are in service for their expected useful life. This program provides for proactive measures relating to maintenance planning, refit strategies and capital upgrades. The program requires all vessels to undergo condition surveys as well as regular inspections at specified intervals. Condition surveys identify repairs and maintenance necessary to meet the standards of all regulatory agencies and to ensure the vessels are in service for their expected useful life. Condition surveys are conducted when vessels reach 10 and 27 years of age and involve a general examination of the vessel. More comprehensive condition surveys are conducted when vessels reach 18 and 36 years of age and involve a detailed examination, including hull thickness testing and a comprehensive survey of overall vessel condition.

BC Ferries utilizes internal and external sources for its running and refit maintenance program. Generally, 25% of all maintenance is performed by on-board crew, 30% is performed by DPMI and 45% is provided under contract by third parties.

DPMI currently focuses on providing planned and emergency maintenance and repair services for BC Ferries. However, BC Ferries intends for DPMI to compete with other ship repair facilities and attract new customers for ship repair work and shipbuilding. DPMI's facility is located on the Fraser River in Richmond, British Columbia. The facility has six berths and utilizes a work force of approximately 190 people.

Condition of Vessels

The median age of BC Ferries' fleet is 32 years. The weighted average age of BC Ferries' vessels based on AEQ capacity is 27 years for BC Ferries' total fleet and 26 years for its vessels operating on Major Routes. Most of the vessels (30 of 35) are in the second half of their expected lives. All of BC Ferries' vessels are maintained to high standards.

Fleet Replacement Plan

Over the past ten years, BC Ferries has made few significant capital expenditures for vessel replacement other than in connection with three PacifiCat catamaran high speed ferries.

In 1994, the government of the day in British Columbia announced a ten year capital plan for BC Ferries which included the construction of the three PacifiCat high speed ferries through a wholly-owned subsidiary. The stated intention of the construction program was to foster and revitalize the ship building industry in British Columbia. The government's intention was to deploy the high speed ferries on BCFC's route between Horseshoe Bay and Departure Bay. In March 2000, based upon an independent inquiry and customer assessments, BCFC and the government determined that the high speed ferries were not economical and not appropriate for BCFC's routes. The three vessels were disposed of in 2003 resulting in a loss of \$53.1 million on disposal of the high speed ferries and related ancillary equipment. Provisions for write-downs to management's best estimated value of the high speed ferries were made as follows: \$40 million in 2002, \$240 million in 2000 and \$48 million in 1999. Costs to store, secure and otherwise maintain the high speed ferries were expensed as incurred.

Significant capital expenditures are required over the next ten years to upgrade and replace vessels within the fleet. BC Ferries' new vessel procurement strategy is designed to provide a rational framework for vessel replacement decisions and implementation of vessel acquisitions. Key provisions in this strategy include:

- acquiring established and proven design, engineering and construction technology;
- worldwide sourcing based on best life cycle costs and values for major expenditures;
- achieving internal economies associated with standardization;
- maximizing negotiating leverage by bundling appropriate projects into large purchase units (for example, multiple vessel acquisition); and
- ensuring vessels are built to maximize revenues.

Over the past several years, BC Ferries has completed condition assessments and detailed surveys on many of its older vessels. Although BC Ferries' vessels are maintained to high standards, BC Ferries has concluded that construction of new vessels to replace its oldest vessels ("V" Class vessels) serving the Major Routes should commence within the next 12 months. All three of the current "V" Class vessels are expected to be retired from regular service by no later than 2009/10 fiscal year. The replacement of the "S" and "C" Class vessels, also serving the Major Routes, is anticipated to commence in the 2018/19 fiscal year, with the last "S" Class vessel anticipated to be retired in the 2044/45 fiscal year. In addition to the replacement of the three "V" Class vessels, four other vessels are expected to be retired before the end of the 2009/10 fiscal year, three of which serve the Northern Routes.

Terminals

Description of Terminals

BC Ferries operates its routes from five major and 42 minor terminals. BC Ferries has exclusive use and control of the five major terminals and 38 of the minor terminals for a 60 year term from April 1, 2003 pursuant to the Master Agreement and the Terminal Leases. BC Ferries also uses, but does not own, four minor (northern) terminals.

The five major terminals are Tsawwassen and Horseshoe Bay in Greater Vancouver, and Swartz Bay, Duke Point and Departure Bay on Vancouver Island. In the 2003/04 fiscal year, the five major terminals accounted for

63% and 58% of BC Ferries' passenger and vehicle traffic, respectively. The following table provides summary information in respect of each of the major terminals:

Major Ferry Terminals					
Major Terminals	Location	Holding Capacity (Cars)	Short Term Parking (Cars)	Long Term Parking (Cars)	Docks
Tsawwassen	Delta	2,000	240	1,100	5
Swartz Bay	North Saanich	820	199	608	5
Horseshoe Bay	West Vancouver	1,265	140	466	3
Duke Point	Nanaimo	1,000	80	200	1
Departure Bay	Nanaimo	900	70	220	3

Of the 42 minor terminals, the Langdale terminal on the Sunshine Coast is the largest, serving approximately 12% of total minor terminal vehicle traffic and approximately 6% of total vehicle traffic in the 2003/04 fiscal year.

The terminals leased by BC Ferries are its key strategic assets. The need for terminal facilities would be a significant entry barrier for competitors. See “— Competition”.

Maintenance

All marine and shore structures at BC Ferries' terminals are subject to regular condition surveys. BC Ferries engages maritime consultants to conduct detailed condition surveys at each terminal every seven years on a staggered basis. In addition to the inspection of marine and shore structures, condition surveys also audit the effectiveness of maintenance and testing programs for equipment used at each terminal. In the 2002/03 fiscal year, condition surveys were conducted at the Swartz Bay and the Tsawwassen terminals. These surveys concluded that both these major terminals are in excellent condition. Condition surveys are currently scheduled for Horseshoe Bay, Departure Bay and Duke Point in the 2004/05 fiscal year.

At regular intervals between condition surveys, BC Ferries performs general inspections of equipment and structures at each terminal.

In December 2003, BC Ferries entered into a memorandum of understanding with SNC-Lavalin Inc. to implement a terminal asset management program. The purpose of the program is to review and improve the management of maintenance and construction at all 47 terminals, and to create a new business unit that will be responsible for the overall management of maintenance and new construction for all terminal facilities.

Terminal Development Plan

Master plans are being developed for the Tsawwassen, Swartz Bay and Duke Point terminals outlining terminal development and revenue enhancement opportunities. A general plan is intended to be developed for the minor terminals. Significant upgrades were recently completed at Horseshoe Bay and Departure Bay terminals. These upgrades generally meet BC Ferries' current requirements at Horseshoe Bay; however, further development at Departure Bay is expected. Significant capital expenditures will be required over the next decade to develop and upgrade BC Ferries' terminals. The Tsawwassen and Swartz Bay terminals are currently undergoing passenger facility upgrades. In addition to facility upgrades, over \$25 million is expected to be spent on the replacement of marine structures at Tsawwassen over the next two years.

Capital Expenditure Plan

Following under-investment for many years, BC Ferries plans to embark on a major capital improvement program. Over the next decade, BC Ferries has planned capital expenditures of approximately \$1.9 billion. Approximately 75% of these planned expenditures are related to new vessel acquisition, vessel upgrades and

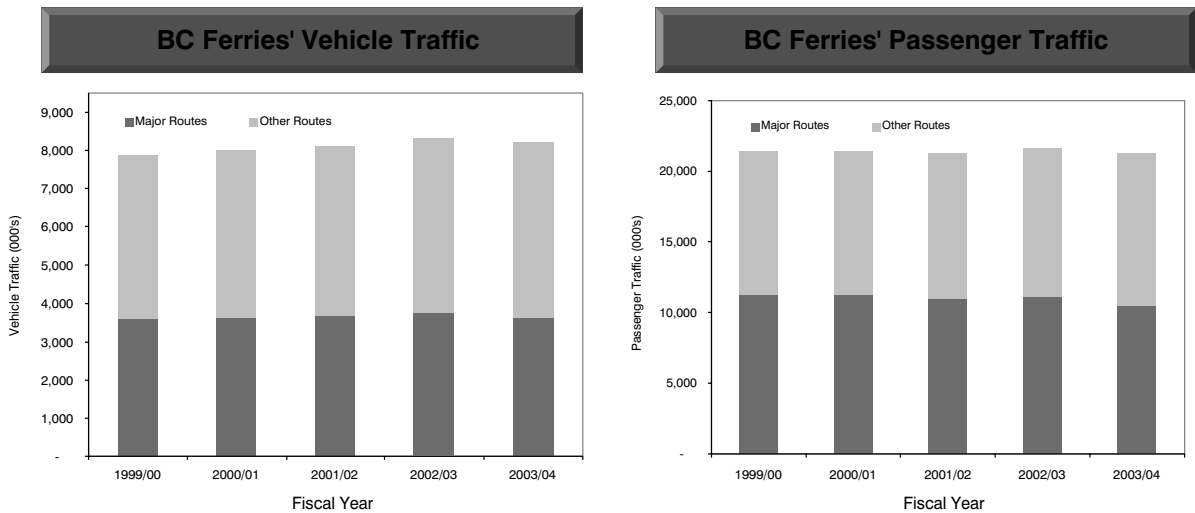
component replacement, with the balance allocated to terminals and other projects (systems and other improvements). These capital expenditures are expected to be funded approximately equally by internal cash flow generation and borrowings.

BC Ferries plans to adopt a prudent and conservative approach in managing its capital plan, including:

- pre-approval by the Commissioner of major expenditures related to regulated services;
- appropriate construction contracts for major expenditures (for example, fixed price contracts);
- phased vessel replacement based on financial capacity and need;
- purchasing proven vessel technology from reputable contractors; and
- worldwide sourcing based on best life cycle costs and value for major expenditures.

Traffic Volumes

Since the introduction of ferry service in the 1960s, BC Ferries and its predecessors have grown passenger and vehicle volumes significantly through the introduction of new routes and service improvements. Over the past 16 years, passenger traffic on BC Ferries has grown 25.6%, due largely to the growth in population of Greater Vancouver and Vancouver Island. Traffic volume has been over 20 million passengers and 7.5 million vehicles in each of the past five fiscal years ending with the 2003/04 fiscal year. During this five year period, vehicle traffic has grown at a compound annual growth rate of 1.2% per annum while passenger traffic has been relatively constant. In the 2003/04 fiscal year, as a result of SARS and the war in Iraq, vehicle traffic and passenger traffic decreased by 0.4% and 1.2%, respectively, from the previous fiscal year. The following charts depict vehicle and passenger traffic over the past five fiscal years:



In the 2003/04 fiscal year:

- vehicle traffic on Major Routes decreased by 1.2% and increased on Other Routes by 0.4%, while vehicle traffic on Northern Routes fell by 0.7%;
- the Major Routes accounted for 51% of total passengers (approximately 80% of passengers on Major Routes were vehicle passengers) and 47% of total automobile equivalent traffic; and
- the Major Routes accounted for 76% of revenues (excluding revenues from government, interest income and income from subsidiaries).

The route between Swartz Bay and Tsawwassen, which is included in the Major Routes, is the largest of BC Ferries' routes in terms of both traffic and revenue. In fiscal 2003/04, this route carried approximately 23% of BC Ferries' vehicle traffic and approximately 28% of passenger traffic and generated approximately 30% of

total revenue. The following table depicts the percentage of total traffic and revenue by route group for the 2003/04 fiscal year:

Percentage of Total Traffic and Revenue by Route Group for the 2003/04 Fiscal Year			
Route Group	% of Total Traffic (Passenger)	% of Total Traffic (Vehicle)	% of Total Revenue ⁽¹⁾
Major Routes	50.7%	44.5%	75.9%
Northern Routes	0.5%	0.4%	3.7%
Other Routes	48.8%	55.1%	20.4%

(1) Revenue data for 12 months ended March 31, 2004 (excluding payments under Federal Provincial Subsidy Agreement, motor fuel tax subsidy, interest income and income from subsidiaries). Revenues include tolls, catering and other income attributable to routes.

Customers

Based on customer surveys conducted by BC Ferries in 2002, approximately 77% of all trips on BC Ferries are for non-business purposes.

On the Major Routes, approximately 37% of passengers reside in the Lower Mainland and approximately 42% of passengers reside on Vancouver Island. On these routes, 23% of trips are for business purposes. Based on the 2002 customer survey results, 17% of customers traveling on Major Routes report having made 20 or more trips annually.

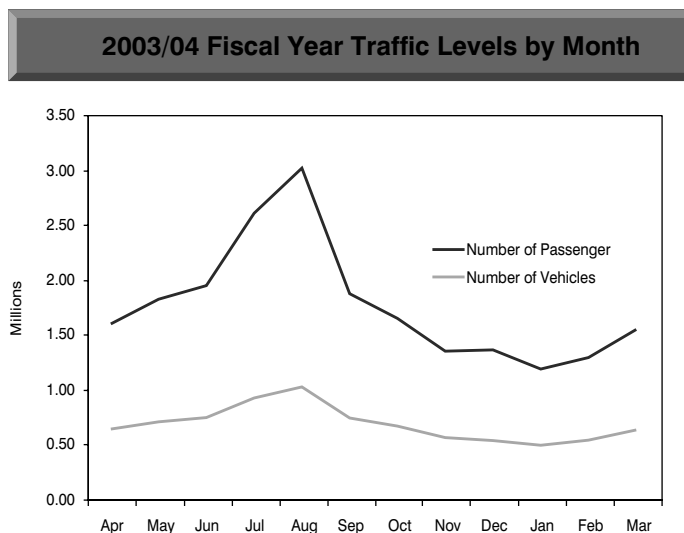
In contrast, based on the 2002 customer survey results, 37% of trips made on the Other Routes are made for business purposes. This is attributable to the higher proportion of remote ports of call serviced by the Other Routes, where there are few alternatives for travel and where more people are required to travel for work. Other Routes have a very high level of repeat travel. Based on the 2002 customer survey results, 52% of customers on Other Routes reported having made 20 or more trips annually.

The Northern Routes, with their higher proportion of leisure travellers, are used 82% of the time for non-business purposes.

Capacity Utilization

Seasonality

Demand for ferry travel is seasonal, with higher levels of demand in the summer months. Seasonality is relatively consistent year to year.

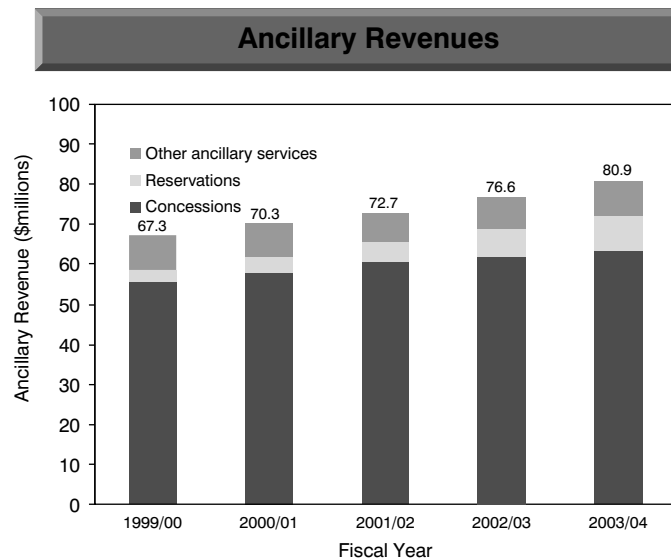


Average Capacity Utilization

In the 2003/04 fiscal year, BC Ferries carried 21.4 million passengers and 8.3 million vehicles. Seasonality results in much higher levels of capacity utilization in the summer months. On an annual basis, BC Ferries' average AEQ capacity utilization has been relatively consistent. Over the past five fiscal years, AEQ capacity utilization has been approximately 65% to 70% for Major Routes, 45% to 50% for Northern Routes and 40% to 45% for Other Routes.

Ancillary Services

In addition to ferry transportation, BC Ferries has a number of ancillary business segments: concessions (food and beverage and retail), parking, reservations and other sales. Ancillary businesses are not regulated under the Coastal Ferry Act or the Coastal Ferry Services Contract, and accounted for approximately 15% of total revenues for the 2003/04 fiscal year. Ancillary revenues are, however, taken into account by the Commissioner in establishing price caps. The graph below depicts BC Ferries' ancillary revenues over the past five fiscal years, broken down between revenues from concessions, reservations and other ancillary services:



Concessions

BC Ferries operates a total of 46 food and beverage outlets on 19 vessels and in four terminals. These outlets generated \$47.2 million of revenue and, after cost of sales of 32.5% of revenue, contributed \$31.8 million of gross margin in the 2003/04 fiscal year. Food and beverage operations range from buffets with liquor service, to fast food style cafeterias, to limited service snack bars and coffee bars.

BC Ferries owns and operates a total of 21 retail gift shop and newsstand outlets on 18 vessels and in three terminals. These shops generated \$12.7 million of revenue and, after cost of sales of 62.8% of revenue, contributed \$4.7 million of gross margin in the 2003/04 fiscal year. Retail operations range from 1,000 square foot gift shops to relatively small newsstands.

Video and vending machines, staterooms and other miscellaneous items contributed \$3.3 million of gross margin in the 2003/04 fiscal year.

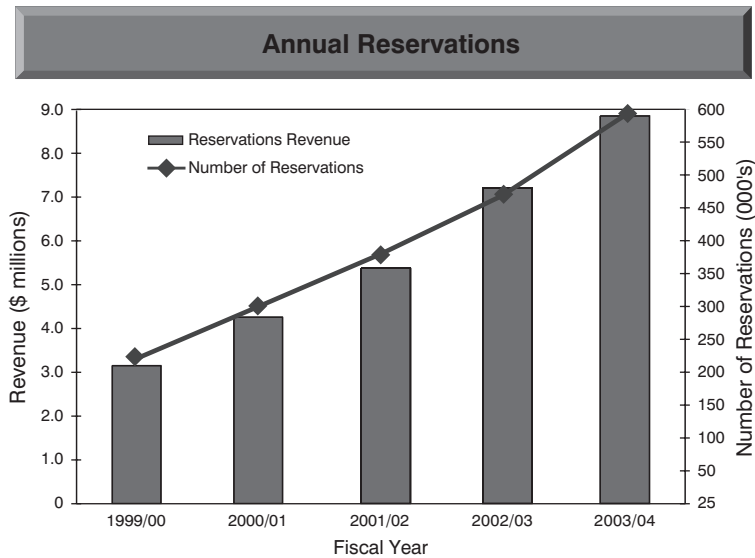
BC Ferries has been successful in pursuing partnering opportunities with recognized food service brands. In 2000, BC Ferries and White Spot, a well known regional restaurant chain, entered into a five year strategic partnership to provide a branded food services program on certain vessels. As a result of this program, burger sales have increased significantly. The success of the White Spot program has led BC Ferries to pursue partnering opportunities with other recognized food service brands, such as Starbucks, Villages Pizza and Bread

Garden. BC Ferries sees partnering programs as a significant opportunity for revenue growth, and intends to focus on further developing its partnering programs.

Reservations

For a fee, customers are able to make passenger vehicle reservations for sailings on certain routes. Passenger vehicle reservations have been offered on select Northern and Other Routes for over 30 years. Reservations on Major Routes have been available to BC Ferries’ passenger vehicle customers since the 1998/99 fiscal year.

Demand for reservations on Major Routes has increased significantly and is BC Ferries’ fastest growing revenue source. By improving access to reservations, lowering costs of distribution (due to automation) and refining pricing and utilization strategies on the Major Routes, BC Ferries plans to generate further revenue from reservations.



Other Ancillary Services

Other ancillary services include parking, assured loading tickets and contracted marketing rights. BC Ferries generates ancillary revenues through the operation of pay parking facilities at most of its terminals. Private sector companies have been hired to manage and operate the parking facilities at certain terminals. BC Ferries recently expanded the parking facilities at its Horseshoe Bay terminal, and is reviewing parking options at all other major terminals with a view to maximizing value from this business segment.

In 1998, BC Ferries entered into an exclusive supply and marketing rights agreement with Coca-Cola. This agreement provides marketing rights fees to BC Ferries.

Human Resources

Employee Relations

As of December 31, 2003, BC Ferries’ workforce (excluding employees of DPMI) consisted of 3,159 FTE employees, comprised of 2,828 unionized FTE employees and 331 non-unionized FTE employees. All unionized employees are members of the British Columbia Ferry and Marine Workers’ Union (the “BCFMWU”).

There have been 11 collective agreements between the BCFMWU and BC Ferries since 1977. The collective agreements typically have had a term of two to three years. The most recent collective agreement expired on October 31, 2003. Following difficult negotiations, BC Ferries and the BCFMWU have been unable

to agree on a new collective agreement but have submitted the matter to binding arbitration. The arbitration is a formal process and is proceeding in the following steps:

- the arbitrator has received initial written submissions from both parties setting out their position;
- each party has responded in writing to the other party's initial submissions;
- the arbitrator will review all submissions from both parties and will call for hearings on key issues in dispute; and
- the arbitrator will issue a final and binding decision which will identify the terms that should be included in a new collective agreement.

The arbitrator has set terms of reference that require him to take into consideration all legislation applicable to BC Ferries, but provide him the flexibility to determine how best to arrive at an equitable resolution of the dispute. BC Ferries expects the arbitrator to issue a final decision in June 2004. This decision will be binding on both parties.

DPMI and its unionized employees are separately negotiating a collective agreement. The parties are currently in mediation under the terms of a "no strike/no lockout" agreement to May 25, 2004. Notwithstanding such agreement, on April 29, 2004 the union served DPMI with 72 hour strike notice.

Although some negotiations with the BCFMWU (or its predecessors) have been protracted, there have been few work stoppages or job actions. The longest work stoppage lasted for three days. This occurred in late 2003, just prior to commencement of the current binding arbitration process. In the past decade, there have been no work stoppages which have had a material impact on the financial results of BC Ferries.

In the event of a strike or threatened strike, BC Ferries' designation as an essential service for purposes of the *Labour Relations Code* allows it to apply to the British Columbia Labour Relations Board for an Essential Services Order to ensure that a base level of service continues. The Labour Relations Board then determines the level of service deemed to be essential. An Essential Services Order requires that BC Ferries' employees provide sufficient resources to meet the level of service set by the Order. BC Ferries has had three Essential Services Orders issued by the Labour Relations Board in anticipation of potential strike action in the past.

Training Programs

BC Ferries has implemented a number of training programs for its employees in order to meet its human resources strategic goals. In the 2000/01 fiscal year, BC Ferries implemented a Marine Officer Development program to ensure succession of certificated marine officers, whose credentials require considerable time and effort to obtain. In the 2002/03 fiscal year, this program resulted in 32 new senior certificates (22 deck and 10 marine engineering) for a total of 89 new certificates obtained during the three year program. Several other training initiatives were recently completed as well, such as a broad-based training program on the handling of dangerous goods, standardized testing of clerical skills, development of musculoskeletal injury worksafe training, creation of customer service standards for front line employees and completion of a comprehensive review of employee development and training.

Competition

The primary source of competition faced by BC Ferries is from air travel. With the entrance of low cost carriers, air travel between the Lower Mainland and Victoria and Comox on Vancouver Island has seen major growth. Compared to air travel, however, BC Ferries has a significant price advantage and provides travellers with access to their own vehicles. Based on Statistics Canada data and passenger capacity estimates derived from official airline guides and carrier schedules, the total volume of traffic carried by air represents only 4% of the total Lower Mainland to Vancouver Island passenger market. BC Ferries believes that air services have been operating between Vancouver and Victoria for a sufficient period of time to have fully impacted BC Ferries' passenger volumes.

From time to time, high speed, passenger-only ferry services have been launched on routes between Vancouver and Vancouver Island. Tariffs charged by operators of these services have generally been higher than

BC Ferries' passenger tariffs. BC Ferries currently has one competitor providing high speed passenger-only ferry services on the route between Vancouver and Nanaimo. BC Ferries is the only ferry operator providing passenger vehicle transportation. Approximately 80% of BC Ferries' passenger volume is represented by vehicle passengers; even if price competitive, high speed passenger-only services are not expected to have a major impact on BC Ferries' total passenger volumes. BC Ferries expects the existing passenger-only competitor to capture less than 1% of BC Ferries' total passenger traffic per annum.

BC Ferries has 100% of the market share for non-commercial vehicle ferry services and nearly 100% of the market share for commercial vehicle with driver ferry services on the British Columbia coast.

BC Ferries has one significant competitor providing commercial daily drop-trailer and barge service (without tractor or driver) from Vancouver to Swartz Bay and Nanaimo. This competitor is estimated to have approximately one-half of the semi-trailer ferry transportation market on the British Columbia coast. In the 2003/04 fiscal year, semi-trailer traffic on BC Ferries' routes accounted for approximately 7% of total revenue.

BC Ferries is not aware of any plans to build a fixed link between Vancouver Island and the Greater Vancouver area, and believes it unlikely that a fixed link will be built in the foreseeable future because of the high construction costs, environmental concerns and significant engineering challenges.

There are significant barriers to entry into the market served by BC Ferries for other ferry operators, including:

- acquiring locations for terminals in prime service areas;
- making the capital commitment necessary to establish the required infrastructure;
- obtaining financial support comparable to the service fees and federal subsidy BC Ferries receives from the Province;
- obtaining environmental approvals to construct terminal facilities; and
- obtaining approvals to connect roads and highways to terminal facilities.

Insurance

BC Ferries carries insurance with reputable insurers covering, among other things:

- loss or damage to its properties and vessels;
- public liability, including liability for bodily injury or property damage suffered by its passengers or third party vessels;
- sudden and accidental environmental impairment, particularly for water pollution; and
- liabilities of directors and officers.

BC Ferries does not have business interruption insurance, but does have a large fleet that provides flexibility in the event a vessel is not available for use.

BC Ferries believes that the types and amounts of insurance coverage it currently maintains are consistent with customary practice in the ferry service industry and are adequate for the conduct of its business. BC Ferries is required to maintain certain insurance coverage under the terms of the Coastal Ferry Services Contract and the Terminal Leases. Recently, Intech Risk Management Inc. completed an independent review of BC Ferries' insurance program to ensure BC Ferries has appropriate coverage for a commercially operated ferry system. It concluded that generally BC Ferries' insurance risk management program is consistent with those of other similar operators and is appropriate for BC Ferries, although the \$3 million deductible on its hull and machinery policy should be reviewed with a view to lowering the deductible provided the costs of doing so are reasonable. BC Ferries is reviewing the level of its insurance deductibles.

Safety and Environmental Programs

Safety Programs and Procedures

BC Ferries is committed to providing a safe environment for its employees and passengers and providing safe operation of its vessels. Safety is regulated federally under the *Canada Shipping Act* and provincially through the Workers' Compensation Board. The *Canada Shipping Act* governs crew and passenger licences, minimum staffing of vessels, vessel construction, vessel operation and safety inspections. Protocols with Transport Canada are being developed with a view to improving standardization and allowing pre-approval of crew and passenger levels prior to undertaking capital initiatives. In 1994, BC Ferries voluntarily adopted the International Safety Management code of the International Maritime Organization (the "ISM code"). The ISM code is an international standard for the management and operation of ships and pollution prevention. The code includes procedures and standards (representing "best practices" in marine operations) for all safety related activities. ISM internal auditors inspect all vessels and shore establishments at least once a year. Lloyd's Register conducts external audits of management ashore once a year and vessels every two and one-half years to ensure that the safety management system meets the requirements of the ISM code. The most recent shore based audit was conducted in October 2003 and no material issues were identified.

BC Ferries develops a yearly Worksafe plan jointly with the Workers' Compensation Board, which specifies safety testing, training and engineering procedures designed to prevent workplace injuries. BC Ferries is also in the process of upgrading the safety systems on all of its vessels. Recently, it approved a five year program to upgrade all "C" Class vessels with a new evacuation system.

Over the past decade, BC Ferries and its predecessor have had two incidents relating to fires which have resulted in damages exceeding \$1 million, the largest of which resulted in damages of \$2.9 million.

Environmental Programs and Procedures

BC Ferries, its operations and properties are subject to federal, provincial, municipal and local environmental laws and requirements. The *Canada Shipping Act* is the primary environmental pollution control law for ships operating in British Columbia. However, other environmental laws such as the *Fisheries Act* (Canada), which prohibits the deposit of deleterious substances into fish habitat, the *Canada Environmental Protection Act* and provincial statutes relating to management of contaminants form part of the environmental regulatory regime. In addition, the Kyoto Protocol may become a significant issue for ferry operators. The Kyoto protocol calls for global reduction of greenhouse gas emissions. BC Ferries expects more stringent emissions regulations for the marine transportation sector and is taking a proactive approach to identify ways to reduce emissions.

BC Ferries is in material compliance with all applicable environmental laws and regulations and has no environmental orders outstanding. In addition, BC Ferries is in material compliance with the permits regulating environmental aspects of its operations, including wastewater discharges and special wastes management. In order to ensure compliance with its permit requirements, BC Ferries uses a third party company to perform continuous monitoring and reporting with regard to its shore based sewage treatment plants. Annual, internal environmental audits of BC Ferries' vessels and shore based facilities have been carried out for the last nine years. In addition, external auditors regularly review environmental performance of BC Ferries by verifying compliance with the ISM code. The most recent review was done as part of the shore based audit conducted by Lloyd's Register in October 2003.

BC Ferries' recent environmental initiatives include implementation of a fleet-wide sewage handling program, use of low sulphur marine diesel in certain applications, storm water system upgrades at certain terminals, improvement and expansion of its recycling programs and replacement of vessel engines with ones that meet emission standards of the International Maritime Organization.

Technology

BC Ferries utilizes current technology solutions to support its customer relations and operations. BC Ferries' internet website is a popular travel website, with over 1.7 million recorded visits to the website in the 2003/04 fiscal year. Online surveys conducted in 2002 showed overall high customer satisfaction with the website. The website has also been used to support the introduction of internet reservations, which generated over \$4.6 million in revenue for the 2003/04 fiscal year.

Over the past two fiscal years, BC Ferries has dedicated significant resources to the upgrade and replacement of information systems, including the upgrade of reservations, point-of-sale and automated ticketing systems and the implementation of new technology for management of human resources, crew scheduling and time collection. On March 31, 2003, BC Ferries and IBM Canada Ltd. formed a five year contractual relationship for the implementation of business and technology solutions for BC Ferries to reduce costs and improve customer service.

In the 2003/04 fiscal year, BC Ferries spent approximately \$22.1 million on technology (operating expenses of \$11.8 million and capital expenditures of \$10.3 million).

REGULATION

BC Ferries is regulated under the Coastal Ferry Act, which provides for the creation of the BCFA, the contracting by the Province for the operation of ferries on specified routes, the establishment of the new ferry system, the establishment of the office of the independent Commissioner and the regulation of ferry operators on an ongoing basis through the office of the Commissioner.

The following is a summary of the Coastal Ferry Act which does not purport to be complete. Reference is made to the full text of the Coastal Ferry Act, a copy of which can be found on BC Ferries' website (www.bcferries.com).

The Coastal Ferry Act applies generally to ferry operators, defined as entities which have been authorized to operate ferries on one or more routes under contracts with the Province. BC Ferries is currently the only ferry operator regulated under the Coastal Ferry Act.

The Coastal Ferry Act requires the Commissioner to undertake regulation in accordance with the following principles:

- priority is to be placed on the financial sustainability of ferry operators;
- ferry operators are to be encouraged to adopt a commercial approach to ferry service delivery;
- ferry operators are to be encouraged to seek additional or alternative service providers on designated routes through fair and open competitive processes;
- ferry operators are to be encouraged to minimize expenses without adversely affecting their safe compliance with core ferry services; and
- there is to be a move to a greater reliance on a user pay system so as to reduce the service fee contributions by the Province over time.

The Coastal Ferry Act also provides that cross subsidization from Major Routes to other designated ferry routes is to be eliminated within the first performance term of the Coastal Ferry Services Contract.

Appointment and Role of Commissioner. The Coastal Ferry Act establishes the office of the Commissioner to regulate operators providing core ferry services pursuant to service contracts with the Province. The Commissioner is appointed by the Lieutenant Governor in Council for a term of six to eight years. The first Commissioner, Martin Crilly, was appointed in August 2003 for a term of seven years. Although the Commissioner is appointed by the Province, the Coastal Ferry Act contains provisions to ensure the independence of the Commissioner. The Commissioner's appointment may only be terminated for mental infirmity, conviction for an indictable offence under the *Criminal Code* (Canada) or a judicial finding of conflict of interest or material breach of duties or obligations. The remuneration or terms of appointment of the Commissioner cannot be changed without the approval of the Commissioner. Up to two deputy commissioners may also be appointed. A decision of the Commissioner cannot be appealed, except on a question of law.

Establishment of Price Caps and Principles for Review. The Commissioner must regulate tariffs that may be charged for core ferry services by setting price caps (the average toll charged) for each route group identified in

the Coastal Ferry Services Contract. In setting a price cap applicable to a route group, the Commissioner must be guided by the following principles:

- the price cap must allow for a return sufficient to enable BC Ferries to recover (i) the portion of operating expenses, including all financing charges, that can reasonably be applied to the route group, (ii) the portion of administrative expenses that can reasonably be applied to the route group, and (iii) the reasonable capital costs that are to be (A) incurred in relation to the route group, and (B) amortized in accordance with generally accepted accounting principles on a straight line basis;
- the price cap, when combined with all other price caps applicable to all route groups served by BC Ferries, must enable BC Ferries to receive a pre-tax return on equity, which return is to be calculated by adding (i) an equity risk premium, provided that the equity risk premium is equivalent to that of other regulated businesses with reasonably similar risk characteristics, and (ii) a bond yield that is consistent with Government of Canada 30 year bonds or with Government of Canada bonds that in aggregate have a similar duration;
- the price cap must take into account the anticipated productivity gain which BC Ferries should achieve in the following performance term as determined by the Commissioner, acting reasonably; and
- BC Ferries is, on an ongoing basis, to actively seek additional or alternative service providers to provide ferry services on the designated ferry routes included in the route group in order to reduce the costs of providing those services.

BC Ferries has the freedom to set individual tolls within each route group, provided the average toll does not exceed the capped level. This will assist BC Ferries in increasing revenues by utilizing innovative pricing strategies to optimize traffic volumes and ferry utilization (for example, seasonal or time of day fare differences). The Coastal Ferry Act establishes price caps for the first five year performance term at the existing tariffs as of April 1, 2003 plus increases on November 1 of each year of 2.8% over the previous year's price cap on Major Routes and 4.4% over the previous year's price cap on Northern Routes and Other Routes. A price cap review, which includes public consultation, will occur before each subsequent four year performance term.

Extraordinary Price Cap Increases. BC Ferries may apply to the Commissioner for an extraordinary price cap increase in relation to a route group in extraordinary circumstances, including the deployment of a new vessel, an extraordinary increase in the price of any non-controllable input such as fuel, an unanticipated and extraordinary change in traffic levels and the introduction of new safety or other regulations that impose a new, unexpected and significant cost burden. Under the Coastal Ferry Services Contract, if the Commissioner authorizes an extraordinary price cap increase, the Province may elect to increase the service fees for the impacted designated route or route group, which would serve to mitigate the impact of the price cap increase, but is not obligated to do so. The Coastal Ferry Service Contract requires BC Ferries and the Province to discuss the possibility of a service fee increase within ten days of a preliminary decision by the Commissioner to authorize an extraordinary price cap increase. Following the Province's decision, the Commissioner will then issue a final ruling.

Route Discontinuance. To discontinue service on any designated route specified in the Coastal Ferry Services Contract, BC Ferries must make an application to the Commissioner. In assessing an application for authorization to discontinue service, the Commissioner must consider whether:

- another form of affordable transportation exists or is likely to be established to link the locations served by the designated ferry route;
- it is possible to operate the designated ferry route economically at an affordable tariff level;
- the Province is willing to reduce the core ferry services required on, or increase its service fee contribution for, the designated ferry route; and
- an extraordinary drop in traffic has occurred because of a change in the local economy or some other unanticipated factor.

The Commissioner must not authorize the discontinuance of a designated route unless:

- BC Ferries has made a suitable economic case for the route's discontinuance; and
- the Commissioner is satisfied that increasing tariffs on the route would not, because of a reduction in user demand or otherwise, result in revenues on the route increasing to the extent necessary to enable economic operation of the route.

The Commissioner may hold a public hearing before authorizing a route discontinuance.

Reduction of Service Levels. BC Ferries must not, except as permitted by the Coastal Ferry Services Contract, reduce service on a designated route below the core ferry services level required for that designated route unless BC Ferries first obtains the authorization of the Commissioner. The Commissioner may authorize a reduction in service if the Commissioner is of the opinion that it is for a temporary period and for an extraordinary situation.

Additional or Alternative Service Providers. In each performance term, BC Ferries is obligated to seek additional or alternative service providers to provide, under contract or otherwise, ferry services on its designated routes in an effort to reduce the costs of providing those services. In addition, BC Ferries is obliged to prepare a plan in each performance term in which it sets out the manner in which it intends to seek additional or alternative service providers to provide ferry services on its designated routes and provide that plan to the Commissioner. If the Commissioner considers BC Ferries has failed to comply with these requirements, the Commissioner may adjust price caps to reflect that failure or order BC Ferries to comply with the requirements. In April 2004, BC Ferries submitted a plan to the Commissioner in respect of the first performance term. The plan identifies several areas to be reviewed over the next four years, including northern services and certain minor routes which will require new vessels, and the Mill Bay to Brentwood Bay route.

Non-regulation of Ancillary Services. The Coastal Ferry Act does not authorize the Commissioner to regulate BC Ferries in relation to ancillary services. Ancillary services include catering and retail concessions, reservations, parking, vessel and major activity procurement, vessel maintenance, terminal development, terminal maintenance and other services not directly related to the provision of core ferry services. Ancillary services are, however, to be taken into account by the Commissioner in establishing price caps.

Reporting Requirements. Both the Commissioner and BC Ferries have reporting requirements under the Coastal Ferry Act. The Commissioner must make an annual report to the Province and that report will be laid before the provincial legislature. BC Ferries must provide to the Commissioner quarterly reports for each of its designated routes in respect of tariffs, traffic patterns, frequency of ferry service, capacity of its vessels and any other information required by the Commissioner and an annual report which must set out information relating to the services it provided during the fiscal year, any records respecting the quality of service it provided and a review of its actions taken with respect to additional or alternative service providers. In addition, BC Ferries must keep certain prescribed records which will be available to the public. These records include audited financial statements, as well as the annual and quarterly reports prescribed by the Coastal Ferry Act.

Funding for the Commissioner. BC Ferries and other ferry operators are charged a levy to cover the reasonable expenses of the Commissioner.

COASTAL FERRY SERVICES CONTRACT

The Coastal Ferry Act authorizes the Province to enter into contracts for the operation of ferries on specified ferry routes. BC Ferries has entered into the Coastal Ferry Services Contract with the Province relating to the provision of ferry services for a 60 year term, commencing April 1, 2003. The Coastal Ferry Services Contract sets out the core ferry transportation services that BC Ferries must provide on designated routes and the service fees payable by the Province for the core ferry transportation services.

The following is a summary of certain provisions of the Coastal Ferry Services Contract which does not purport to be complete. Reference is made to the Coastal Ferry Services Contract, a copy of which can be found on BC Ferries' website (www.bcferries.com), for the full text of its provisions.

The Coastal Ferry Services Contract was entered into between the Province and BC Ferries on April 1, 2003. Among other things, it establishes the routes to be operated, the service levels to be met by BC Ferries, the service fees to be paid by the Province for the provision of such services and certain provincial social program reimbursements.

Term and Renewal. The Coastal Ferry Services Contract has a 60 year term, but may be renewed for an additional 60 year term if mutually agreed. If the Coastal Ferry Services Contract is not renewed the Province has the option to purchase all the outstanding shares of BC Ferries at fair market value (determined as if the Coastal Ferry Services Contract had been renewed for 20 years), or may solicit proposals from others interested in providing ferry services on one or more designated routes. If the Province elects not to contract with BC Ferries for the provision of ferry services on a designated route after the expiry of the initial 60 year term of the Coastal Ferry Services Contract, BC Ferries has the right to require the Province to purchase surplus vessels that were used on that route for net book value, subject to certain conditions. If the Province fails to comply with the notice requirements in respect of the exercise of its renewal option, BC Ferries may renew and extend the term of the Coastal Ferry Services Contract for one additional period of 20 years on the same terms and conditions.

Performance Terms. The first performance term under the Coastal Ferry Services Contract is the five year period from April 1, 2003 to March 31, 2008. Each subsequent performance term will be four years.

Services and Service Levels. BC Ferries is required to operate its ferry system in a manner that complies with or exceeds specified core service levels in relation to designated ferry routes. The Coastal Ferry Services Contract specifies routes and core service levels per route (hours of operation, minimum capacity and frequency and number of trips), subject to an allowance for short term, temporary service disruptions. For the first two years of the first performance term, the core service levels for each designated route are the number of trips and number of hours during which home port departures occur, as specified in the 2002/03 published schedule for that route. Accordingly, current service levels reflect the service levels in existence during the 2002/03 fiscal year. During the first two years of the first performance term, there will be an anticipated 83,000 round trips per annum (over 9,800 on Major Routes, approximately 73,000 on Other Routes and roughly 350 on Northern Routes). Core service levels for the last three years of the first performance term allow for more scheduling flexibility, as long as adequate capacity is provided to carry the previous year's traffic and the required number of trips specified in the Coastal Ferry Services Contract are provided.

Service Fees. The Province must pay service fees to BC Ferries for the provision of services. The service fees are estimated to be approximately \$106 million per annum for the first performance term. The service fees consist of:

Ferry Transportation Fees. These fees, which are capped at \$91.9 million (not inflation linked) per year for the first performance term, are designed to make Northern Routes and Other Routes financially viable without cross subsidization from the Major Routes. Accordingly, these fees apply only to Other Routes and Northern Routes. Northern Routes are allocated maximum annual ferry transportation fees of \$13.5 million and Other Routes are allocated maximum annual ferry transportation fees of \$78.4 million. The fees are payable on a monthly basis based on estimated trips and are reconciled quarterly.

Social Program Reimbursement. This payment, which is estimated at \$11.9 million annually for the first performance term, provides a reimbursement to BC Ferries for toll discounts established by the Province and given to students, seniors, the disabled and through the medical travel assistance program. The payment is variable based on volume and amount of discounts provided.

Unregulated Route Fee. This fee provides funding for unregulated routes through a \$1.7 million per year flow-through for private operators for the first performance term. In the event that aggregate costs payable by BC Ferries to those operators exceeds \$1.8 million per year, the Province will pay an additional fee equal to the excess costs above \$1.8 million to a maximum of \$200,000.

Adjustment of Service Levels and Fees. Core service levels in relation to a designated ferry route may not be adjusted before April 1, 2005, but may be adjusted after that date by mutual agreement if such adjustments result in improved schedules, customer service or operational efficiency. With respect to core service

adjustments put forward by BC Ferries, concurrence by the Province is not to be unreasonably withheld during the first performance term. Core service levels are required to be reviewed and may be adjusted by agreement of the Province for each subsequent performance term. Temporary service level reductions can be made at any time with authorization of the Commissioner, following an event of force majeure, as a result of a lawful lockout by BC Ferries, or (subject to certain restrictions) by mutual agreement. If BC Ferries deploys a new capital asset in the form of one or more vessels on a designated ferry route and the size of the new vessel or vessels enhances capacity on that designated route, the core service level in relation to that designated route may be amended at any time by mutual agreement of the parties and if such an amendment is made, the parties must amend all portions or provisions of the Coastal Ferry Services Contract affected by such amendment, including, as applicable, service fees.

Route Discontinuance. The Coastal Ferry Services Contract permits BC Ferries to apply to the Commissioner for authorization to discontinue a route after April 1, 2006. The Province is required to pay the service fees on such route until the date of discontinuance. If a vessel becomes surplus to BC Ferries' requirements as a result of a route discontinuance authorized by the Commissioner, BC Ferries has an option to require the Province to purchase the surplus vessel for net book value, provided that BC Ferries has used all reasonable commercial efforts to redeploy the surplus vessel to another ferry route in British Columbia.

Unregulated Routes. BC Ferries is responsible for negotiating and administering contracts with independent operators on certain unregulated routes. Under the Coastal Ferry Services Contract, the Province provides funding to BC Ferries in respect of such unregulated routes, as described under "— Service Fees" above.

Option to Purchase Vessels. The Province has an option to purchase each vessel owned by BC Ferries (free and clear of all liens) for net book value if BC Ferries wishes to dispose of a vessel which is no longer needed. Subject to the terms of the Acknowledgement Agreement, the Province also has an option to purchase each of the vessels owned or leased by BC Ferries and used to provide services under the Coastal Ferry Services Contract upon the occurrence of an event of default under the Coastal Ferry Services Contract by BC Ferries.

Entitlement to Federal Subsidy. The Coastal Ferry Services Contract provides that the Province will continue to make available to BC Ferries the proceeds of a federal subsidy pursuant to the Canada / British Columbia Coastal Ferry Subsidy Agreement dated April 18, 1977. The subsidy agreement is terminable only by the joint agreement of the Province and the Government of Canada. In the event the Canada / British Columbia Coastal Ferry Subsidy Agreement is amended or renewed, BC Ferries and the Province must discuss the application of proceeds to BC Ferries under the amended or renewed agreement. The amount of the subsidy under the subsidy agreement was \$24.0 million in the 2003/04 fiscal year. The subsidy is adjusted annually based on the Vancouver Consumer Price Index.

Public Accountability. The Coastal Ferry Services Contract requires that BC Ferries hold public meetings and prepare audited financial statements, a business plan and conduct customer satisfaction surveys on an annual basis.

Indemnities and Insurance. BC Ferries has agreed to indemnify the Province from and against all losses and claims the Province may directly or indirectly sustain by reason of any act or omission of BC Ferries or any of its agents, subsidiaries, employees, officers, directors or subcontractors, in connection with the provision of ferry services, except for losses that arise out of or occur directly or indirectly by reason of any act or omission of the Province. BC Ferries is obligated under the Coastal Ferry Services Contract to obtain and maintain, at its own expense, marine protection and indemnity insurance for not less than US\$500 million per incident to cover legal liability of BC Ferries for loss, damage or expense arising out of, or incidental to, the ownership, operation, chartering, maintenance or use of any vessel pursuant to the Coastal Ferry Services Contract, including liability for personal injury, illness or death, or loss or damage to the property of a third party and including pollution coverage. BC Ferries is also required to maintain hull and machinery insurance. Where applicable, the Province is to be named as an additional insured.

Events of Default and Remedies. The Coastal Ferry Services Contract provides that the following events will constitute an event of default under the agreement:

- BC Ferries fails to comply with any material provision of the agreement and such failure is not cured within 30 business days after notice, or longer if the failure would reasonably require more than 30 days to rectify;
- any representation or warranty made by BC Ferries or any information furnished or submitted to the Province by BC Ferries is materially untrue or incorrect;
- BC Ferries fails to give notice to the Province of a default under the agreement;
- an order is made, resolution passed or petition filed for the liquidation or winding up of BC Ferries;
- BC Ferries becomes insolvent or commits an act of bankruptcy or a bankruptcy petition or proposal is filed or a receiver of BC Ferries is appointed;
- BC Ferries fails to pay any sum owed by it which materially adversely affects its ability to perform its obligations under the Coastal Ferry Services Contract;
- BC Ferries ceases to carry on business as a going concern;
- any action is taken to enforce any security interests which materially affects BC Ferries' ability to carry on business as a going concern;
- BC Ferries fails to make any payment due under one or more of the Terminal Leases; or
- BC Ferries fails to comply with any order issued by the Commissioner.

Upon an event of default by BC Ferries under the Coastal Ferry Services Contract, or at any time thereafter, the Province may, at its option, subject to the terms of the Acknowledgement Agreement and any trust deed to secure borrowings, elect to do any one or more of the following:

- suspend or adjust any instalment of the service fees;
- require BC Ferries to remedy the default within a period of time specified by the Province and if not remedied within that time period perform the obligations itself at BC Ferries' expense;
- waive the default;
- exercise its option to purchase the vessels;
- request that the Commissioner issue an order requiring BC Ferries to remedy the default;
- bring legal action; or
- pursue any other remedy available to it at law or in equity.

In addition, the BCTFA can terminate the Terminal Leases upon the occurrence of an event of default under the Coastal Ferry Services Contract, as described under "Terminal Leases" below.

TERMINAL LEASES

BC Ferries and the BCTFA entered into a Master Agreement effective March 31, 2003 as a part of the restructuring of BC Ferries, and amended the Master Agreement by an agreement dated April 1, 2003. The Master Agreement provides for the transfer of ownership of the 43 terminals from BC Ferries to the BCTFA pursuant to the Coastal Ferry Act. As compensation for the transfer, the BCTFA issued a \$330.6 million promissory note to BC Ferries. In addition, the BCTFA leased the terminals to BC Ferries pursuant to the Terminal Leases effective April 1, 2003. BC Ferries has pre-paid the lease payments under the Terminal Leases for the full 60 year term by surrendering to the BCTFA the promissory note issued to BC Ferries by the BCTFA.

The following is a summary of the Master Agreement and the Terminal Lease Agreements which does not purport to be complete. Reference is made to the Master Agreement and the Terminal Leases, copies of which can be found on BC Ferries' website (www.bcferries.com), for the full text of their provisions.

Master Agreement

The Master Agreement contains the following provisions, among others:

Adjacent Property Agreements, Permits and Licenses. BC Ferries agrees to obtain the written consent of the BC Minister of Transportation to use portions of highways required by BC Ferries in its provision of ferry services in compliance with the Coastal Ferry Services Contract. BC Ferries also agrees to obtain the written consent of Land and Water British Columbia, Inc. (“LWBC”) to use all portions of Crown lands administered by LWBC which are required for BC Ferries to maintain anchors in water outside of the ferry terminal properties and to comply with the Coastal Ferry Services Contract.

Covenants. BC Ferries is required to pay BCTFA an annual management and administration fee of \$10,000 (consumer price index adjusted every five years), and, subject to certain exceptions, certain costs incurred by BCTFA in the management of the Terminal Leases, up to a maximum of \$100,000 per calendar year.

First Nations Matters. The Province retains its liability, to the extent any exists, for the acts and omissions of the Province that occurred prior to BC Ferries’ possession of the terminal lands, and the Province agrees to reimburse BC Ferries for any damages it suffers as a result of a determination by a Canadian court that there has been an unjustifiable infringement of aboriginal rights or title by the Province in connection with the terminal lands. In addition, the Province will reimburse BC Ferries for damages suffered by BC Ferries if there is a final court decision or a treaty settlement that recognizes or confers upon a First Nation a proprietary or other interest in the ferry terminal properties and that right or interest interferes with BC Ferries’ quiet enjoyment of the ferry terminal properties as set out in the Terminal Leases.

Terminal Leases

Forty-three of the 47 terminals utilized by BC Ferries are leased to BC Ferries by BCTFA pursuant to individual Terminal Leases dated April 1, 2003. Each Terminal Lease provides BC Ferries with control and responsibility for maintaining, developing and managing the terminals, at its cost. BC Ferries will retain ownership of any leasehold improvements until termination. The more significant terms of the Terminal Leases are set forth below.

Net Leases. BC Ferries is responsible for paying all expenses relating to each Terminal Lease, including taxes and other expenses relating to the use, repair, maintenance, development, management or operation of the terminal properties.

Term of Lease. Each Terminal Lease has a term of 60 years commencing on April 1, 2003. Subject to the renewal of the Coastal Ferry Services Contract, the Terminal Leases may be renewed for an additional term of 20 years. The BCTFA is not required to pay any compensation to BC Ferries at the expiration of a Terminal Lease.

Rent. Rental payments have been fully prepaid for the 60 year term.

Use. Provided BC Ferries obtains all applicable permits and complies with all laws, it is entitled to use the ferry terminal properties for any use or purpose consistent with the provision of ferry transportation services and ancillary services in accordance with the Coastal Ferry Services Contract. BC Ferries may remove, construct and redesign the ferry terminal facilities and leasehold improvements, subject to obtaining consent from BCTFA where the work may interfere with third party rights or requires the redesign of a highway.

Insurance. BC Ferries is obligated to obtain, at its own expense, comprehensive general liability insurance in amount not less than \$25,000,000 per occurrence (with BCTFA as an additional insured), property insurance for all property located on the ferry terminal properties and other insurance if any construction is to be carried out. BC Ferries may self-insure with BCTFA’s consent, not to be unreasonably withheld.

Indemnity. BC Ferries has agreed to indemnify BCTFA against all claims, liabilities or losses arising as a result of any injury or damage caused or contributed to by reason of ownership, use or occupancy of the ferry terminal properties, the presence of hazardous substances and other matters.

Repairs and Maintenance. BC Ferries is responsible for repairing and maintaining the ferry terminal properties.

Taxes. BC Ferries is required to pay all taxes payable in respect of the terminal properties, including property taxes.

Right to Terminate. If BC Ferries is authorized by an order of the Commissioner to discontinue all designated ferry routes from a particular terminal, the Terminal Lease for that terminal will be terminated. Where a terminal property is destroyed or so damaged as to be unfit for occupancy as a result of an event of force majeure, and the cost of restoration is not covered by insurance or by compensation from the Province, BC Ferries may elect to terminate the applicable Terminal Lease.

Remedies for Default. If BC Ferries fails to meet its obligations under a Terminal Lease or upon an event of default under the Coastal Ferry Services Contract, BCTFA may re-enter and take possession of the ferry terminal properties (including leasehold improvements) and at its option terminate the lease, subject to the terms of the Acknowledgement Agreement.

CORPORATE GOVERNANCE

Directors and Executive Officers of BC Ferries

The Board of Directors of BC Ferries consists of members appointed annually by the BCFA. There are, therefore, no direct appointees of the Provincial government on the Board of Directors of BC Ferries. However, if BC Ferries fails to pay the required dividends on the preferred shares of BC Ferries held by the Province for three years (whether or not consecutive), the Province may appoint two members to the Board of Directors of BC Ferries until all arrears of dividends have been paid.

The following table and notes thereto set out the names, municipalities of residence, principal occupations and particulars of each of the directors and executive officers of BC Ferries. Unless otherwise specified, all of the individuals noted below have been engaged in their stated principal occupations, or in other executive capacities with the organizations by which they are currently engaged, for at least the past five years.

<u>Name and Municipality of Residence</u>	<u>Position</u>	<u>Principal Occupation</u>
ELIZABETH J. HARRISON, QC Vancouver, British Columbia	Chair and Director	Partner, Farris, Vaughan, Wills & Murphy, Barristers and Solicitors.
DOUGLAS ALLEN Oak Bay, British Columbia	Director	Partner, Sage Group, a management consulting firm; served as Interim President and Chief Executive Officer of BC Ferries from October 2002 to May 2003.
MARILYN BAKER Reid Island, C.V.R.D., British Columbia	Director	Retired since 2001; prior thereto, member of the Canada Immigration and Refugee Board; prior thereto, contractor for the Union of B.C. Municipalities and Manager of Business Counselling, Business Development Bank of Canada; prior thereto, mayor of the District of North Vancouver.
SANDY M. FULTON Vancouver, British Columbia	Director	President, S.M. Fulton & Associates, a management consulting firm, since 2001; prior thereto, Executive Vice President, Operations of Crown Pacific Partners L.P., a forest products company.
THOMAS W. HARRIS Nanaimo, British Columbia	Vice Chair and Director	Owner and President, Tom Harris Chevrolet Oldsmobile Cadillac Ltd., Tom Harris Cellular Ltd., Vancouver Island Auto Sales Ltd. and Woodgrove Chevrolet Oldsmobile Ltd.

<u>Name and Municipality of Residence</u>	<u>Position</u>	<u>Principal Occupation</u>
JOHN R. HENDERSON, FCA Sechelt, British Columbia	Director	Managing Director, The Pacific Rim Group, a business and financial advisory firm.
MAUREEN MACARENKO Prince Rupert, British Columbia	Director	President, G.W. Nickerson Co. Ltd., a deep sea shipping agency.
G. RAYMOND WHITEHEAD Coquitlam, British Columbia	Director	Retired since 1998; prior thereto, Regional Director, Canadian Union of Public Employees of BC.
GRAHAM M. WILSON North Vancouver, British Columbia	Director	President, Grawil Consultants Inc., a management and financial consultancy company, since March 2002; prior thereto, Executive Vice President and Chief Financial Officer of Westcoast Energy Inc., and President and Chief Executive Officer, Services Division, Westcoast Energy Inc.
DAVID L. HAHN ⁽¹⁾ Victoria, British Columbia	President and Chief Executive Officer	President and Chief Executive Officer of BC Ferries; prior thereto, Chief Operating Officer of Ogden Aviation Services Inc.; prior thereto, Director of Marketing of Hertz Corporation.
ROBERT P. CLARKE Victoria, British Columbia	Executive Vice President, Finance and Chief Financial Officer	Executive Vice President, Finance and Chief Financial Officer of BC Ferries; prior thereto, Vice President, Finance & Administration of BC Transit.
MICHAEL J. CORRIGAN Victoria, British Columbia	Executive Vice President, Business Development	Executive Vice President, Business Development of BC Ferries; prior thereto, Director, Business Development & Customer Care of Centra Gas.
WILLIAM R. COTTICK Victoria, British Columbia	Vice President, Corporate Affairs, General Counsel and Corporate Secretary	Vice President, Corporate Affairs, General Counsel and Corporate Secretary of BC Ferries; prior thereto, Principal, William R. Cottick law practice; prior thereto, Vice President, General Counsel and Secretary, Jannock Limited.
DEREK R. JOHNSTON Victoria, British Columbia	Vice President, Human Resources	Vice President, Human Resources of BC Ferries; prior thereto, Manager, Human Resources of BC Assessment Authority.
DAVID J.M. MARSHALL Victoria, British Columbia	Vice President, Mainland Services and Operational Planning	Vice President, Mainland Services and Operational Planning of BC Ferries; prior thereto, Vice President, Engineering and Construction of BC Ferries.
MARK STEFANSON Victoria, British Columbia	Vice President, Communications	Vice President, Communications of BC Ferries; prior thereto, Executive Director, Communications & Policy of the Ministry of Environment, Lands & Parks.

<u>Name and Municipality of Residence</u>	<u>Position</u>	<u>Principal Occupation</u>
TRAFFORD M. TAYLOR Victoria, British Columbia	Executive Vice President, Operations	Executive Vice President, Operations of BC Ferries; prior thereto, Vice President, Inter-Island and Northern Services of BC Ferries; prior thereto, Marine Superintendent, Inter-Island Services South of BC Ferries.

(1) Mr. Hahn was an officer of Covanta Energy Corp. (formerly Ogden Corporation) prior to 1998, and was Executive Vice President and Chief Operating Officer of Ogden Aviation Services Inc., a wholly-owned subsidiary of Covanta, from 1998 to 2003. On April 1, 2002, Covanta and its subsidiaries, including Ogden Aviation, filed petitions under Chapter 11 of the United States Bankruptcy Code. As a result of the Chapter 11 proceedings, the New York Stock Exchange suspended trading in Covanta's stock in May 2002. Proceedings under Chapter 11 and the suspension of trading in Covanta stock are ongoing.

The following are brief profiles of the executive officers of BC Ferries:

David L. Hahn, President and Chief Executive Officer

David Hahn has over 20 years of executive experience, much of it with Ogden Corporation in New York. Over the seven years prior to joining BC Ferries he held the position of Chief Operating Officer at Ogden Aviation Services Inc., managing United States and international operations, including 25,000 employees and airport operations in 30 countries. Ogden Aviation provided ground and cargo handling, passenger services, fuelling, airport infrastructure development and management, aircraft sales and charter services. Prior to joining Ogden Corporation, Mr. Hahn was the Director of Marketing for Hertz Corporation. He specializes in business restructuring, strategic planning, revitalized marketing, revenue growth, acquisitions and customer service. Mr. Hahn assumed the position of President and Chief Executive Officer of BC Ferries on May 5, 2003.

Robert P. Clarke, Executive Vice President, Finance and Chief Financial Officer

Rob Clarke joined BC Ferries in May 1999 as Vice President of Finance and Corporate Services, and since April, 2003 has served as Executive Vice President, Finance and Chief Financial Officer. He is a Certified General Accountant with extensive financial management experience in the public and private sectors, including transportation and marine enterprises. Mr. Clarke is responsible for all financial management and information systems functions of BC Ferries. Prior to joining BC Ferries, Mr. Clarke held the position of Vice President, Finance & Administration with BC Transit, the provincial Crown corporation charged with providing public transportation throughout British Columbia outside of Greater Vancouver.

Michael J. Corrigan, Executive Vice President, Business Development

Mike Corrigan joined BC Ferries in March 2003, bringing with him 18 years of experience working in energy distribution and transportation businesses in Canada and the United States. His responsibilities include leading BC Ferries' marketing program and its efforts to improve customer service, developing new business opportunities and acquiring new vessels. Prior to joining BC Ferries, Mr. Corrigan held the position of Director, Business Development & Customer Care with a subsidiary of Terasen, a provider of energy and utility services.

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

Bill Cottick joined BC Ferries in October 2003. He brings to BC Ferries over 30 years of broad legal experience, both in private practice and in industry, including 12 years as a senior legal executive in large Canadian public companies in the transportation, environmental management, health services and construction products fields. He is responsible for a number of legal and strategic activities within BC Ferries, including support for the Board of Directors and oversight of all legal matters.

Derek R. Johnston, Vice President, Human Resources

Derek Johnston was appointed Vice President, Human Resources in March 2000. He has over 20 years of senior management experience in labour relations and human resource programs in the public sector. Prior to

joining BC Ferries, Mr. Johnston held the position of Manager, Human Resources with BC Assessment Authority, a Crown corporation responsible for providing property assessment in British Columbia. Mr. Johnston is responsible for setting policy and overseeing training programs, workforce planning and development, bargaining, labour relations, compensation and benefits, and direct delivery of human resources services to client groups.

Captain David J.M. Marshall, Vice President, Mainland Services and Operational Planning

Captain David Marshall joined BC Ferries in October 2000 as Vice President, Engineering and Construction, and assumed his current position in February 2003. His background includes 27 years in the Canadian Forces, culminating in command appointments at the Naval Engineering Unit (Atlantic) and Canadian Forces Base Esquimalt. Captain Marshall's responsibilities include day-to-day operations associated with mainland services, and operational planning for the entire system.

Mark Stefanson, Vice President, Communications

Mark Stefanson joined BC Ferries as Vice President, Corporate Communications, in May 1999. Prior to joining BC Ferries, he held the position of Executive Director, Communications & Policy with the Ministry of Environment, Lands & Parks. He has over 25 years experience in communications, issues management, media relations, public consultation and environmental management. Mr. Stefanson oversees employee, customer, stakeholder and news media communications, and is responsible for public consultation, public relations and community relations programs.

Captain Trafford M. Taylor, Executive Vice President, Operations

Captain Trafford Taylor joined BC Ferries in 1991 after serving at sea and ashore in the Merchant Marine. Since joining BC Ferries, Captain Taylor has overseen the sea trials and entry into service of four new-builds and has served as Marine Superintendent for Inter-Island Services, South. Prior to assuming his current position on November 1, 2003, he served as Vice President, Inter-Island and Northern Services.

Committees of the Board

The Board of Directors of BC Ferries has constituted an Audit and Finance Committee, a Governance Committee and a Safety, Health and Environment Committee.

Audit and Finance Committee

The Audit and Finance Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities. It is composed of Douglas Allen, Sandy Fulton, John Henderson, Maureen Macarenko and Graham Wilson (chair). This Committee has the mandate to:

- review the financial reports and other financial information provided by BC Ferries to its shareholder;
- 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 management and the Board of Directors have established;
- monitor the management of the principal risks that could impact the financial reporting of BC Ferries; and
- review and approve the audit plan, process, results, and performance of BC Ferries' independent external auditors and the internal audit department while providing an open avenue of communication between the external auditors, the internal auditors, management and the Board of Directors.

The Audit and Finance 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 any person in the organization. It has the authority to retain, at BC Ferries' expense, special legal, accounting and other consultants or experts it deems necessary in the performance of its duties.

Governance Committee

The Governance Committee, which also functions as the Human Resources Committee, has the mandate to assist the Board in:

- reviewing the policies and practices of the Board;
- ensuring the Board's continuing ability to fulfill its legislative mandate; and
- implementing effective due diligence over the operations of BC Ferries.

It is composed of Douglas Allen (chair), Marilyn Baker, Thomas Harris and Graham Wilson.

Safety, Health and Environment Committee

The Safety, Health and Environment Committee has the mandate to assist the Board in:

- exercising due diligence over the safety, health and environmental operations of BC Ferries;
- developing, reviewing, and making recommendations as required on matters related to BC Ferries' safety, health and environmental policies and practices; and
- monitoring compliance with government regulations and with BC Ferries' commitment to excellence on these issues.

It is composed of Sandy Fulton, Maureen Macarenko and Raymond Whitehead (chair).

Directors of the BCFA

The Coastal Ferry Act provides that the BCFA is to be governed by a nine member board composed of seven members appointed by the BCFA board of directors and two members appointed by the Lieutenant Governor in Council, on the recommendation of the Province. Two directors are appointed by the BCFA at its discretion while the remaining directors are appointed from a list of three to five nominees from each of four designated coastal regions (four members) and the BC Ferries trade union (one member). The Coastal Ferry Act requires that directors include persons with experience in transportation, finance, tourism and labour, but cannot be elected officials, employees of BC Ferries (except for its chief executive officer) or employees of a nominating entity. After expiry of the current terms, directors will have staggered terms of office of three years. Directors may not be appointed for more than two consecutive terms. Pursuant to section 4 of the Coastal Ferry Act, the individuals who, immediately before the coming into force of the Coastal Ferry Act, were the directors of BCFC, became the first directors of the BCFA.

Currently, the Board of Directors of the BCFA is the same as that of BC Ferries. There is no requirement that the Board of Directors of BC Ferries mirror that of the BCFA or vice versa. All of the current directors of the BCFA were appointed pursuant to the Coastal Ferry Act as of April 1, 2004 for various terms of one to three years.

EXECUTIVE COMPENSATION

Compensation

The following table sets forth, for the periods indicated, the compensation paid to each person who served as Chief Executive Officer during the fiscal year ended March 31, 2004 and the four other most highly compensated executive officers of BC Ferries (together, the “Named Executive Officers”) for the fiscal year ended March 31, 2004.

Name & Principal Position	Year	Annual Compensation			All Other Compensation \$(³)
		Salary \$	Bonus ⁽¹⁾ \$	Other Annual Compensation \$(²)	
David L. Hahn President and Chief Executive Officer ⁽⁴⁾	2004	304,680	—	—	11,792
	2003	—	—	—	—
	2002	—	—	—	—
Douglas Allen Former President and Chief Executive Officer ⁽⁵⁾	2004	55,244	—	—	—
	2003	177,147	—	—	—
	2002	—	—	—	—
Robert P. Clarke Executive Vice President, Finance and Chief Financial Officer	2004	139,240	—	—	15,790
	2003	128,433	20,069	—	15,712
	2002	118,280	16,961	—	15,631
Michael J. Corrigan Executive Vice President, Business Development ⁽⁶⁾	2004	150,000	—	—	13,284
	2003	12,240	—	—	79
	2002	—	—	—	—
Captain Trafford M. Taylor Executive Vice President, Operations ⁽⁷⁾	2004	133,669	—	—	15,748
	2003	94,625	—	—	14,083
	2002	88,090	—	—	13,147
Captain David J. M. Marshall Vice President, Mainland Services and Operational Planning	2004	129,948	—	—	15,719
	2003	126,945	18,192	—	15,699
	2002	115,730	17,050	—	15,612

- (1) Bonuses for the fiscal year ended March 31, 2004 have not yet been determined.
- (2) The value of total annual perquisites and other personal benefits for each Named Executive Officer does not exceed the lesser of \$50,000 or 10% of total annual salary and bonus and is not reported herein.
- (3) Amounts shown in this column include pension adjustments and life insurance premiums.
- (4) Mr. Hahn was appointed President and Chief Executive Officer on May 5, 2003.
- (5) Mr. Allen served as President and Chief Executive Officer on a contract basis from October 16, 2002 until May 5, 2003. The contract amount shown represents the full compensation paid in respect of Mr. Allen acting as President and Chief Executive Officer.
- (6) Mr. Corrigan was appointed Executive Vice President, Business Development on March 1, 2003.
- (7) Captain Trafford Taylor assumed the position of Executive Vice President, Operations on November 1, 2003.

Defined Benefit Pension Plan

Each of the Named Executive Officers, with the exception of Mr. Allen, and all other BC Ferries employees participate in the Public Service Pension Plan, a multi employer, contributory, defined benefit pension plan established by the Province for employees of the Public Service and certain crown corporations, agencies, institutions and other employers approved by the Plan’s board of trustees. Plan benefits are determined by a formula based on the highest five-year average Public Service pensionable salary and years of service and integrated with the Canada Pension Plan. Increases to the pension payments are based on the annual increase in the Consumer Price Index and are subject to availability of funds in the Inflation Adjustment Account.

Both participating employers and participating employees are required to make plan contributions based on the participating employees' pensionable salary. Pension benefits which exceed the *Income Tax Act* (Canada) limits for registered pension plans are paid through the Supplemental Benefits Account.

The following table sets forth the aggregate normal annual pension benefits payable to participating employees under the plan at age 65 assuming that the year's maximum pensionable earnings under the Canada Pension Plan in the future is the same as in 2004.

Remuneration	Years of Service				
	15	20	25	30	35
\$100,000	\$ 30,000	\$ 40,000	\$ 50,000	\$ 60,000	\$ 70,000
\$125,000	\$ 37,500	\$ 50,000	\$ 62,500	\$ 75,000	\$ 87,500
\$150,000	\$ 45,000	\$ 60,000	\$ 75,000	\$ 90,000	\$105,000
\$175,000	\$ 52,500	\$ 70,000	\$ 87,500	\$105,000	\$122,500
\$200,000	\$ 60,000	\$ 80,000	\$100,000	\$120,000	\$140,000
\$225,000	\$ 67,500	\$ 90,000	\$112,500	\$135,000	\$157,000
\$250,000	\$ 75,000	\$100,000	\$125,000	\$150,000	\$175,000
\$300,000	\$ 90,000	\$120,000	\$150,000	\$180,000	\$210,000
\$350,000	\$105,000	\$140,000	\$175,000	\$210,000	\$245,000
\$400,000	\$120,000	\$160,000	\$200,000	\$240,000	\$280,000
\$450,000	\$135,000	\$180,000	\$225,000	\$270,000	\$315,000
\$500,000	\$150,000	\$200,000	\$250,000	\$300,000	\$350,000

The estimated full years of actual credited service in the plan, at their normal retirement date (age 65), capped at 35 years pensionable service and based on compensation at March 31, 2004, and estimated total annual retirement benefits payable upon normal retirement for the Named Executive Officers other than Mr. Allen, are as follows:

Name	Credited Service (yrs)	Retirement Benefit
Robert P. Clarke	32	\$96,000
Michael J. Corrigan	23	\$63,900
David L. Hahn	13	\$85,800
David J. M. Marshall	19	\$49,400
Trafford M. Taylor	16	\$48,000

Employment Agreements

Each of Messrs. Hahn, Clarke, Corrigan, Taylor and Marshall has entered into an employment agreement with BC Ferries that provides for a current annual base salary (\$335,000 in the case of Mr. Hahn, \$150,000 in the case of Messrs. Clarke, Corrigan and Taylor, and \$129,948 in the case of Mr. Marshall), an annual bonus based on the achievement of individual and corporate goals (the maximum amount of which is 50% of base salary in the case of Mr. Hahn and 35% of base salary in the case of Messrs. Clarke, Corrigan, Taylor and Marshall) and retirement, health and other benefits. In addition, Mr. Hahn is entitled to a payment equal to 12 months of base salary if his employment is terminated within the first three years of service and 18 months of base salary thereafter.

Mr. Allen provided his services on a contract basis from October 16, 2002 until May 15, 2003 (after May 5, 2003, as advisor to the chief executive officer) and received total compensation of \$55,244 in the 2003/04 fiscal year. This contract amount represents the full compensation paid in respect of Mr. Allen acting as President and Chief Executive Officer.

Directors' Compensation

The Chair of the Board is entitled to an annual fee of \$75,000 and all other directors are entitled to an annual fee of \$16,500 per annum. Directors are also entitled to a fee of \$1,000 per board or committee meeting attended (\$500 for telephone meetings up to two hours in length), including meetings of the board or board committees of a subsidiary of BC Ferries, provided that directors may receive only one meeting fee per day in the event that more than one meeting is attended on a given day. In addition, the Chair of the Audit and Finance Committee and the Vice Chair of the Board of Directors are entitled to an additional annual fee of \$10,000. The Chairs of the other Board committees are entitled to an additional annual fee of \$5,000, and members of Board committees are entitled to an additional annual fee of \$3,000. All directors are reimbursed for reasonable travel related expenses incurred in attending board or committee meetings, and for any reasonable expenses incurred while on BC Ferries business. Directors who are officers or employees of BC Ferries do not receive retainers or fees. Directors who hold the same position as Chair, Vice Chair, Chair of a Board Committee, or member of a specific Board Committee for both BC Ferries and BCFA are entitled to receive a fee for only one of such duplicated positions. In addition, directors and their spouses are entitled to ferry passes for their personal use.

During the 2003/04 fiscal year, directors received honoraria and fees for attending scheduled board and board committee meetings. In addition to such honoraria and fees, certain directors received additional fees for board related activities, such as conducting interviews for the chief executive officer and corporate secretary positions, conducting strategic planning reviews, representing BC Ferries at public functions, meeting with management and travelling on BC Ferries business. The fees received by such directors are as follows: Douglas Allen, \$10,875; Elizabeth Harrison, \$4,500; Thomas Harris, \$3,000; Maureen Macarenko, \$7,500; Raymond Whitehead, \$5,250; Graham Wilson, \$2,250.

INDEBTEDNESS OF DIRECTORS AND EXECUTIVE OFFICERS

As at March 31, 2004, there was no indebtedness owed to BC Ferries by any of its directors or executive officers and their respective associates.

SHARE AND LOAN CAPITAL

Share Capital

The authorized capital of BC Ferries consists of 1,000,000 Class "A" Common shares without par value (the "Class A Shares"), one Class "B" Common share without par value (the "Class B Share"), and 80,000 Class "C" Preferred shares with a par value of \$1,000 per share (the "Preferred Shares").

Common Shares

Each Class A Share and Class B Share (collectively, "Common Shares") entitles the holder thereof to receive notice of, to attend, and to one vote at, meetings of the shareholders of BC Ferries. The Common Shares are not entitled to dividends unless declared by the directors of BC Ferries out of monies lawfully available for dividends after payment of the preferential cash dividend payable to the holders of the Preferred Shares. In the event of any liquidation, dissolution or winding up of BC Ferries, or other distributions of the assets of BC Ferries, the holders of the Common Shares will be entitled to their *pro rata* share of the assets of BC Ferries, subject to the preferential distribution to the holders of the Preferred Shares.

The one authorized Class B Share is currently held by the BCFA. There are currently no Class A Shares issued or outstanding. The Class A Shares are issuable only upon conversion of the Preferred Shares in accordance with their terms.

Preferred Shares

The Preferred Shares do not entitle the holders thereof to receive notice of, to attend, or to vote at, meetings of the shareholders of BC Ferries, except as otherwise provided by law. Holders of the Preferred Shares are entitled to fixed cumulative preferential cash dividends as and when declared at the rate of 8% per annum. Dividends, if declared, will be payable annually. Holders of the Preferred Shares will not be entitled to any dividends other than or in excess of the fixed cumulative dividend.

There are currently 75,477 Preferred Shares issued and outstanding, all of which are owned by the Province. So long as there are any Preferred Shares issued and outstanding, BC Ferries may not, without the approval of the holders of the Preferred Shares, (i) amend its constating documents, (ii) declare or pay any dividends on any other class of shares, (iii) redeem, purchase or otherwise pay off shares of any other class, (iv) issue any additional shares of any class or securities exchangeable or convertible into shares of any class other than Class A Shares upon conversion of Preferred Shares, (v) take any steps to liquidate, dissolve, or wind up, or (vi) sell, lease or otherwise dispose of all or substantially all of its property or assets.

The Preferred Shares may, at the option of the holders thereof, be converted into Class A Shares on a one-for-one basis if BCFA, as the registered and beneficial holder of the one issued and outstanding Class B Share, sells, transfers or otherwise disposes of the Class B Share, or any beneficial interest in the Class B Share.

Provincial Debenture

As part of the restructuring of BCFC into BC Ferries, BC Ferries issued a debenture in the principal amount of \$427.7 million to the Province. The debenture bears interest payable semi-annually in arrears and is due April 1, 2006. The maturity date for a portion of the principal, under certain conditions, is extendible to April 1, 2008. The interest rate is currently 5.18% per annum and is subject to adjustment under certain conditions. The debenture is secured by registered vessel mortgages on BC Ferries' vessels, a registrable mortgage on the leasehold interest under the Terminal Leases and a general security agreement on all of BC Ferries' personal property.

The principal amount outstanding under the debenture may be prepaid in whole or in part at the option of BC Ferries without premium or penalty. BC Ferries intends to use all of the net proceeds of this offering, other than the amount required to fund the Debt Service Reserve Fund, along with a portion of the proceeds from the Credit Facility, to prepay the full principal amount and all accrued interest under the debenture, and the security held by the Province will then be released. See "Use of Proceeds".

CONSOLIDATED CAPITALIZATION

The following table sets forth the consolidated capitalization of BC Ferries as of March 31, 2004, on an actual basis and as adjusted to reflect the sale of the Series 04-1 Bonds offered by this prospectus, the incurrence of indebtedness under the Credit Facility and the application of the estimated net proceeds as described under “Use of Proceeds.” This table should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, “Share and Loan Capital” and the consolidated financial statements and related notes appearing elsewhere in this prospectus.

	Outstanding as at March 31, 2004	Outstanding as at March 31, 2004 after giving effect to the offering
	(in thousands)	
Long term debt:		
Credit Facility ⁽¹⁾	\$ —	\$200,000
5.18% Debenture due April 1, 2006	427,701	—
Bonds offered by this prospectus	—	250,000
Total long term debt	427,701	450,000
Shareholders’ equity:		
Capital stock		
Common shares	1	1
Preferred shares	75,477	75,477
Retained earnings	21,947	21,947
Total shareholders’ equity	97,425	97,425
Total capitalization	\$525,126	\$547,425

(1) Total availability of \$355 million in three tranches. See “Capital Markets Platform — Credit Facility”.

PRO FORMA INTEREST COVERAGE

The interest coverage set forth below has been prepared and included in this prospectus in accordance with the disclosure requirements of applicable Canadian securities laws and has been calculated on a pro forma basis after giving effect to the issuance of the Series 04-1 Bonds, the incurrence of indebtedness under the Credit Facility and the repayment of the 5.18% debenture held by the Province.

The annual interest requirements on BC Ferries’ long term debt (using applicable interest rates) for the twelve months ended March 31, 2004, were \$20.6 million. BC Ferries’ earnings before deduction of interest on long term debt and income taxes for the twelve months ended March 31, 2004 amounted to \$50.7 million and 2.5 times annual interest requirements for the twelve months ended March 31, 2004.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion and analysis of the consolidated financial condition and results of operations of BC Ferries. This discussion should be read in conjunction with the consolidated financial statements and accompanying notes contained elsewhere in this prospectus and the disclosure contained throughout this prospectus. Except where otherwise indicated, all financial information reflected herein is expressed in Canadian dollars and determined on the basis of Canadian generally accepted accounting principles.

Overview

BC Ferries is one of the largest ferry operators in the world. The consolidated operating revenues and net earnings of BC Ferries for the year ended March 31, 2004 were \$533.7 million and \$28.0 million, respectively. At March 31, 2004, BC Ferries operated \$551.5 million of capital assets comprised primarily of vessels and terminals.

BC Ferries receives service fees pursuant to the Coastal Ferry Services Contract with the Province. In exchange for a fee, BC Ferries provides agreed ferry service levels on specified routes and administers certain social policy initiatives on behalf of the Province. As part of the 2003 restructuring of BC Ferries, the provincial motor fuel tax subsidy received by BC Ferries in prior years was eliminated as at April 2, 2003.

Pursuant to a contract between the federal and provincial governments, the Province receives a subsidy to support the provision of ferry, coastal freight and passenger services in the waters of British Columbia. This subsidy is remitted to BC Ferries through the Province. The annual subsidy adjusts with the Vancouver Consumer Price Index.

Effective April 2, 2003 BC Ferries became subject to GST. Having formerly been a provincial Crown corporation, BC Ferries was not assessed for, nor did it pay GST. Because the primary business of BC Ferries is the provision of vehicle and passenger ferry services, an exempt supply under the Excise Tax Act, BC Ferries' ability to obtain input tax credits is impaired. The unrecoverable GST was \$8.5 million for the year ended March 31, 2004.

In March 2000, BC Ferries' predecessor and the government of British Columbia determined that the three PacifiCat high speed ferries built in previous years were not economical, were not operationally effective for their intended service and should be sold. The high speed ferries were sold at auction in March 2003 for a loss of \$53.1 million. This loss was in addition to write-downs in 1999, 2000 and 2002 totalling \$328 million.

DPMI operates a refit and maintenance facility in Richmond, British Columbia. The company commenced operations as a subsidiary on July 1, 2003. The results of the year ended March 31, 2004 reflect additional costs incurred in transitioning from a business unit of the Company to a separate legal entity.

In total, operations, maintenance and administration expenses increased over prior years. The primary factors driving changes in operations expense are labour costs, fuel costs and the addition of GST expense. Maintenance expense increases reflect the Company's commitment to safety, requirements of an aging fleet, and the requirements of operating within a regulatory environment. The primary factors driving changes in administration expense are labour cost (including severance) and the development of new business initiatives. Management continues to focus on administration expense in order to ensure efficiency.

The following table sets forth selected consolidated financial information of BC Ferries for each of the years indicated.

	Years ended March 31,		
	2004	2003	2002
	(in thousands)		
Revenue			
Tolls	\$323,023	\$315,618	\$305,710
Ferry service fees	105,806	—	—
Federal-Provincial Subsidy Agreement	23,975	23,377	22,953
Retail	63,206	61,762	60,374
Other income	17,721	14,866	12,329
Motor fuel tax subsidy	—	74,243	71,706
Total revenue	<u>533,731</u>	<u>489,866</u>	<u>473,072</u>
Expenses			
Operations, maintenance, administration	411,046	397,759	384,846
Cost of retail goods sold	23,298	22,046	22,479
Amortization	47,355	44,050	46,056
Total expenses	<u>481,699</u>	<u>463,855</u>	<u>453,381</u>
Earnings from operations	52,032	26,011	19,691
Gain on foreign exchange	190	150	176
Interest expense	(22,672)	(1,364)	(1,757)
Loss on disposal and write-down of capital assets	(1,565)	(412)	(732)
Earnings before the following	27,985	24,385	17,378
Loss on disposal of high speed ferries	—	(53,107)	—
Provision for write-down of high speed ferries	—	—	(40,000)
Net earnings (loss)	<u>\$ 27,985</u>	<u>\$ (28,722)</u>	<u>\$ (22,622)</u>

BC Ferries believes that its results of operations are best examined by analyzing changes in the components of its earnings from operations.

Changes in BC Ferries' earnings from operations from period to period are primarily affected by changes in:

- toll revenue;
- ferry service fees received from the Province;
- motor fuel tax subsidy received from the Province;
- revenue from retail sales;
- federal-provincial subsidy received;
- revenues from other segments;
- costs related to salaries, wages and benefits;
- costs related to fuel;
- other operational expenses;
- the cost of retail goods sold; and
- amortization.

Results of Operations

Year Ended March 31, 2004 Compared to Year Ended March 31, 2003

Earnings from Operations

Earnings from operations for the 2003/04 fiscal year were \$52.0 million compared to \$26.0 million for the 2002/03 fiscal year. The increase in earnings from operations of \$26.0 million resulted from:

	(\$ millions)
Higher toll revenue	7.4
First year of ferry service fees	105.8
Elimination of motor fuel tax subsidy	(74.2)
Higher revenues from retail sales	1.4
Increase in federal-provincial subsidy	0.6
Higher revenues from other segments	2.9
Lower costs related to salaries, wages and benefits	3.0
Higher costs related to fuel	(4.0)
Higher costs related to other operational expenses	(12.3)
Higher cost of retail goods sold	(1.3)
Higher amortization	(3.3)
Increase in earnings from operations	<u>26.0</u>

Higher Toll Revenue

Toll revenue for the 2003/04 fiscal year was \$323.0 million compared with \$315.6 million for the 2002/03 fiscal year. This increase in toll revenue was due mainly to the 3.8% increase in tariffs implemented December 2002. Traffic on Major Routes lagged behind prior year results, reflecting the impact of the war in Iraq and the outbreak of SARS on the British Columbia tourism sector. These reductions of 1.2% for vehicles and 2.5% for passengers were not as large as the impact on the BC tourism sector as a whole. Traffic was also adversely affected by labour related disruptions to sailings over a five day period in December 2003, including a total work stoppage which lasted for three days.

First Year of Ferry Service Fees

Ferry service fees of \$105.8 million were received for the 2003/04 fiscal year. The Coastal Ferry Services Contract came into effect at the beginning of the 2003/04 fiscal year.

Elimination of Motor Fuel Tax Subsidy

The provincial motor fuel tax subsidy received in prior years was eliminated as at April 2, 2003.

Higher Revenues from Retail Sales

Food and retail revenue for the 2003/04 fiscal year was \$63.2 million compared with \$61.8 million for the 2002/03 fiscal year. Average per passenger spending increased by 3.5% from the 2002/03 fiscal year, while gross profit per passenger on food and retail increased by 1.6% over the prior year.

Increase in Federal-Provincial Subsidy

Pursuant to a contract between the federal and provincial governments, the Province receives a subsidy to support the provision of ferry, coastal freight and passenger services in the waters of British Columbia. This subsidy is remitted to BC Ferries by the Province. For the 2003/04 fiscal year, the subsidy received was \$24.0 million. The annual subsidy adjusts with the Vancouver Consumer Price Index.

Higher Revenues from Other Segments

Other income for the 2003/04 fiscal year was \$17.7 million compared with \$14.8 million for the 2002/03 fiscal year. This change was largely driven by volume increases in reservation usage, primarily from passenger-vehicle reservations for the Horseshoe Bay-Langdale route, that were made available for the first time in July 2003, and the Swartz Bay-Tsawwassen route.

Lower Costs Related to Salaries, Wages and Benefits

The cost of salaries, wages and benefits decreased by \$3.0 million in the 2003/04 fiscal year compared to the 2002/03 fiscal year. This decrease resulted primarily from an overall decrease in salaries, wages and premiums of \$1.7 million mainly due to fewer employees and less overtime requirements, and a \$2.6 million decrease in workers' compensation claims liability due to valuation adjustments in the prior year. These decreases were offset by various benefit cost increases.

Higher Costs Related to Fuel

The cost of fuel increased \$4.0 million in the 2003/04 fiscal year compared to the 2002/03 fiscal year. Of this increase, \$3.4 million was the result of increases in fuel prices net of hedging operations, and \$2.0 million was as a result of non-recoverable GST (which was not payable in the 2002/03 fiscal year). This was partially offset by a reduction in fuel usage of 2.5 million litres, representing \$1.0 million. Additional savings were achieved through negotiated supplier discounts.

Higher Costs Related to Other Operational Expenses

The cost of other operational expenses increased \$12.3 million in the 2003/04 fiscal year compared to the 2002/03 fiscal year. This increase included \$4.7 million for unexpected vessel repairs and maintenance, \$1.9 million for a corporate initiative to acquire new uniforms for employees, \$1.6 million for the cost of property taxes resulting from BC Ferries' change to an assessment based taxation method, and \$6.5 million for non-recoverable GST. This increase was offset by \$2.0 million in insurance claim experience.

Higher Cost of Retail Goods Sold

The cost of retail goods sold increased \$1.3 million in the 2003/04 fiscal year compared to the 2002/03 fiscal year. This increase was driven by increased food and retail sales.

Higher Amortization

Amortization expense increased by \$3.3 million for the 2003/04 fiscal year compared to the 2002/03 fiscal year. This increase was driven by the revision of the useful lives of assets to be replaced by expected vessel and terminal improvement projects.

Interest Expense

Interest expense for the 2003/04 fiscal year includes a \$22.1 million increase of interest payable on long-term debt primarily due to the \$427.7 million debenture held by the Province. This debenture was issued on April 2, 2003.

Losses on Disposal of Assets

Losses on disposals during the 2003/04 fiscal year includes \$1.7 million as a result of the Queen of Cowichan 1997 passenger upgrades being replaced by the current mid-life upgrade project, and \$0.7 million for cancelled business cases. These losses were reduced by a gain of \$1 million resulting from the disposal by BC Ferries' wholly owned subsidiary, Catamaran Ferries International Inc., of the high speed ferry construction facility, its last remaining capital asset.

Net Earnings (Loss)

For the 2003/04 fiscal year, net earnings were \$28.0 million compared with a net loss of \$28.7 million for the 2002/03 fiscal year.

Year Ended March 31, 2003 Compared to Year Ended March 31, 2002

Earnings from Operations

Earnings from operations for the 2002/03 fiscal year were \$26.0 million compared to \$19.7 million for the 2001/02 fiscal year. The increase in earnings from operations of \$6.3 million resulted from:

	<u>(\$ millions)</u>
Higher toll revenue	9.9
Increase in motor fuel tax subsidy	2.5
Higher revenues from retail sales	1.4
Increase in federal-provincial subsidy	0.5
Higher revenues from other segments	2.5
Higher costs related to salaries, wages and benefits	(6.5)
Lower costs related to fuel	2.2
Higher costs related to other operational expenses	(8.6)
Lower cost of retail goods sold	0.4
Lower amortization	<u>2.0</u>
Increase in earnings from operations	<u>6.3</u>

Higher Toll Revenue

Toll revenue for the 2002/03 fiscal year was \$315.6 million compared to \$305.7 million for the 2001/02 fiscal year. This increase is comprised of an increase of 2.9% in toll revenues from passengers and 3.5% from vehicles. Of total toll revenue growth, \$6.1 million was attributable to an increase in traffic and \$3.8 million was due to a 3.8% tariff increase implemented in December 2002. Vehicle traffic in the 2002/03 fiscal year totalled 8.3 million while total passengers were 21.6 million (annual increases of 2.7% and 1.8% respectively).

Increase in Motor Fuel Tax Subsidy

A motor fuel tax subsidy from the Province of 1.25 cents per litre provided revenue of \$74.2 million for the 2002/03 fiscal year compared to \$71.7 million for the 2001/02 fiscal year. This increase was due to an increase in motor fuel consumption over the year.

Higher Revenues from Retail Sales

Food and retail revenue increased to \$61.8 million for the 2002/03 fiscal year, an increase of \$1.4 million over the 2001/02 fiscal year. Over 70% of retail revenue was derived from food and beverage services, with the remaining portion from gift shop sales and video/vending contracts. Growth in retail revenues reflects the impact of a 2.5% increase in food and beverage prices effective May 1, 2002 and increased ridership.

Increase in Federal-Provincial Subsidy

BC Ferries received revenue of \$23.4 million in the 2002/03 fiscal year pursuant to an agreement between the federal and provincial governments for the provision of ferry services in the waters of British Columbia. The payment adjusts annually with the Vancouver Consumer Price Index. The payments received in the 2001/02 fiscal year totalled \$23.0 million.

Higher Revenues from Other Segments

Other income increased to \$14.8 million for the 2002/03 fiscal year, an increase of \$2.5 million over the 2001/02 fiscal year. Over 70% of other income was derived from reservations and parking, with the remaining portion from assured loading tickets and marketing rights fees. Growth in other income was primarily a result of

volume increases in reservation usage, resulting in an increase of \$1.8 million in other income. Also contributing to growth in other income was increased parking revenue from a new 460 car parkade at the Horseshoe Bay terminal.

Higher Costs Related to Salaries, Wages and Benefits

Salaries, wages and benefits increased by \$6.5 million to \$248.1 million for the 2002/03 fiscal year. This increase is due primarily to increases in benefits, including valuations for Workers' Compensation Board, long term disability liabilities and Medical Service Plan premium increases and wage increases of 2% implemented November 2001 and 1.8% implemented November 2002. Further increases for the 2002/03 fiscal year resulted from the one-time cost of reorganization initiatives.

Lower Costs Related to Fuel

The total cost of fuel dropped \$2.2 million to \$45.9 million for the 2002/03 fiscal year. During the 2002/03 fiscal year the average price of fuel rose by 7.6%, while consumption decreased 1.2% (1.6 million litres). The elimination of the high speed ferries from operations was the primary reason for the drop in fuel consumption. The fuel hedging program realized a gain of \$3.5 million, helping to mitigate exposure to rising fuel prices.

Higher Costs Related to Other Operational Expenses

The cost of other operational expenses increased \$8.6 million for the 2002/03 fiscal year compared to the 2001/02 fiscal year. This increase was largely due to vessel refit and maintenance activities, transition and core review activities.

Lower Cost of Retail Goods Sold

The cost of retail goods sold decreased by \$0.4 million for the 2002/03 fiscal year. This decrease was due to a reduction in food and beverage cost of sales and improved shipboard product management.

Lower Amortization

Amortization decreased by \$2.0 million for the 2002/03 fiscal year. This decrease reflects accelerated amortization recorded in the 2001/02 fiscal year due to the reclassification of assets.

Interest Expense

Interest expense for the 2002/03 fiscal year includes interest paid on the capital leases relating to the Queen of Surrey and Queen of Oak Bay. Further details regarding obligations under capital leases can be found in the notes to the consolidated financial statements included elsewhere in this prospectus.

Losses on Disposal of Assets

The three high speed ferries and ancillary equipment were sold by international, unreserved auction on March 24, 2003 for proceeds, less auction commissions, of \$17.2 million, resulting in a loss on disposal of assets held for resale in the 2002/03 fiscal year of \$53.1 million.

Net Earnings (Loss)

For the 2002/03 fiscal year, BC Ferries' net loss was \$28.7 million. Excluding the loss on disposal of the high speed ferries, net income for the 2002/03 fiscal year would have been \$24.4 million. These results compare with net earnings (before fast ferry write down provision) of \$17.4 million in the 2001/02 fiscal year.

Liquidity and Capital Resources

To date BC Ferries has funded its operations and growth from cash flow from operations, government subsidies, bank financing and loans from the Province. BC Ferries does not view common equity as a potential source of capital and has no present intention of offering equity to the public or other investors.

Capital expenditures were \$59.7 million in the 2003/04 fiscal year and \$58.2 million in the 2002/03 fiscal year. The majority of these capital expenditures were related to improvements at the Horseshoe Bay terminal and the mid life upgrade on the Queen of Coquitlam. Substantial investments in accounting, maintenance and human resource systems were also undertaken over the past two years. Over the next decade, approximately \$1.9 billion in capital expenditures is planned to replace ageing vessels and upgrade terminals. Approximately 75% of such expenditures will be associated with new vessel acquisitions, vessel upgrades and component replacement, with the balance allocated to terminals and other projects.

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, BC Ferries received recognition of prepayment of rent under terminal leases concluded with BCTFA. The leases grant to BC Ferries exclusive access and use of ferry terminal properties for a period of 60 years commencing April 1, 2003. The leases are renewable for an additional period of 20 years at a total cost of \$20 per lease if the Coastal Ferry Services Contract is renewed. BC Ferries must manage, maintain and develop the terminals at its own cost.

At March 31, 2004, BC Ferries had net cash and short term investments of \$17.9 million compared to \$14.6 million at March 31, 2003 and \$17.5 million at March 31, 2002.

Cash provided by operating activities for the 2003/04 fiscal year was \$69.5 million compared to \$73.8 million for the 2002/03 fiscal year, primarily due to increased earnings from operations which was more than offset by increases in amortization and changes in non-cash working capital mainly due to changes in payables to employees and trade payables. There were significant non-cash charges in the 2002/03 fiscal year related to the disposition of the PacifiCat high speed ferries. Cash provided by operating activities for the 2002/03 fiscal year was \$73.8 million compared to \$66.8 million for the 2001/02 fiscal year.

BC Ferries estimates that cash provided by operating activities will be sufficient to fund approximately half of the capital expenditures over the next decade, with the remaining portion funded by borrowings.

In conjunction with the issue of the Series 04-1 Bonds, BC Ferries will enter into the Credit Facility with a syndicate of Canadian banks which is designed to operate as part of the Capital Markets Platform. Under the Credit Facility, BC Ferries will be provided with a 364-day revolving operating facility with a one year term-out in an amount of up to \$77.5 million, and a three-year revolving extendible facility in an amount up to \$77.5 million. The revolving term facilities will be available for general corporate purposes. A bridge term facility in an amount of up to \$250 million will be used to repay, in part, obligations to the Province. See "Capital Markets Platform — Credit Facility".

Critical Accounting Estimates

Workers' Compensation Claims Liability

BC Ferries financial statements include an estimate for residual workers' compensation claims liability, arising from the Workers' Compensation Board (the "WCB") deposit class coverage system, in which BCFC participated prior to March 31, 2003.

The WCB provided BCFC with an actuarial valuation of the unfinalized claims remaining to be paid out relating to incidents on or prior to March 31, 2003. This estimate is included in the calculation of deferred employee obligations and reflected in BC Ferries' financial statements for the year ended March 31, 2003. BCFC had also engaged its own actuary to estimate the unfinalized claims. This estimate was \$3.5 million less than that reached by the WCB, due in large part to an adjustment made in the WCB valuation to reflect the longer term experience of the provincial government. Had the lower actuarial valuation been recorded, the net loss, deficit and deferred employee costs for the year ended March 31, 2003 would have been less than currently reflected by \$3.5 million.

Public Service Pension Plan

The employees of BCFC, as eligible employees of a Crown corporation, were members of the Public Service Pension Plan (the "Plan"), a defined benefit, multi-employer pension plan. On April 2, 2003, BCFC was converted from a Crown corporation into an independent company incorporated under the *Company Act*

(British Columbia). In February 2004, BC Ferries and the BCFMWU jointly submitted a formal application for all BC Ferries employees and BC Ferries to remain within the Plan. In March 2004 the Public Service Pension Board of Trustees agreed to continue the Plan for BC Ferries and its employees.

The Plan is exempt from the requirements under the *Pension Benefits Standards Act* (British Columbia) 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 Plan valuation, as at March 31, 2002, indicated a surplus in the Basic Account of \$546 million.

Other Estimates

The preparation of 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 disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates.

Future Accounting Changes

Hedging transactions

The Canadian Institute of Chartered Accountants (the “CICA”) has issued Accounting Guideline 13 relating to hedging relationships (the “Guideline”), which is effective for years beginning on or after July 1, 2003. The Guideline addresses the identification, designation, documentation and effectiveness of hedging transactions for the purpose of applying hedging accounting. It also deals with accounting for the discontinuance of hedge relationships.

In April 2003, the CICA approved certain revisions to the Guideline. Under the revised Guideline, BC Ferries will be required to document its hedging transactions and explicitly demonstrate that the hedges are sufficiently effective in order to continue accrual accounting for positions hedged with derivatives. The effect on net income of adopting the Guideline will be immaterial.

Asset retirement obligations

The CICA has approved a new accounting standard relating to asset retirement obligations, to replace the current guidance on future removal costs. The new standard is effective for years beginning on or after January 1, 2004. It requires recognition of a liability at its fair value for any legal obligation associated with the retirement of property, plant and equipment when those obligations result from the acquisition, construction, development or normal operation of the assets. A corresponding asset retirement cost is required to be added to the carrying amount of the related asset and amortized to expense on a systematic and rational basis. While the full effect on BC Ferries of adopting this standard has not yet been determined, BC Ferries believes that the effect on net income upon adoption of the standard will be immaterial.

CAPITAL MARKETS PLATFORM

Some of BC Ferries’ ongoing financial requirements will be financed with debt. In conjunction with its financial advisors, BC Ferries has developed a financing plan referred to from time to time in this prospectus as the Capital Markets Platform. This plan encompasses an ongoing program capable of accommodating a variety of corporate debt instruments and borrowings ranking *pari passu*, including term bank debt, revolving bank lines of credit, publicly issued and privately placed debt securities, commercial paper, medium term notes and interest rate and currency swaps and other hedging instruments.

BC Ferries and Computershare Trust Company of Canada, as trustee (the “Trustee”), will enter into a master trust indenture to be dated as of May 19, 2004 (the “Indenture”) which establishes common security and a set of common covenants by BC Ferries for the benefit of all of its lenders under the Capital Markets Platform. Bonds are to be issued under supplemental indentures (“Supplemental Indentures”) to the Indenture, either as obligation bonds (“Obligation Bonds”), to directly evidence the indebtedness of BC Ferries to the holder of such bonds, or by way of pledged bonds (“Pledged Bonds”), to be held by the holder as security for the indebtedness

specified in the pledge (including obligations in respect of swap obligations and letters of credit which do not otherwise constitute Borrowings). It is expected that publicly issued and privately placed debt securities will be in the form of Obligation Bonds, whereas all other indebtedness of BC Ferries under the Capital Markets Platform, including the bank indebtedness described below under “Credit Facility” and commercial paper, will be secured by Pledged Bonds. The specific terms and conditions of each series of bonds are to be set forth in the Supplemental Indenture authorizing that series.

Terms used in this section which are not otherwise defined have the meanings given to such terms under “— Definitions” below.

Indenture

The following section provides a brief summary of the principal security provisions and covenants contained in the Indenture, and is qualified in its entirety by reference to the Indenture. For purposes of clarity, this overview summarizes certain complex provisions of the Indenture and omits descriptions of many provisions which may be considered to be of a customary nature. For full particulars of BC Ferries’ obligations and the rights of the Bondholders under the Indenture, potential investors should refer to the Indenture and the Supplemental Indenture authorizing the Series 04-1 Bonds, copies of which may be inspected at the head office of BC Ferries during normal business hours at any time during the period of distribution of the Series 04-1 Bonds offered hereby.

Nature of Obligations Issued and Secured

The Indenture authorizes the issuance of different series (each a “Series”) of bonds (for ease of reference, each a “Bond”). The Bonds may be issued as Obligation Bonds, which evidence direct borrowings by BC Ferries, or as Pledged Bonds which will be pledged to collaterally secure bank borrowings, obligations under letters of credit, commercial paper and obligations under derivative instruments, such as interest rate and currency hedging agreements. Each Series of Bonds will be secured under the Indenture and will rank *pari passu* with all other Series of Bonds issued thereunder (subject to sinking funds and reserve accounts established for particular Series). Each Series of Bonds will be created by the execution and delivery of a Supplemental Indenture. The Indenture will provide that the principal terms attaching to each Series of Bonds shall be set out in the related Supplemental Indenture. The principal terms for each Series of Bonds may include the following terms affecting such Series:

- (a) principal amount of the Series;
- (b) fixed or variable rates of interest or discount, including accruals and payment dates for interest;
- (c) currency of obligations or payment;
- (d) tenor of obligation, including rights to extend, prepay, redeem and reprice and amortization requirements;
- (e) additional covenants and Events of Default;
- (f) repurchase, tender, redemption and call features and procedures;
- (g) requirements to establish certain funds (including any sinking fund or series reserve account for such Series) or to contribute to funds;
- (h) procedures for the sale of Bonds of the Series;
- (i) whether such Bonds are Obligation Bonds or Pledged Bonds;
- (j) any special voting requirements applicable to the Bonds of such Series;
- (k) any restriction on the use of proceeds from the issue of the Bonds of such Series; and
- (l) form of instrument (including registered or book-entry).

Unless restricted by the terms of a Supplemental Indenture, all proceeds from Borrowings secured under the Indenture will be used to finance or refinance existing indebtedness of BC Ferries, to establish reserves or for other purposes related or ancillary to the business of BC Ferries from time to time, including the Coastal Ferry Business and the Core Business.

Right of Province to Purchase

The Indenture provides for the right of the Province, at any time at its option and upon providing written notice, to purchase all, but not less than all, of the outstanding Bonds at a price equal to the Redemption Price for each Series of Bonds as set out in the Supplemental Indenture authorizing such Series of Bonds.

Additional Indebtedness Test

There is no limit on the aggregate amount of Borrowings which may be secured under the Indenture. However, other than Permitted Borrowings, BC Ferries will not be permitted to issue any Additional Indebtedness (whether or not secured under the Indenture) unless the Trustee has been provided with a certificate of a senior officer of BC Ferries certifying the following matters, as evidence of BC Ferries' compliance with the test for incurring such Additional Indebtedness (the "Additional Indebtedness Test"):

- (a) that no Default or Event of Default exists or would exist immediately after the issuance of such Additional Indebtedness;
- (b) that the Debt Service Coverage Ratio is at least 1.5:1 and, taking into account the Additional Indebtedness and the use of the proceeds therefrom (with respect to such proceeds, taking into account only EBITDAR derived from the use of such proceeds which BC Ferries reasonably expects to be sustainable), would be at least 1.5:1;
- (c) that the amounts held in the Debt Service Reserve Fund and any Sinking Fund (after reflecting deposits to be made on the date of issuance of such Additional Indebtedness) are at least equal to the amount required to be maintained in the Debt Service Reserve Fund or such Sinking Fund;
- (d) that such Additional Indebtedness ranks no higher than *pari passu* with any previously issued Bonds; and
- (e) that the Leverage Ratio, taking into account the Additional Indebtedness and the use of proceeds therefrom, would not exceed:
 - (i) if the common shares of BC Ferries are wholly owned by the BCFA, the Province or any Crown Corporation:
 - (A) before April 1, 2006, 90%;
 - (B) on or after April 1, 2006, 85%; or
 - (ii) if the common shares of BC Ferries are not wholly owned by the BCFA, the Province or any Crown Corporation, 75%.

The Additional Indebtedness Test does not apply to the issue of Subordinated Debt. BC Ferries may only issue Subordinated Debt if:

- (a) immediately after the issuance of such Subordinated Debt, the aggregate principal amount of all Subordinated Debt then outstanding would be less than 5% of the net book value of the fixed assets of BC Ferries and its Designated Subsidiaries; or
- (b) in any other case, at least two Rating Agencies have confirmed that the issuance of such Subordinated Debt would not have an Adverse Rating Effect.

Security

As security for the obligations of BC Ferries under the Indenture (the “Security”), the Trustee shall be granted:

- (a) a registered first mortgage and charge over Vessels owned by BC Ferries or any Designated Subsidiary;
- (b) a first mortgage and charge over the Ferry Terminal Leases, which will not be registered unless a Default or Event of Default occurs and is continuing and the Trustee is directed to do so by a Bondholders’ Request;
- (c) a security interest and charge over all the present and future personal property of BC Ferries or any Designated Subsidiary including, without limitation:
 - (i) all book debts and sources of revenue;
 - (ii) all assets held in the Debt Service Reserve Fund and any Sinking Fund including, without limitation, all Permitted Investments contained therein; and
 - (iii) all Material Contracts and other contracts; and
- (d) a floating charge on all present and future right and title of BC Ferries or any Designated Subsidiary to all real property interests and personal property not charged under the security described above, now owned or later acquired.

Each Designated Subsidiary shall provide a guarantee of BC Ferries’ obligations under the Indenture and provide security as described above.

Debt Service Reserve Fund

The Indenture requires BC Ferries to establish a segregated fund designated as the “Debt Service Reserve Fund”, comprised of Series Reserve Accounts for each Series of Obligation Bonds with a term of one year or more and, if so provided in the relevant Supplemental Indenture, Pledged Bonds, into which BC Ferries shall cause to be deposited an amount equal to not less than six months Forecast Debt Service or such greater amount as may be specified in the Supplemental Indenture authorizing such Series of Bonds. Funds in the Debt Service Reserve Fund must be invested in Permitted Investments or held in cash or cash equivalents; provided, however, that irrevocable letters of credit from appropriately rated banks may be substituted for cash in the Debt Service Reserve Fund.

BC Ferries is required to fund each Series Reserve Account with not less than the amounts specified in the Indenture and in the Supplemental Indenture authorizing the applicable Series of Bonds at the time of the issuance of such Series of Bonds. Money in a Series Reserve Account will be used to pay principal, interest and other amounts due in respect of the applicable Series of Bonds at the direction of BC Ferries or to the extent such payments have not been made when due. To the extent that funds are otherwise unavailable to meet Debt Service payments in respect of a Series of Obligation Bonds, BC Ferries may use the funds in the relevant Series Reserve Account to pay Debt Service for such Series of Obligation Bonds. In such event, BC Ferries shall replenish the Debt Service Reserve Fund with all due diligence and prior to the making of any Discretionary Expenditures and in any event no later than the end of the 12 month period which commences on the date of the first withdrawal made by BC Ferries from any Series Reserve Account. Upon the Debt Service Reserve Fund being fully replenished, such 12 month cure period shall recommence upon the next following withdrawal from any Series Reserve Account. BC Ferries is required to replenish the Debt Service Reserve Fund as follows:

- (a) the amount required to be replenished in each of the relevant Series Reserve Accounts shall equal the funds withdrawn to pay amounts due in respect of the applicable Series of Obligation Bonds plus deposit to a trust account with the Trustee of an amount equal to that portion of the Gross Interest Obligations and the Total Principal Reduction Amount of all Series of Obligation Bonds that would be due if the date for payment thereof was the day on which the deposit was made and such Gross Interest Obligations and the Total Principal Reduction Amount accrued on a daily basis, provided that such amount which is equal to the Gross Interest Obligations and the Total Principal Reduction Amount of

all Series of Obligation Bonds may be used to pay Debt Service in respect of Obligation Bonds without any further obligation to replenish the trust account in respect of such payments and shall not be an additional amount required to be retained in the Debt Service Reserve Fund;

- (b) the Debt Service Reserve Fund shall be regarded as replenished on a date when all Series Reserve Accounts which have been drawn against are Fully Funded and the trust account for Debt Service has been funded as required, and no withdrawal has thereafter reduced the amounts in such accounts; and
- (c) without relieving BC Ferries of its obligation to replenish the Debt Service Reserve Fund with all due diligence, BC Ferries shall, in priority to all other Series Reserve Accounts in respect of which a deficiency exists, replenish the Series Reserve Account or the Series Reserve Accounts which, relative to all other Series Reserve Accounts, have the greatest deficiency requiring replenishment from time to time, where such deficiency shall be measured (on an ongoing basis and for each deposit to any Series Reserve Account) as a percentage calculated by dividing the amount required to be replenished in each Series Reserve Account (such amount not to exceed, for such purposes, the amount equal to 12 months Forecast Debt Service for the Series of Obligation Bonds to which such Series Reserve Account relates) by the amount equal to the balance required to be held in such Series Reserve Account (such amount not to exceed, for such purpose, an amount equal to 12 months Forecast Debt Service for the Series of Obligation Bonds to which such Series Reserve Account relates); provided that where:
 - (i) any Series Reserve Accounts have the same greatest deficiency, or no Series Reserve Account has a greater deficiency than any other Series Reserve Account requiring replenishment, all such Series Reserve Accounts shall be replenished on a pro rata basis; and
 - (ii) there are no Series Reserve Accounts in respect of which the amount required to be replenished is less than or equal to 12 months Forecast Debt Service for the Series of Obligation Bonds to which such Series Reserve Account relates, the abovementioned deficiency shall be measured as a percentage calculated by dividing the amount required to be replenished in each Series Reserve Account by the amount equal to the balance required to be held in such Series Reserve Account.

Additional funds, accounts within funds or additional amounts to be deposited within funds or accounts may be required under Supplemental Indentures which will prescribe the allocation thereof and whether such funds must be segregated or deposited in trust.

Covenants

Affirmative Covenants

In addition to specific covenants contained in the Supplemental Indentures, BC Ferries makes the following affirmative covenants in the Indenture:

- (a) to pay or cause to be paid the principal, interest and other amounts, if any, due in respect of all Bonds in accordance with their terms on a timely basis;
- (b) to maintain proper books of record and accounts in accordance with generally accepted accounting principles and to cause each Designated Subsidiary to do so;
- (c) to maintain its corporate existence and the corporate existence of each Designated Subsidiary (but a Designated Subsidiary may be wound up into or amalgamated with BC Ferries or another Designated Subsidiary);
- (d) to comply in all material respects with all applicable laws and to cause each Designated Subsidiary to do so;
- (e) to pay taxes and to cause each Designated Subsidiary to do so;
- (f) to comply in all material respects with the Material Contracts; and
- (g) to carry on the Coastal Ferry Business directly or through a Designated Subsidiary and to carry on any business or activity outside of the Core Business only indirectly through a person which is not a Designated Subsidiary (subject to its right to contract with others to carry on any part of the Coastal Ferry Business).

Negative Covenants

In addition to specific covenants contained in the Supplemental Indentures, the following negative covenants apply to BC Ferries and its Designated Subsidiaries under the Indenture:

- (a) *Negative Pledge.* Not to create, incur, assume or suffer to exist any Lien on, of or upon the undertaking, property or assets of BC Ferries or any Designated Subsidiary, except for Permitted Liens (which include Capital Leases and Purchase Money Obligations);
- (b) *Restriction on Dispositions.* Not to sell, lease, license or otherwise dispose of assets to any entity which is not BC Ferries or a Designated Subsidiary, other than:
 - (i) inventory or other similar assets disposed of in the ordinary course of business;
 - (ii) assets where the proceeds are reinvested in the Core Business or the Coastal Ferry Business (provided that BC Ferries is in material compliance with the provisions of the Coastal Ferry Services Contract) within 12 months of the disposition;
 - (iii) obsolete capital assets disposed of for fair market value or sold to the Province pursuant to the purchase option set out in the Coastal Ferry Services Contract;
 - (iv) dispositions of assets for fair market value, or to the Province pursuant to any vessel purchase option or right set out in the Coastal Ferry Services Contract other than in the circumstances set out in paragraph (v) below, provided:
 - (A) BC Ferries would meet the Additional Indebtedness Test for an amount equal to the proceeds of disposition; or
 - (B) the net proceeds of disposition are used to prepay outstanding Borrowings within 12 months of the disposition (such prepayment to occur by prepayment, redemption or Offer to Purchase);
 - (v) disposition of all or substantially all of the vessels pursuant to the exercise by the Province of the purchase option set out in the Coastal Ferry Services Contract upon the occurrence of an event of default under the Coastal Ferry Services Contract, provided that the proceeds of sale must be applied by BC Ferries to the redemption, on a pro rata basis, of all Obligation Bonds (or, where required by the terms of the Supplemental Indenture authorizing a Series of Obligation Bonds, to fund an Offer to Purchase, on a pro rata basis, the Obligation Bonds of such Series instead of the redemption of Obligation Bonds of such Series) and, if so specified in the Supplemental Indenture relating to a Series of Pledged Bonds, the Pledged Bonds of that Series; or
 - (vi) disposition of assets not otherwise permitted in an aggregate amount in any 12 month period of up to 3% of the net book value of the fixed assets of BC Ferries and its Designated Subsidiaries;
- (c) *Restriction on Disposition of Major Ferry Terminal Properties.* Not to voluntarily sell, lease, license or otherwise dispose of its leasehold interest in the Major Ferry Terminal Properties except for the following interests which may be granted with respect to Ferry Terminal Properties:
 - (i) subleases or licenses on terms consistent with an arm's length transaction and in good faith, such as a prudent owner of similar real property would from time to time enter into;
 - (ii) dispositions of portions of a Major Ferry Terminal Property or the granting of encumbrances as a prudent owner so long as such disposition or encumbrance cannot reasonably be expected to materially adversely affect the validity or enforceability of the Security in relation to the balance of the Collateral or the utility of the Major Ferry Terminal Property for its purpose;
 - (iii) the adjustment of boundaries in accordance with the terms of the relevant Ferry Terminal Lease;
 - (iv) the exchange of such real property for real property of a similar type, function, access and utility and of substantially similar fair market value, provided BC Ferries would be able to meet its obligations under the Coastal Ferry Services Contract; or

- (v) the acquisition or disposition of rights ancillary to such leasehold interests;
- (d) *Restriction on Amendment of Material Contracts.* Not to amend, waive or delete any material provision in any Material Contract unless, after such amendment, waiver or consent is effective, such changes taken as a whole cannot be expected to materially adversely affect the interest of the Bondholders or the Security or the ability of BC Ferries to operate the Coastal Ferry Business, and in any event not to amend the Coastal Ferry Services Contract to reduce the amount payable to BC Ferries under the vessel purchase option set out in that agreement;
- (e) *Restrictions on Distributions.* Not to make any Distributions (including any payments in respect of Subordinated Debt) unless:
 - (i) the Debt Service Reserve Fund is fully funded;
 - (ii) no Default or Event of Default has occurred and is continuing;
 - (iii) if, at the time of the Distribution, the common shares of BC Ferries are wholly owned by BCFA:
 - (A) for the 12 months ended on the most recently completed fiscal quarter for which financial statements have been issued by, or have been approved by the Board of Directors of, BC Ferries, the Debt Service Coverage Ratio is 1.3:1 or greater and the Leverage Ratio does not exceed 90% as at the end of such fiscal quarter (if the Distribution is made at any time prior to April 1, 2006) or 85% as at the end of such fiscal quarter (if the Distribution is made at any time on or after April 1, 2006); and
 - (B) for the 12 months commencing on the date after the most recently completed fiscal quarter for which financial statements have been issued by, or have been approved by the Board of Directors of, BC Ferries, after giving effect to the Distribution, the projected Debt Service Coverage Ratio for such period is 1.3:1 or greater and the Leverage Ratio will not exceed 90% for such period (if the Distribution is made at any time prior to April 1, 2006) or 85% for such period (if the Distribution is made at any time on or after April 1, 2006); and
 - (iv) if, at the time of the Distribution, the common shares of BC Ferries are not wholly owned by BCFA:
 - (A) for the 12 months ended on the most recently completed fiscal quarter for which financial statements have been issued by, or have been approved by the Board of Directors of, BC Ferries, the Debt Service Coverage Ratio is 1.5:1 or greater and the Leverage Ratio does not exceed 75% as at the end of such fiscal quarter; and
 - (B) for the 12 months commencing on the day after the most recently completed fiscal quarter for which financial statements have been issued by, or have been approved by the Board of Directors of, BC Ferries, after giving effect to the Distribution, the projected Debt Service Coverage Ratio for such period is 1.5:1 or greater and the Leverage Ratio will not exceed 75% for such period;
- (f) *Restriction on Swap Agreements.* Not to enter into any swap agreement or similar transaction other than for the purpose of hedging indebtedness, anticipated indebtedness or operating expenditures (including fuel and currency requirements) incurred in the normal course of business;
- (g) *Restriction on Guarantees and Investments.* Not to create any guarantee (other than a guarantee by a Designated Subsidiary of the obligations of BC Ferries under the Indenture) or make any investment in a person that is not a Designated Subsidiary unless:
 - (i) at the time of such guarantee or investment, the aggregate of all guarantees and investments (including the proposed guarantee or investment) made pursuant to this paragraph (i) amounts to less than 10% of shareholders' equity of BC Ferries and its Designated Subsidiaries on a consolidated basis;

- (ii) at the time of such guarantee or investment, BC Ferries would meet the requirements for making a Distribution and the Leverage Ratio, taking into account such guarantee or investment, would not exceed 75%; or
 - (iii) prior to the making of the guarantee or investment, at least two Rating Agencies confirm that the proposed guarantee or investment will not have an Adverse Rating Effect; and
- (h) *Restriction on Sale/Leaseback, Lease/Leaseback.* Not to enter into a Sale/Leaseback or Lease/Leaseback transaction unless BC Ferries would be able to incur an amount equal to the Attributable Indebtedness relating to such Sale/Leaseback or Lease/Leaseback under the Additional Indebtedness Test.

Expropriation

The Indenture provides for the following in the case of an expropriation of assets of BC Ferries or its Designated Subsidiaries:

- (a) In the event of an expropriation of all or substantially all of the assets of BC Ferries and its Designated Subsidiaries, or all or substantially all of the assets used by BC Ferries and its Designated Subsidiaries in the Coastal Ferry Business, the proceeds of such expropriation will be applied by the Trustee to the redemption, on a pro rata basis, of all Obligation Bonds (or, where required by the terms of the Supplemental Indenture authorizing a Series of Obligation Bonds, to fund an Offer to Purchase Obligation Bonds of such Series instead of the redemption of Obligation Bonds of such Series) and, if so specified in the Supplemental Indenture relating to a Series of Pledged Bonds, the Pledged Bonds of that Series.
- (b) In the event of an expropriation (other than an expropriation described in paragraph (a)) of assets used by BC Ferries and its Designated Subsidiaries in the Coastal Ferry Business, the aggregate book value of which is more than 25% of the Coastal Ferry Business Book Value, or in the event of an expropriation of a Major Vessel or a Major Ferry Terminal Property, the proceeds of such expropriation must be reinvested in the Coastal Ferry Business to the extent such reinvestment is necessary for BC Ferries to comply with the Coastal Ferry Services Contract, and any proceeds remaining after such mandatory reinvestment may be reinvested by BC Ferries in the Coastal Ferry Business in its discretion. To the extent any expropriation proceeds are not reinvested in the Coastal Ferry Business (whether such reinvestment is mandatory or discretionary) within 12 months after such proceeds are received, then:
 - (i) if such unreinvested proceeds exceed 10% of the Coastal Ferry Business Book Value, the unreinvested proceeds must be applied by BC Ferries to the redemption, on a pro rata basis, of all Obligation Bonds (or, where required by the terms of the Supplemental Indenture authorizing a Series of Obligation Bonds, to fund an Offer to Purchase, on a pro rata basis, the Obligation Bonds of such Series instead of the redemption of Obligation Bonds of such Series) and, if so specified in the Supplemental Indenture relating to a Series of Pledged Bonds, the Pledged Bonds of that Series; or
 - (ii) if such unreinvested proceeds are less than or equal to 10% of the Coastal Ferry Business Book Value, and BC Ferries would be unable to meet the Additional Indebtedness Test if it were to borrow an amount equal to such unreinvested proceeds, the unreinvested proceeds must be applied by BC Ferries to prepay outstanding Borrowings selected by BC Ferries (such prepayment to occur by prepayment, redemption or an Offer to Purchase);

provided that BC Ferries will not be required to apply unreinvested proceeds to the redemption of Bonds, the prepayment of Borrowings or an Offer to Purchase if, at the time such redemption, prepayment or Offer to Purchase would otherwise be required, the Leverage Ratio is less than 60% or if such unreinvested proceeds are less than or equal to 10% of the Coastal Ferry Business Book Value and BC Ferries would be able to meet the Additional Indebtedness Test if it were to borrow an amount equal to such unreinvested proceeds.

- (c) In the event of an expropriation (other than an expropriation described in paragraph (a) or (b)) of assets of BC Ferries and its Designated Subsidiaries, the aggregate book value of which is more than 25% of the Core Business Book Value, the proceeds of such expropriation may be reinvested by BC Ferries in the Core Business in its discretion. To the extent any expropriation proceeds are not reinvested in the Core Business within 12 months after such proceeds are received, then:
- (i) if such unreinvested proceeds exceed 10% of the Core Business Book Value, the unreinvested proceeds must be applied by BC Ferries to the redemption, on a pro rata basis, of all Obligation Bonds (or, where required by the terms of the Supplemental Indenture authorizing a Series of Obligation Bonds, to fund an Offer to Purchase, on a pro rata basis, the Obligation Bonds of such Series instead of the redemption of Obligation Bonds of such Series) and, if so specified in the Supplemental Indenture relating to a Series of Pledged Bonds, the Pledged Bonds of that Series; or
 - (ii) if such unreinvested proceeds are less than or equal to 10% of the Core Business Book Value, and BC Ferries would be unable to meet the Additional Indebtedness Test if it were to borrow an amount equal to such unreinvested proceeds, the unreinvested proceeds must be applied by BC Ferries to prepay outstanding Borrowings selected by BC Ferries (such prepayment to occur by prepayment, redemption or an Offer to Purchase);

provided that BC Ferries will not be required to apply unreinvested proceeds to the redemption of Bonds, the prepayment of Borrowings or an Offer to Purchase if, at the time such redemption, prepayment or Offer to Purchase would otherwise be required, the Leverage Ratio is less than 60% or if such unreinvested proceeds are less than or equal to 10% of the Core Business Book Value and BC Ferries would be able to meet the Additional Indebtedness Test if it were to borrow an amount equal to such unreinvested proceeds.

Insurance

BC Ferries is required to maintain insurance, including property insurance and comprehensive general insurance in such amounts and on such terms as are customarily held by passenger and vehicle ferry operators. The Indenture provides for the following in the case of damage to or destruction of assets of BC Ferries or its Designated Subsidiaries:

- (a) In the event of damage or destruction to a Major Vessel or a Major Ferry Terminal Property, the proceeds of insurance must be reinvested in the Coastal Ferry Business to the extent such reinvestment is necessary for BC Ferries to comply with the Coastal Ferry Services Contract, and any proceeds remaining after such mandatory reinvestment may be reinvested by BC Ferries in the Coastal Ferry Business in its discretion. To the extent any insurance proceeds are not reinvested in the Coastal Ferry Business (whether such reinvestment is mandatory or discretionary) within 12 months after such proceeds are received, then:
 - (i) if such unreinvested proceeds exceed 10% of the Coastal Ferry Business Book Value, the unreinvested proceeds must be applied by BC Ferries to the redemption, on a pro rata basis, of all Obligation Bonds (or, where required by the terms of the Supplemental Indenture authorizing a Series of Obligation Bonds, to fund an Offer to Purchase, on a pro rata basis, the Obligation Bonds of such Series instead of the redemption of Obligation Bonds of such Series) and, if so specified in the Supplemental Indenture relating to a Series of Pledged Bonds, the Pledged Bonds of that Series; or
 - (ii) if such unreinvested proceeds are less than or equal to 10% of the Coastal Ferry Business Book Value, and BC Ferries would be unable to meet the Additional Indebtedness Test if it were to borrow an amount equal to such unreinvested proceeds, the unreinvested proceeds must be applied by BC Ferries to prepay outstanding Borrowings selected by BC Ferries (such prepayment to occur by prepayment, redemption or an Offer to Purchase);

provided that BC Ferries will not be required to apply unreinvested proceeds to the redemption of Bonds, the prepayment of other Borrowings or an Offer to Purchase if, at the time such redemption,

prepayment or Offer to Purchase would otherwise be required, the Leverage Ratio is less than 60% or if such unreinvested proceeds are less than or equal to 10% of the Coastal Ferry Business Book Value and BC Ferries would be able to meet the Additional Indebtedness Test if it were to borrow an amount equal to such unreinvested proceeds.

- (b) In the event of any other damage to or destruction of assets of BC Ferries and its Designated Subsidiaries, BC Ferries may receive the proceeds and apply them in its discretion provided that it complies with the Coastal Ferry Services Contract.

The Indenture provides that the Trustee may maintain insurance on behalf of BC Ferries if BC Ferries fails to do so.

Events of Default

In addition to any specific Events of Default set out in any Supplemental Indenture which will apply to the related Series, the following shall constitute Events of Default under the Indenture:

- (a) failure to pay principal, interest, premium or other amounts on any Bond issued under the Indenture within five business days of the due date;
- (b) a Notice of Default is delivered to BC Ferries by the Province or BCTFA in respect of the Coastal Ferry Services Contract or a Ferry Terminal Lease for a Major Ferry Terminal Property or Notices of Default are delivered to BC Ferries by the Province or BCTFA in respect of Ferry Terminal Leases for Ferry Terminal Properties which, in the aggregate, represent 10% of the net book value of all assets represented by the Ferry Terminal Properties or are used for routes which, in the aggregate, represent 10% of the directly attributable revenues of BC Ferries and its Designated Subsidiaries on a consolidated basis in respect of the Coastal Ferry Business;
- (c) failure to maintain the amount required in the Debt Service Reserve Fund and such failure continues, in respect of amounts required to be deposited in the Debt Service Reserve Fund under the terms of the Indenture, for a period of 12 months or such other period as may be specified for a Series in the Supplemental Indenture with respect to such Series;
- (d) if any representation or warranty made by BC Ferries is untrue in any material respect and such misrepresentation continues for a period of 30 days or such longer period as may be required by BC Ferries to remedy the misrepresentation with all due diligence;
- (e) failure to comply with other obligations in the Indenture and such failure continues for a period of 30 days or such longer period as may be required by BC Ferries to remedy the default with all due diligence;
- (f) if proceedings are commenced for the dissolution, liquidation or winding up of BC Ferries or one or more Designated Subsidiaries (which owns a Major Vessel, is a lessee under a Ferry Terminal Lease for a Major Ferry Terminal Property or represents 10% or more of the assets or revenues of BC Ferries and its Designated Subsidiaries on a consolidated basis) under any bankruptcy or insolvency law or for the suspension of its operations unless such proceedings are being actively and diligently contested by BC Ferries or such Designated Subsidiary in good faith and have been stayed within 60 days;
- (g) if BC Ferries or one or more Designated Subsidiaries (which owns a Major Vessel, is a lessee under a Ferry Terminal Lease for a Major Ferry Terminal Property or represents 10% or more of the assets or revenues of BC Ferries and its Designated Subsidiaries on a consolidated basis) makes an assignment for the benefit of its creditors or applies to any court for the appointment of a receiver or trustee for itself or for any substantial portion of its property or commences or acquiesces in any proceeding under any bankruptcy, insolvency, reorganization, arrangement or readjustment of debt law or statute or any proceeding for the appointment of a receiver for itself or any substantial part of its property which is material to the conduct of its business, or suffers any receivership or trusteeship to remain undischarged for a period of 45 days or if BC Ferries or such Designated Subsidiary becomes or is declared bankrupt or unable to pay its debts as they become due;

- (h) a default by BC Ferries or any Designated Subsidiary in any payment relating to any Borrowing (other than under the Indenture) in a principal amount of not less than \$10 million which has not been remedied or cured by BC Ferries or such Designated Subsidiary within any applicable grace period relating to such Borrowing, unless such default has been cured or waived within ten days after the expiry of such applicable grace period or in any event prior to acceleration of the Bonds under the Indenture, or there is a default by BC Ferries or any Designated Subsidiary under any other term relating to any Borrowing in a principal amount of not less than \$10 million where the lender has accelerated such indebtedness;
- (i) an expropriation of all or substantially all of the assets of BC Ferries and its Designated Subsidiaries, or all or substantially all of the assets used by BC Ferries and its Designated Subsidiaries in the Coastal Ferry Business; or
- (j) if the holder of any Subordinated Debt commences proceedings to enforce payment of the Subordinated Debt in accordance with the terms of the Subordinated Debt.

Remedies

Upon the occurrence of an uncured Event of Default, the Trustee may, and if directed by a Bondholders' Request shall:

- (a) declare all Bonds outstanding under the Indenture to be immediately due and payable; and
- (b) enforce the Security or any part thereof.

Modification

Except as noted below, the Indenture or the Supplemental Indentures may be amended, varied or modified under the authority of an Extraordinary Resolution of the holders of the Bonds or by an instrument or instruments in writing signed by the holders of not less than 66⅔% of the principal amount of all Bonds outstanding, or if such amendment affects only the terms and conditions of one or more Series of Bonds, by an Extraordinary Resolution passed by the holders of each Series so affected, or by an instrument or instruments in writing signed by the holders of not less than 66⅔% of the principal amount of Bonds outstanding of each Series so affected, approving the amendments. The Indenture defines an Extraordinary Resolution as a resolution passed at a meeting of the holders of the Bonds duly convened for that purpose and held in accordance with the provisions of the Indenture, by the affirmative vote of not less than 66⅔% of the votes cast in respect of such resolution, or if so provided in a Supplemental Indenture, passed by the holders of Bonds of that Series then outstanding satisfying the requirements of that Supplemental Indenture.

A Special Resolution is required in order to amend or otherwise vary certain defined terms, sections and provisions in the Indenture, any power exercisable by a written direction of a bondholder, the Security provided or granted to the Trustee by BC Ferries or the pari passu ranking of the Bonds. The Indenture defines a Special Resolution as a resolution in writing or passed at a meeting of the holders of Bonds of all Series affected by the subject matter of the resolution duly convened for that purpose and held in accordance with the provisions of the Indenture, and passed by the holders of Bonds of all Series affected by the subject matter of the resolution representing not less than 90% of the votes cast in respect of such resolution, or if so provided in a Supplemental Indenture, passed by the holders of Bonds of that Series then outstanding satisfying the requirements of that Supplemental Indenture.

The quorum for any meeting of the holders of Bonds or a Series will be one or more holders representing more than 50% of the principal amount of outstanding indebtedness evidenced or secured by Bonds or Bonds of such Series then outstanding, present in person or represented by proxy. If due to a lack of quorum, however, a meeting of holders of Bonds or a Series of Bonds is adjourned, the quorum at the adjourned meeting will be those holders of Bonds or a Series of Bonds present in person or by proxy, notwithstanding that they do not represent more than 50%.

The Trustee may also consent, without the consent of the holders of the Bonds, to certain modifications of the Indenture or the Supplemental Indentures which in the opinion of counsel do not prejudice the interests of such holders.

Defeasance

The Indenture provides that BC Ferries may deposit with the Trustee as trust funds in trust, specifically pledged as security for and dedicated solely to the benefit of the holders of all outstanding Bonds or all outstanding Bonds of a particular Series, money or non-callable obligations in the currency of such Bonds and which are obligations of, or unconditionally guaranteed by the central government of the country in whose currency such Bonds are denominated and which, through the scheduled payment of principal and interest in the case of government obligations provide money in an amount sufficient (and in the currency of and not later than the due date of any payment on the relevant Bonds, and after deducting any taxes payable on income or capital gains on amounts invested) to pay and discharge when due the principal of, premium, if any, and interest on such Bonds, and BC Ferries shall irrevocably direct the Trustee to apply such money and/or proceeds of such government obligations to such payments with respect to such Bonds. BC Ferries is also required to deliver an opinion of Canadian and US tax counsel to the effect that the holders of the relevant Bonds shall be subject to Canadian and United States federal income tax as if such deposit and defeasance had not occurred. In such case, BC Ferries shall be discharged and released from all of its obligations to the holders of such Bonds and any security in respect of such Bonds (other than the money and government obligations deposited with the Trustee to defease such Bonds) shall be released and the sole right of the holders of such Bonds shall be to receive, from such trust fund established to defease such Bonds, payments in respect of the principal of, premium, if any, and interest on such Bonds when such payments are due.

Definitions

Certain defined terms used in the Indenture are set forth below. Reference is made to the Indenture for full definitions of all such terms as well as any other capitalized terms used in “Capital Markets Platform” or “Details of the Offering” for which no definition is provided.

“**Additional Indebtedness**” means on any date on or after the date of the Indenture:

- (a) an agreement entered into by BC Ferries or a Designated Subsidiary on that date pursuant to which an obligation may be incurred; or
- (b) an obligation created, incurred or assumed by BC Ferries or a Designated Subsidiary on that date, other than an obligation created, incurred or assumed pursuant to an agreement entered into by BC Ferries or a Designated Subsidiary before that date if such prior obligation already comprises Borrowings of BC Ferries or such Designated Subsidiary; or
- (c) the redesignation by BC Ferries on that date of all or part of a Credit Facility, such that it ceases to be a Restricted Credit Facility,

provided:

- (d) the agreement, obligation or redesignation causes an increase in Borrowings at the time it is entered into, created, incurred, assumed or redesignated, and is not an agreement or obligation between BC Ferries and a Designated Subsidiary or between Designated Subsidiaries; and
- (e) as a result, the Borrowings of BC Ferries or a Designated Subsidiary (reduced by the balances, if any, then held in any Series Sinking Funds) increase on that date.

“**Adverse Rating Effect**” means at any time:

- (a) the withdrawal of a rating, or reduction below the then current rating, for any outstanding Obligation Bonds by any Rating Agency which, at such time, has a current rating on any such outstanding Obligation Bonds; or

- (b) the placement of BC Ferries or any outstanding Obligation Bonds on credit watch (other than with positive implications) or an adverse change in the credit outlook for BC Ferries or any outstanding Obligation Bonds by any such Rating Agency;

provided that an Adverse Rating Effect shall be deemed not to have occurred so long as BC Ferries and all outstanding Obligation Bonds have ratings of at least A– with a stable outlook or the equivalent thereof by each of the Rating Agencies rating the Bonds.

“**Attributable Indebtedness**” in respect of a Sale/Leaseback Transaction or a Lease/Leaseback Transaction means, as at the time of determination, the amount of Capital Lease Obligations under such lease where such lease is a Capital Lease or the amount of the Capitalized Operating Lease Obligations under such lease where such lease is a Capitalized Operating Lease.

“**Bondholders’ Request**” means an instrument requesting the Trustee to take or refrain from taking some action or proceeding as specified therein, signed in one or more counterparts by the holder or holders of Bonds representing not less than 25% of the principal amount of all Bonds then outstanding, a resolution passed by holders of outstanding Bonds representing more than 50% of the votes cast in respect of such resolution at a meeting or, if so provided in any Supplemental Indenture relating to a Series of Bonds passed by the holders of Bonds of that Series then outstanding satisfying the requirements of that Supplemental Indenture.

“**Bonds**” means all Obligation Bonds and Pledged Bonds (as such terms are defined in the second paragraph under “Capital Markets Platform”) issued pursuant to the Indenture and any Supplemental Indenture.

“**Borrowing**” means (without duplication), with respect to any person at any time, whether recourse is to all or a portion of the assets of such person and whether or not contingent:

- (a) every obligation for borrowed money;
- (b) subject to certain provisions of the Indenture relating to Pledged Bonds, every obligation evidenced by bonds, debentures, notes or other similar instruments;
- (c) every reimbursement obligation with respect to letters of credit, letters of guarantee, bankers’ acceptances or similar instruments:
 - (i) due or owing, where such instruments have been issued as assurance of performance of obligations (except for other Borrowings) in the ordinary course of business; and
 - (ii) whether or not due or owing, where such instruments have been issued in any other circumstance;
- (d) Purchase Money Obligations;
- (e) Capital Lease Obligations;
- (f) Capitalized Operating Lease Obligations;
- (g) every obligation issued or assumed as the deferred purchase price of property or services (but excluding trade accounts payable or expenses incurred in the ordinary course of business), net of payments and prepayments;
- (h) all obligations under any conditional sale or other title retention agreements with respect to any property;
- (i) every swap agreement relating to the hedging of a Borrowing, provided that for purposes of determining the amount of Borrowings outstanding at any time in respect of such swap agreement, there shall be included as Borrowings the net amount (positive or negative) that would be carried in the accounts of such person at that time with respect to such agreements as a liability in accordance with generally accepted accounting principles;
- (j) the maximum amount of every obligation of the type referred to in paragraphs (a) to (h) above that may be available to such person pursuant to any agreement or instrument (other than any undrawn amount under any Restricted Credit Facility) whether or not the conditions precedent to availability under such agreement or instrument have been met; and

(k) Guarantees by such person of obligations of any other person of the type referred to in this definition, provided, however, that Borrowings shall not include Subordinated Debt, any Borrowings between BC Ferries and its Designated Subsidiaries or any liability for deferred income taxes.

“**Capital Lease**” means any lease of property of any nature of a person which, in accordance with generally accepted accounting principles, is required to be classified and accounted for on the balance sheet of such person as an asset.

“**Capital Lease Obligations**” means the obligations of a person to pay rent or other amounts under a lease which is classified and accounted for as a Capital Lease on the balance sheet of such person and, for purposes of the Indenture, the amount of such obligations shall in each case be the capitalized amount thereof, but excluding rent which is prepaid under the Ferry Terminal Leases as at the date of the Indenture.

“**Capitalized Operating Lease**” means a lease of a Vessel, a major component of a Vessel or a lease of a Ferry Terminal Property or an Other Ferry Terminal Property, in each case where the original term of the lease and any mandatory renewals is five years or more and where such lease is not a Capital Lease.

“**Capitalized Operating Lease Obligations**” means the capitalized obligation of a person to pay rent or similar amounts (including taxes on rent or similar amounts, but excluding amounts determined by BC Ferries, acting reasonably, to be allocable to other taxes, utilities and operating costs) under a Capitalized Operating Lease, the amount of such capitalized obligation to be determined by deeming any such Capitalized Operating Lease (notwithstanding its accounting treatment under generally accepted accounting principles) to be a Capital Lease for the purposes of this calculation, but excluding rent which is prepaid under the Ferry Terminal Leases as at the date of the Indenture.

“**Coastal Ferry Business**” means the ownership and leasing (as tenant or lessee) and operation of the Vessels and Ferry Terminal Properties used in the BC Ferry System (as defined in the Coastal Ferry Services Contract) and any other coastal ferry route between two terminals in British Columbia.

“**Coastal Ferry Business Book Value**” means the net book value of the fixed assets of BC Ferries and its Designated Subsidiaries used in the Coastal Ferry Business.

“**Collateral**” means all of the property and assets of BC Ferries and any Designated Subsidiaries and all proceeds thereof.

“**Consolidated Net Income**” means, for any relevant period, the net income or net loss reported in the quarterly and annual consolidated statement of income included in the consolidated financial statements of BC Ferries most recently issued or approved by its Board of Directors prepared in accordance with generally accepted accounting principles.

“**Core Business**” means the following businesses and services:

- (a) the management, operation, maintenance, repair and development of ferry terminals;
- (b) the acquisition, management, operation, maintenance and repair of vessels to provide ferry services; and
- (c) such other business or service which, in the opinion of BC Ferries, acting reasonably, is related, ancillary or complementary to the businesses and services set forth in subsections (a) and (b).

“**Core Business Book Value**” means the net book value of the fixed assets of BC Ferries and its Designated Subsidiaries used in the Core Business.

“**Crown Corporation**” means a corporation which is a “government corporation” under the *Financial Administration Act* (British Columbia).

“**Debt Service**” means, for any date, the sum of the Net Interest Amount, the Total Principal Reduction Amount and Rent for the one year period ending on that date.

“**Debt Service Coverage Ratio**” means, on any date, the ratio of (a) EBITDAR less Income Taxes to (b) Debt Service, calculated on a consolidated basis for BC Ferries and its Designated Subsidiaries for the four fiscal

quarters ending on the last day of the most recent fiscal quarter for which quarterly or annual financial statements are issued or are required to have been issued by BC Ferries or have been approved by the Board of Directors of BC Ferries.

“**Designated Subsidiary**” means each wholly-owned subsidiary which has been designated by BC Ferries in accordance with the terms of the Indenture.

“**Discretionary Expenditures**” means any expenditure by BC Ferries or any Designated Subsidiary which is not an expenditure in the ordinary course of business in relation to operating costs, maintenance capital expenditures, taxes, Rent or payment of Debt Service as it becomes due.

“**Distribution**” by a person means:

- (a) any dividend or distribution on or in respect of the shares of such person (including any payment in connection with any merger or consolidation) to the direct or indirect holders of its shares (except dividends or distributions payable solely in shares or in options, warrants or other rights to purchase shares, and except dividends or distributions payable by a Designated Subsidiary to BC Ferries or another Designated Subsidiary);
- (b) any purchase, redemption, acquisition or retirement for value with respect to any shares of such person or any direct or indirect parent of such person (except purchases, redemptions, acquisitions or retirements for value with respect to any shares of a Designated Subsidiary); and
- (c) any payments made on account or in respect of any Subordinated Debt.

“**EBITDAR**” means, for any relevant period and without duplication, the Consolidated Net Income for such period,

plus:

- (a) the net loss of Non-Designated Subsidiaries deducted in calculating Consolidated Net Income;
- (b) the aggregate consolidation adjustments that were deducted in calculating Consolidated Net Income in respect of transactions between Non-Designated Subsidiaries and, as the case may be, BC Ferries or Designated Subsidiaries;
- (c) Net Interest Amount;
- (d) Income Taxes;
- (e) amounts deducted in calculating Consolidated Net Income in respect of depreciation and amortization of BC Ferries and Designated Subsidiaries;
- (f) amounts deducted in calculating Consolidated Net Income in respect of Rent payable by BC Ferries and Designated Subsidiaries;
- (g) cash dividends received by BC Ferries and Designated Subsidiaries from Non-Designated Subsidiaries which have not otherwise been included in Consolidated Net Income;
- (h) non-cash items deducted in calculating Consolidated Net Income in respect of write-downs of Vessels and losses realized on the disposition of vessels to the extent such losses were deducted in calculating Consolidated Net Income;
- (i) amounts deducted in calculating Consolidated Net Income in respect of extraordinary items of BC Ferries and Designated Subsidiaries; and
- (j) amounts deducted in calculating Consolidated Net Income in respect of interest on Subordinated Debt payable by BC Ferries and Designated Subsidiaries;

minus:

- (j) the net income of and any other amount relating to Non-Designated Subsidiaries added in the calculation of Consolidated Net Income, other than cash dividends received by BC Ferries and its Designated Subsidiaries;

- (k) the aggregate consolidation adjustments that were added in calculating Consolidated Net Income in respect of transactions between Non-Designated Subsidiaries and, as the case may be, BC Ferries or Designated Subsidiaries;
- (l) non-cash items added in calculating Consolidated Net Income in respect of write-ups of Vessels, and proceeds of disposition of Vessels in excess of their respective book value to the extent such excess was added in calculating Consolidated Net Income; and
- (m) amounts added in calculating Consolidated Net Income in respect of extraordinary items of BC Ferries and Designated Subsidiaries;

all of which shall be calculated in accordance with generally accepted accounting principles unless otherwise expressly described.

“Ferry Terminal Leases” means the leases entered into by BC Ferries as tenant pursuant to the Master Agreement with respect to certain Ferry Terminal Properties, as amended or supplemented from time to time.

“Ferry Terminal Properties” means those properties leased to BC Ferries under the Ferry Terminal Leases and any other real property from time to time acquired or leased by BC Ferries or any Designated Subsidiary for use as a ferry terminal for the purposes of operating the Coastal Ferry Business.

“Forecast Debt Service” means, at any date, the amount, determined by BC Ferries, acting reasonably and using reasonable assumptions, equal to the sum of the Gross Interest Obligations and Principal Reduction Amount for a particular Series of Bonds or for all Obligation Bonds, as the context may require, for such period as the context may require.

“Gross Interest Obligations” means, without duplication, with respect to any period, the total amount of (a) interest, fees and other amounts accrued as or in the nature of interest on Borrowings (including Capital Leases) by BC Ferries and its Designated Subsidiaries in that period, in accordance with generally accepted accounting principles and (b) amounts paid or payable by BC Ferries or any Designated Subsidiary in respect of swap agreements included in Borrowings to the extent such amounts reflect a swap or hedge in respect of interest on Borrowings; but excluding (v) any amount which constitutes Rent, (w) any rent which has been prepaid under the Ferry Terminal Leases as at the date of this Indenture, (x) interest on Subordinated Debt, (y) legal, consultant’s and other costs (but excluding commitment or similar fees) incurred in the ordinary course of business in connection with the negotiation and documentation of transactions by which such Borrowings are incurred and (z) any make-whole premium on the redemption of any Borrowing which is not amortized over the term of any subsequent Borrowing in accordance with generally accepted accounting principles; provided that for the purpose of calculating Forecast Debt Service for a particular Series of Bonds, “Gross Interest Obligations” shall be the total amount of interest, fees and other amounts accrued on or in the nature of interest on such Series of Bonds for the relevant period.

“Gross Interest Receivables” means, with respect to any period, the total amount of interest, fees and other amounts accrued as revenue of BC Ferries or a Designated Subsidiary in that period on the credit balance of any fund or account established pursuant to the Indenture or any Supplemental Indenture and any amounts received or receivable by BC Ferries or a Designated Subsidiary in respect of swap agreements included in Borrowings to the extent such amounts reflect a swap or hedge in respect of interest on Borrowings.

“Guarantee” by any person means any obligation (other than an endorsement in the ordinary course of business of negotiable instruments for deposit or collection) of such person guaranteeing, or in effect guaranteeing, any Borrowings or other obligation of any other person (the “primary obligor”) in any manner, whether directly or indirectly, including any obligation incurred through an agreement, contingent or otherwise, by such person:

- (a) to purchase such Borrowings or obligation or any property or assets constituting security therefor;
- (b) to advance or supply funds (i) for the purchase or payment of such Borrowings or obligation, (ii) for the purpose of maintaining working capital, net worth or other balance sheet condition of the primary obligor, or (iii) otherwise to advance or make available funds for the purchase or payment of such Borrowings or obligation;

- (c) to lease property or to purchase securities or other property or services primarily for the purpose of assuring the owner of such Borrowings or obligation of the ability of the primary obligor to make payment of the Borrowings or obligation; or
- (d) otherwise to assure or indemnify the owner of the Borrowings or obligation of the primary obligor against loss in respect thereof.

For the purposes of all computations made under the Indenture, a Guarantee in respect of any Borrowings shall be deemed, without duplication, to be equal to the principal amount of such Borrowings and any capitalized interest thereon (and any other amount which becomes due and owing) which has been guaranteed, and a Guarantee in respect of any other obligation or liability shall be deemed to be Borrowings equal to the maximum aggregate amount of such obligation or liability unless the Guarantee provides for a maximum liability (whether or not with interest on unpaid amounts thereunder), in which case the Guarantee shall be deemed to be equal to such maximum liability.

“Income Taxes” means amounts deducted in calculating Consolidated Net Income in respect of income taxes of BC Ferries and Designated Subsidiaries.

“Investment” means any investment, in cash or by delivery of property, made directly or indirectly in any person whether by acquisition of securities, indebtedness or other obligations or by loan, advance, capital contribution, granting of financial assistance or otherwise; provided, however, that “Investment” shall not include a routine investment in property to be used or consumed in the ordinary course of business.

“Lease/Leaseback” means an arrangement under which any property or asset is leased by BC Ferries or any Designated Subsidiary to some other person which (for consideration) leases or otherwise gives or grants the right to use such property or asset to BC Ferries or any Designated Subsidiary, regardless of the accounting treatment of such arrangement.

“Leverage Ratio” means, on any date, the ratio of aggregate Borrowings to the sum of aggregate Borrowings and consolidated shareholders’ equity of BC Ferries and its Designated Subsidiaries, calculated on a consolidated basis for BC Ferries and its Designated Subsidiaries on the last day of the most recent fiscal quarter for which quarterly or annual financial statements are issued, or are required to have been issued, by BC Ferries or have been approved by the Board of Directors of BC Ferries.

“Lien” means any mortgage, lien, pledge, assignment, charge, security interest, title retention agreement intended as security, hypothec, execution, seizure, attachment, garnishment or other similar encumbrance.

“Major Ferry Terminal Property” means any Ferry Terminal Property used to provide ferry transportation services on a Major Route, as from time to time amended, but in any event including the Ferry Terminal Properties located at Tsawwassen, Swartz Bay, Duke Point, Departure Bay and Horseshoe Bay.

“Major Route” means a route described as a “Major Route” in the Coastal Ferry Services Contract (including Schedule “A” to that contract), but in any event including any route between two Major Ferry Terminal Properties.

“Major Vessel” means any Vessel designated by BC Ferries, acting reasonably, as a Vessel which is principally used on one or more Major Routes, taking into account seasonal rotation, maintenance rotation and interchangeability of Vessels which may be used for temporary service on a route.

“Master Agreement” means the agreement dated for reference April 1, 2003 and effective March 31, 2003 made between the BCTFA, BC Ferries, the Province as represented by Land and Water British Columbia Inc. and the Province as represented by the Minister of Transportation with respect to, inter alia, the entering into of the Ferry Terminal Leases, as amended by agreement dated April 1, 2003 and as may be further amended and supplemented from time to time.

“Material Contracts” means:

- (a) the Coastal Ferry Services Contract;
- (b) the Master Agreement;

- (c) the Ferry Terminal Leases in respect of the Major Ferry Terminal Properties;
- (d) the Acknowledgement Agreement; and
- (e) any other contract which may be so designated in a Supplemental Indenture.

“**Minor Route**” means a designated ferry route under the Coastal Ferry Services Contract other than a Major Route.

“**Net Interest Amount**” means, with respect to any period, the Gross Interest Obligations for such period less the Gross Interest Receivables for such period or, in the case of prospective calculations, the estimated Gross Interest Obligations for such period less the estimated Gross Interest Receivables for such period.

“**Non-Designated Subsidiary**” means any subsidiary of BC Ferries which is not a Designated Subsidiary.

“**Offer to Purchase**” means an offer by BC Ferries to purchase up to the principal amount of a Series of Obligation Bonds specified in the offer at the redemption price for such Bonds.

“**Other Ferry Terminal Property**” means any real property from time to time acquired or leased by BC Ferries or any Designated Subsidiary for use as a ferry terminal for a purpose other than operating the Coastal Ferry Business.

“**Permitted Borrowings**” means:

- (a) a Restricted Credit Facility; and
- (b) Borrowings other than any Restricted Credit Facility (including Refunding Bonds) which are incurred, or the proceeds of which are used, to renew, extend, repay, redeem, purchase, refinance or refund (each, a “refinancing”, and “refinance” and “refinanced” shall have corresponding meanings) any Borrowings of BC Ferries or any Designated Subsidiary outstanding on the date of the Indenture or permitted to be incurred pursuant to the Indenture, provided that:
 - (i) the Borrowing (a “new Borrowing”) which is incurred to refinance a particular Borrowing (the “existing Borrowing”) shall not exceed the amount of the existing Borrowing which is so refinanced, plus the expenses of BC Ferries or the Designated Subsidiary incurred in connection with such refinancing (but excluding any make-whole or other premium); and
 - (ii) either:
 - (A) the refinancing occurs not more than two years before the maturity date of the existing Borrowing; or
 - (B) the term and average life of the new Borrowing are at least as long as the remaining term and average life of the existing Borrowing, and the present value of all principal and interest payments under the new Borrowing (discounted at the interest rate on the existing Borrowing), plus the amount of any make-whole or other premium payable upon repayment of the existing Borrowing, is less than or equal to the principal of and accrued interest on the existing Borrowing immediately prior to the repayment of the existing Borrowing.

“**Permitted Investments**” means:

- (a) Canadian dollar deposits with or promissory notes, bills of exchange or other debt securities of or unconditionally guaranteed or accepted by the Government of Canada or by a Bank or by any province of Canada;
- (b) interest bearing deposits or certificates of deposit or similar arrangements having a remaining term to maturity not greater than one year with, or discount debt obligations having a remaining term to maturity not greater than one year issued, accepted or guaranteed by, any bank, trust company or other regulated deposit taking institution in Canada, the long term debt of which has a rating of at least A – or the equivalent thereof for such debt by one of the Rating Agencies, if such debt is rated by only one of the Rating Agencies, or in any other case, by at least two of the Rating Agencies; and

- (c) indebtedness of any issuer (including any corporation) with a remaining term to maturity not to exceed one year, the long term debt of which has a rating of at least A – or the equivalent thereof for long term debt by one of the Rating Agencies, if such debt is rated by only one of the Rating Agencies, or in any other case, by at least two of the Rating Agencies, or the short term debt of which is rated in one of the highest three sub-categories for short term debt by one of the Rating Agencies, if such debt is rated by only one of the Rating Agencies, or in any other case, by at least two of the Rating Agencies.

“Principal Reduction Amount” means, with respect to any period, the total amount of principal paid or payable on Borrowings (or, for the purpose of calculating the Forecast Debt Service for a particular Series of Bonds, the total principal paid or payable in respect of such Series of Bonds) by BC Ferries and its Designated Subsidiaries in that period, including principal in respect of Capital Leases and any mandatory deposit or contribution to a Sinking Fund in that period, but excluding (a) any principal payment in such period in respect of a Borrowing which, by its terms, is payable in a single instalment upon maturity, (b) any principal payment which is the last payment in a series of amortizing payments the amount of which is materially greater than the amount of the payments in such series in respect of a Borrowing which matures in such period, provided that an amount equal to what would otherwise have been the next payment in the series of amortizing payments shall be included, (c) any amounts which constitute Rent and (d) any rent which has been prepaid under the Ferry Terminal Leases as at the date of the Indenture.

“Purchase Money Obligations” means any Borrowings representing any unpaid part of, or incurred or assumed to pay the whole or any part of, the cost of acquisition, development or construction of any property or asset acquired by BC Ferries or any Designated Subsidiary and intended to be used in carrying on the business of BC Ferries or any Designated Subsidiary and any expenditures made for accessions thereto, if such Borrowing is incurred or assumed within six months after the acquisition, development or construction of such property or asset and is financially of advantage to BC Ferries or any Designated Subsidiary.

“Rating Agencies” means Moody’s Investor Service, Inc., Standard & Poor’s Ratings Service, Dominion Bond Rating Service Limited and any other nationally recognized credit rating agency approved by an Extraordinary Resolution and specified in a Supplemental Indenture, and **“Rating Agency”** means any one of them.

“Rent” means, with respect to any period, obligations in the nature of a principal reduction or interest which would be payable on any Capitalized Operating Lease if such lease were accounted for as a Capital Lease, but excludes any rent which has been prepaid under the Ferry Terminal Leases as at the date of the Indenture.

“Restricted Credit Facility” means a credit facility or part thereof entered into by BC Ferries or a Designated Subsidiary and exclusively allocated by BC Ferries or such Designated Subsidiary for the repayment of the principal amount of any Borrowings or to secure the repayment thereof.

“Sale/Leaseback” means an arrangement under which title to any property or asset, or an interest therein, is transferred by BC Ferries or any Designated Subsidiary to some other person which (for consideration) leases or otherwise gives or grants the right to use such property or asset or interest therein to BC Ferries or any Designated Subsidiary whether or not in connection therewith the transferor also acquires a right or is subject to an obligation to re-acquire the property, asset or interest, and regardless of the accounting treatment of such arrangement.

“Subordinated Debt” means indebtedness for borrowed money owing by BC Ferries to any person which is fully subordinated and postponed to all outstanding Bonds whether such Bonds are outstanding at the time such indebtedness is incurred or are issued any time thereafter, is unsecured, permits any payment in respect thereof (including principal and interest) to be made if, and only if, the amount of such payment could then be made as a Distribution under the Indenture but not where there is a default under senior indebtedness, permits payment of interest to be deferred by BC Ferries for at least 27 months and precludes any action to enforce rights of the holder in the event of a default on such indebtedness for a period of 36 months following such event of default or during the continuance of any Event of Default under the Indenture.

“Total Principal Reduction Amount” means, for any period, the total of all Principal Reduction Amounts in that period.

“Vessels” means the vessels and their various major components owned or leased by BC Ferries, or any of its Designated Subsidiaries.

Credit Facility

In conjunction with the entering into of the Indenture, BC Ferries will enter into a credit facility with a syndicate of Canadian banks (the “Credit Facility”) which will be secured under the Capital Markets Platform. Under the Credit Facility, BC Ferries will be provided with a 364 day revolving operating facility with a one year term-out in an amount up to \$77.5 million (“Tranche A”), a three-year revolving extendible facility in an amount up to \$77.5 million (“Tranche B”) and a \$200 million two year non-revolving bridge term facility (“Tranche C”). Tranche A and Tranche B will be available for working capital purposes, including to fund the Series Reserve Account for Tranche C, to fund the upgrade and acquisition of vessels and terminal upgrades and other general corporate uses and Tranche C will be used to repay, in part, obligations to the Province and to fund the Series Reserve Accounts under the Indenture and the Supplemental Indentures. BC Ferries will be required to apply (i) the proceeds of any issuance of Obligation Bonds after the issue of the Series 04-1 Bonds, and (ii) proceeds of disposition, insurance and expropriation which BC Ferries is permitted to retain, to the permanent repayment of obligations outstanding under Tranche C until such obligations are paid in full.

The Credit Facility will contain customary provisions such as representations and warranties, affirmative and negative covenants, conditions precedent and events of default. The Credit Facility agreement will not contain material restrictions on BC Ferries in addition to those contained in the Indenture, except that, under the Credit Facility Agreement, BC Ferries must maintain a minimum Debt Service Coverage Ratio of 1.50:1. It is an event of default if BC Ferries ceases to be at least 51% owned by the BCFA or the Province and BC Ferries may not pay dividends on Common Shares until Tranche C is repaid.

The Credit Facility agreement will provide for various margins over certain benchmark interest rates, including the Canadian prime rate, the U.S. base rate, the bankers’ acceptance rate and LIBOR for the purpose of calculating interest rates and fees payable on the obligations and commitments under the Credit Facility, and the applicable margin will be determined by reference to BC Ferries’ credit rating from time to time.

Debt Service Reserve Account

BC Ferries will establish a Series Reserve Account in an amount equal to six months Forecast Debt Service on all amounts outstanding under Tranche C. In the event that the Debt Service Coverage Ratio is less than 1.75:1, BC Ferries must, prior to making any Discretionary Expenditures and within a 12 month period, increase the amount in the Series Reserve Account to an amount equal to nine months Forecast Debt Service for Tranche C. In the event that the Debt Service Coverage Ratio is less than 1.5:1, BC Ferries must, prior to making any Discretionary Expenditures and within a 12 month period, increase the amount in the Series Reserve Account to an amount equal to 12 months Forecast Debt Service for Tranche C. In lieu of a Series Reserve Account on Tranches A and B, BC Ferries will leave undrawn an amount equal to interest at the prime rate on the Tranche A and B commitments for six months, nine months or 12 months in the circumstances described above for the Series Reserve Account for Tranche C.

Security

The Credit Facility will be secured by the issuance to the administrative agent for the lenders under the Credit Facility of a Pledged Bond issued under a Supplemental Indenture to the Indenture (the “Pledged Bond Indenture”). In the event of a default under the Credit Facility agreement, the lenders will be entitled to the remedies described under “Indenture — Remedies” above and the Pledged Bond Indenture will provide for the ability of the holder of the Pledged Bond to make a Bondholders’ Request.

The Indenture provides that a Pledged Bond and the pledge related thereto will be subject to the following conditions:

- (a) a Pledged Bond will not be transferable or negotiable except to an assignee of the Borrowings secured by such bond and only in conjunction with an assignment of the related pledge or the entering into of a new pledge complying with the provisions of the Indenture;

- (b) notwithstanding the principal amount of a Pledged Bond or the interest rate expressed to be payable thereon, such Pledged Bond will constitute an obligation of BC Ferries only to the extent of the lesser of (i) the outstanding amount of the Borrowings secured by such Pledged Bond, and (ii) the principal amount of such Pledged Bond and interest accrued thereon;
- (c) at any meeting of the Bondholders or in respect of any Extraordinary Resolution, the holder of a Pledged Bond will be entitled to that number of votes which the holder of an Obligation Bond in an amount equal to such lesser amount in clause (b) above would be entitled; and
- (d) all rights of the holder of a Pledged Bond will be divisible with respect to the Borrowings secured thereby.

Acknowledgement Agreement

The Province, the BCTFA, BC Ferries and the Trustee will enter into an Acknowledgement Agreement pursuant to which the Province and the BCTFA will acknowledge and agree, amongst other things, that:

- (a) BC Ferries intends, as security for the observance and performance by BC Ferries of its obligations under the Indenture and any Supplemental Indenture, to assign all of its right, title and interest in the Coastal Ferry Services Contract and the Master Agreement to the Trustee for the benefit of the holders of the Bonds;
- (b) BC Ferries intends, as security for the observance and performance by BC Ferries of its obligations under the Indenture and any Supplemental Indenture, to mortgage by way of sublease to the Trustee for the benefit of the holders of the Bonds, all right, title and interest in each of the Terminal Leases;
- (c) the Trustee will have the right upon an Event of Default under the Indenture to take possession of the Collateral and to appoint a receiver to operate the business of BC Ferries in accordance with the terms of the Coastal Ferry Services Contract;
- (d) the Trustee or receiver will have the right to cure defaults under the Coastal Ferry Services Contract and the Terminal Leases within the time periods provided in the Acknowledgement Agreement;
- (e) subject to certain exceptions, the Province and BCTFA will not exercise their remedies (including any remedies under the Terminal Leases) upon the occurrence of an Event of Default under the Coastal Ferry Services Contract or Terminal Leases so long as the receiver appointed by the Trustee is using reasonable commercial efforts to conduct the business of BC Ferries in accordance with the terms of the Coastal Ferry Services Contract and the Terminal Leases;
- (f) if there is a service default (defined as the failure to provide services on a route in accordance with the core service level for that route under the Coastal Ferry Services Contract, except as permitted by that contract) in respect of a particular route and the Trustee or a receiver has not commenced rectification of such default within the time period required or is no longer diligently proceeding with rectification of such default, then after notice, unless such default is cured, the Province may terminate such route and any Terminal Lease used exclusively for such route and shall concurrently exercise its option to purchase vessels used on such route;
- (g) if there are service defaults in respect of Minor Routes which represent 50% of the directly attributable revenue of all Minor Routes and the Trustee or a receiver has not commenced rectification of such defaults within the time period required or is no longer diligently proceeding with rectification of such defaults, then after notice, unless such defaults are cured, the Province may terminate all Minor Routes and any Terminal Leases used exclusively for Minor Routes and shall concurrently exercise its option to purchase vessels used on Minor Routes;
- (h) if there are service defaults on routes which represent 50% of the directly attributable revenue from all routes and the Trustee or a receiver has not commenced rectification of such defaults within the time period required or is no longer diligently proceeding with rectification of such defaults, then after notice, unless such defaults are cured, the Province may terminate all routes under the Coastal Ferry

Services Contract and all Terminal Leases and shall concurrently exercise its option to purchase all vessels;

- (i) the termination of a particular route or Terminal Lease by the Province or BCTFA will eliminate any requirement in the Coastal Ferry Services Contract to provide services on such route or routes to or from the Ferry Terminal Property which is the subject of the terminated Terminal Lease; and
- (j) if, following the occurrence of an event of default under the Coastal Ferry Services Contract or under a Terminal Lease, there is a disruption in the provision of services under the Coastal Ferry Services Contract that is not a temporary service disruption (as defined in the Coastal Ferry Services Contract), or there is a disruption as a result of an event of force majeure and the Province is in a materially better position than BC Ferries to restore the disrupted services during the continuance of the event of force majeure, the Province may assume management of the operations of BC Ferries in accordance with the terms of the Acknowledgement Agreement until the appointment of a receiver by the Trustee.

DETAILS OF THE OFFERING

The Series 04-1 Bonds

The securities offered by this prospectus consist of \$250 million aggregate principal amount of 5.74% Senior Secured Bonds, Series 04-1, due May 27, 2014. The Series 04-1 Bonds are Obligation Bonds and are being issued pursuant to the Capital Markets Platform described under “Capital Markets Platform” and are governed by the Indenture and the Supplemental Indenture authorizing the Series 04-1 Bonds. The following is a summary of the material attributes and characteristics of the Series 04-1 Bonds, which does not purport to be complete. For full particulars, reference should be made to the Indenture and to the Supplemental Indenture authorizing the Series 04-1 Bonds.

The Series 04-1 Bonds will be issued pursuant to the Supplemental Indenture to be dated the date of issuance of the Series 04-1 Bonds between BC Ferries and the Trustee providing for the creation and issue of the Series 04-1 Bonds. The aggregate principal amount of the Series 04-1 Bonds which may be issued under the Supplemental Indenture will be limited to \$250 million. The Series 04-1 Bonds will be direct obligations of BC Ferries secured in the manner provided for under the Indenture. See “Capital Markets Platform — Indenture”. The Series 04-1 Bonds will rank *pari passu* with all present and future indebtedness of BC Ferries issued pursuant to the Capital Markets Platform, subject to the Series Reserve Account and any Sinking Funds established for any particular series of Bonds.

The Series 04-1 Bonds will be dated May 27, 2004, will bear interest at the rate of 5.74% per annum from and including the date of issue of such Series 04-1 Bonds, payable on May 27 and November 27 of each year commencing on November 27, 2004, and will mature on May 27, 2014.

Form and Denomination

The Series 04-1 Bonds will be issued in “book-entry only” form and beneficial interests therein must be purchased or transferred through participants (“Participants”) in the depository service of The Canadian Depository for Securities Limited (“CDS”) or such other person who is designated in writing by BC Ferries to act as depository. On the issue of the Series 04-1 Bonds, BC Ferries will cause a global certificate representing such Series 04-1 Bonds (the “Global Bond”) to be delivered to, and registered in the name of, CDS or its nominee. Except as described below, no purchaser of a beneficial interest in the Series 04-1 Bonds will be entitled to a certificate or other instrument from BC Ferries or CDS evidencing that purchaser’s ownership thereof, and no holder of a beneficial interest in the Series 04-1 Bonds will be shown on the records maintained by CDS except through a book-entry account of a Participant acting on behalf of such holder. The ability of a holder having a beneficial interest in the Series 04-1 Bonds outstanding in “book-entry only” form to pledge such interest or otherwise take action with respect to such interest (other than through a Participant) may be limited due to the lack of a physical certificate.

BC Ferries and the Trustee do not and will not have any liability for the records maintained by CDS relating to beneficial interests in the Series 04-1 Bonds or the book-entry accounts maintained by CDS, or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests, or any advice

or representation made or given by CDS or made or given herein with respect to the rules and regulations of CDS or any action to be taken by CDS or at the direction of its Participants.

In addition, the Series 04-1 Bonds may be issued in fully registered form to holders or their nominees other than CDS or its nominee in certain circumstances.

Transfer of Series 04-1 Bonds

Transfer of beneficial ownership of Series 04-1 Bonds represented by the Global Bond will be effected through records maintained by CDS or its nominee for the Global Bond (with respect to interests of Participants) and through the records of Participants (with respect to interests of persons other than Participants).

Payment of Principal and Interest

Payments of interest, principal and premium, if any, on the Global Bond will be made to CDS or its nominee, as the case may be, as registered holder of the Global Bond.

BC Ferries will not withhold any amount from the payment of interest, premium or principal to any Bondholder resident outside of Canada for the purposes of the Tax Act unless required to do so by law. The Series 04-1 Bonds make no provision for increased interest or payment of any other amount if BC Ferries is required by law to withhold any amount in respect of a Bondholder resident outside of Canada.

Redemption

Under the Supplemental Indenture, the Series 04-1 Bonds may be redeemed in whole or in part at the option of BC Ferries at any time, upon not less than 30 days' and not more than 60 days' notice to the holders of the Series 04-1 Bonds to be redeemed, and upon payment by BC Ferries of the redemption price on the redemption date. The redemption price is calculated as the greater of (i) the face amount of the Series 04-1 Bonds to be redeemed and (ii) that price which will provide a yield to maturity on such Series 04-1 Bonds equal to the average of the yields to maturity calculated by two investment dealers selected by BC Ferries on the day which is the fifth business day before the redemption date of a Government of Canada bond with a similar average life (calculated from the redemption date) plus 0.19%, in either case plus accrued interest on the Series 04-1 Bonds to the redemption date.

Debt Service Reserve Account

In addition to the requirements for the Debt Service Reserve Fund set out in the Indenture, the Supplemental Indenture requires that, in the event that the Debt Service Coverage Ratio is less than 1.75:1, BC Ferries must, prior to making any Discretionary Expenditures and within a one year period, increase the amount in the Series Reserve Account for the Series 04-1 Bonds to an amount equal to nine months Forecast Debt Service for the Series 04-1 Bonds. In the event that the Debt Service Coverage Ratio is less than 1.5:1, BC Ferries must, prior to making any Discretionary Expenditures and within a one year period, increase the amount in the Series Reserve Account to an amount equal to 12 months Forecast Debt Service for the Series 04-1 Bonds.

The Series Reserve Account for the Series 04-1 Bonds will initially be \$7.175 million, which will be funded from the net proceeds from the sale of the Series 04-1 Bonds or from drawings under the Credit Facility.

Security

The obligations of BC Ferries in respect of Series 04-1 Bonds will be secured pursuant to the terms of the Indenture.

Covenants

The Supplemental Indenture incorporates by reference all of the covenants contained in the Indenture. In addition, the Supplemental Indenture provides that BC Ferries and its Designated Subsidiaries will not incur any

Capital Lease Obligations, Capitalized Operating Lease Obligations or Purchase Money Obligations in respect of vessels unless, at the time such Capital Lease Obligations, Capitalized Operating Lease Obligations or Purchase Money Obligations are incurred the total net book value of all vessels subject to such obligations (disregarding any vessels for which such obligations have been prepaid in full other than nominal consideration and certain transfer costs) does not, and after giving effect to the incurrence, will not exceed: (a) until the earlier of April 1, 2006 and the date that obligations for three vessels have been incurred, 55% of the net book value of all vessels used by BC Ferries in the Coastal Ferry Business, including the full capital amount in regard to vessel assets not yet put into service; and (b) on or after the earlier of April 1, 2006 and the date that obligations for three vessels have been incurred, 50% of the net book value of all vessels used by BC Ferries in the Coastal Ferry Business, including the full capital amount in regard to vessel assets not yet put into service.

USE OF PROCEEDS

The net proceeds from the sale of the Series 04-1 Bonds offered hereby are estimated to be \$246.8 million after deducting the Underwriters' fee and the expenses of this offering payable by BC Ferries, estimated to be approximately \$1.2 million. The net proceeds from this offering, together with drawings of \$200 million under the Credit Facility, will be used as follows: approximately \$431.2 million to repay indebtedness and accrued interest owed to the Province; approximately \$9.8 million to fund the initial deposits required to be made to the Debt Service Reserve Fund maintained by BC Ferries pursuant to the Indenture and the Supplemental Indentures authorizing the Series 04-1 Bonds and the Pledged Bonds issued to the Lenders under the Credit Facility; and the balance for general corporate purposes. See "Share and Loan Capital — Provincial Debenture", "Capital Markets Platform — Credit Facility" and "Details of the Offering — Debt Service Reserve Account".

CREDIT RATINGS

Dominion Bond Rating Service Limited ("DBRS") and Standard & Poor's Ratings Services ("S & P") have assigned provisional ratings of A (low) and A-, respectively, to the Series 04-1 Bonds. Credit ratings are intended to provide investors with an independent measure of the credit quality of an issuer of securities. The credit ratings accorded to the Series 04-1 Bonds are not recommendations to purchase, hold or sell such securities inasmuch as such ratings are not a comment upon the market price of the securities or their suitability for a particular investor. There is no assurance that any rating will remain in effect for any given period of time or that any rating will not be revised or withdrawn entirely by a rating agency in the future if, in its judgment, circumstances so warrant.

DBRS's credit ratings are on a long term debt rating scale that ranges from AAA to D, which represents the range from highest to lowest quality of such securities rated. The assignment of a "high" or "low" modifier within each rating category indicates relative standing within such category. DBRS states that its long term debt ratings are meant to give an indication of the risk that the borrower will not fulfill its obligations in a timely manner with respect to both interest and principal commitments. DBRS ratings do not take factors such as pricing or market risk into consideration and are expected to be used by purchasers as one part of their investment process. Every DBRS rating is based on quantitative and qualitative considerations that are relevant for the borrowing entity.

S & P's issue credit rating scale ranges from AAA to D, which represents the range from highest to lowest quality of the issue rated. The addition of a plus (+) or minus (-) designation after a rating indicates the relative standing within the major rating categories. S & P states that its issue credit ratings are a current opinion of the creditworthiness of an obligor with respect to a specific financial obligation, a specific class of financial obligations or a specific financing program. This opinion takes into consideration the creditworthiness of guarantors, insurers, or other forms of credit enhancement on the obligation and takes into account the currency in which the obligation is denominated. Issue credit ratings also take into account the protection afforded by, and relative position of, the obligation in the event of bankruptcy, reorganization or other arrangement under the laws of bankruptcy and other laws affecting creditors' rights. Issue credit ratings are based on current information furnished by obligors or obtained by S & P from other sources it considers reliable. S & P does not perform an audit in connection with any issue credit rating and may, on occasion, rely on unaudited financial information. Issue credit ratings may be changed or withdrawn as a result of changes in, or unavailability of, such information, or based on other circumstances. S & P's credit ratings are expressed in terms of default risk. As such, they pertain to senior obligations of an entity.

RISK FACTORS

Prospective purchasers of the Series 04-1 Bonds offered hereby should carefully consider the risk factors set forth below as well as the other information in this prospectus before making a purchase of Bonds.

Traffic Volume and Toll Revenue Risk

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

There is a risk that over the long term there could be a general decline in travel (or a reduction in the growth rate) on the BC Ferries system due to compounding real increases in tolls. BC Ferries is permitted under the Coastal Ferry Act to increase tolls on Major Routes and the remaining routes by 2.8% and 4.4%, respectively, each year during the first performance term. BC Ferries increased its tolls on Major Routes and other routes by the maximum amounts effective January 7, 2004 (deferred from November 1, 2003) and plans to increase tolls again on November 1, 2004. BC Ferries' forecasts take into account price elasticities of demand. However, such elasticities could change as real prices increase, thereby resulting in an increasing negative impact of real tariff increases.

Impact of Competition

While there are significant barriers to entry, BC Ferries faces the risk of competitors entering the vehicle and passenger ferry market and potentially eroding BC Ferries' market share. This risk is greater on the most profitable routes, potentially from other ferry services in addition to other forms of transportation.

Event Risk

BC Ferries faces the potential for a drop in traffic on vessels due to event risk, as a relatively high percentage of its trip volumes are for non-business purposes (approximately 77% for Major Routes, 82% for Northern Routes, and 63% for Other Routes). This exposure to event risk has been reflected in the relatively flat passenger volumes over the past two years that are largely as a result of a decline in tour bus volumes due to the terrorist attacks in the United States on September 11, 2001, the SARS outbreak in the winter of 2002/03 and the Iraq conflict. BC Ferries' traffic on vessels may decline or not increase as expected if events affecting tourism, such as SARS, occur again.

Asset Risk

BC Ferries operates in a capital intensive industry that requires a substantial amount of capital expenditures. BC Ferries plans approximately \$1.9 billion of capital expenditures over the next decade, with approximately 75% of those expenditures related to new vessel acquisitions, vessel upgrades and component replacement. BC Ferries plans to replace 40% of its fleet over the next ten years.

At March 31, 2004, after giving effect to the sale of the Bonds offered by this prospectus, the incurrence of indebtedness under the Credit Facility and the application of the net proceeds thereof, BC Ferries would have had total indebtedness of \$450 million. The Indenture permits BC Ferries to incur additional indebtedness subject to certain limitations. BC Ferries' level of indebtedness could increase its vulnerability to general adverse economic and industry conditions, and limit its flexibility in planning for, or reacting to, changes in its business. Also, there can be no assurance that BC Ferries will have access to sufficient resources or will be able to maintain its fleet by extending the economic life of existing vessels through major refurbishment.

Accident/Casualty Loss Risk

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

Due to the nature of its business, BC Ferries may be subject to liability claims arising out of accidents or disasters involving vessels on which BC Ferries' customers are traveling, including claims for serious personal injury or death. Although BC Ferries believes it maintains adequate insurance, there can be no assurance that the insurance coverage will be sufficient to cover all such accidents or disasters.

Tax Risk

BC Ferries has received an advance income tax ruling from CRA that, provided the facts and other statements set out therein are accurate, BC Ferries is a corporation (a "Tax Exempt Corporation") described in paragraph 149(1)(d.1) of the Tax Act. This ruling is non-binding in respect of a holder of Series 04-1 Bonds. This ruling is also subject to a proposed amendment to subsection 149(1.3) of the Tax Act announced by the Department of Finance on December 20, 2002, the essential elements of which are now included in a February 27, 2004 release from the Department of Finance of draft amendments to the Tax Act. BC Ferries has received a non-binding opinion from CRA that proposed subsection 149(1.3), if amended as proposed on December 20, 2002, will not cause BC Ferries to cease to be a Tax Exempt Corporation. There can be no assurance that subsection 149(1.3) of the Tax Act will be amended as proposed, or that BC Ferries is and will continue to be a Tax Exempt Corporation.

If BC Ferries is not, or ceases to be, a Tax Exempt Corporation: (i) the Series 04-1 Bonds may not be qualified investments for a trust governed by a registered retirement savings plan, registered retirement income fund, registered education savings plan or deferred profit sharing plan and may be prohibited investments for a registered pension plan, which could result in the imposition of penalties and the deregistration of the fund or plan; and (ii) BC Ferries may become subject to tax under the Tax Act.

Environmental Risk

BC Ferries' operations are subject to various environmental laws and regulations dealing with the transportation, storage, presence, use, disposal and handling of hazardous materials and hazardous wastes, discharge of storm water and vessel fuel delivery. If BC Ferries were to be involved in an environmental accident or to be found in material violation of applicable law and regulations, it could be responsible for material clean-up costs, property damage, and fines or other penalties, any of which could have a material adverse effect on BC Ferries. Although BC Ferries believes it maintains adequate environmental insurance, there can be no assurance that the insurance coverage will be sufficient to cover all such losses.

Regulatory Risk

There is a risk that the Commissioner will interpret the Coastal Ferry Act in a manner unfavourable to BC Ferries.

BC Ferries' 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, may impose a new, unexpected and significant cost burden on BC Ferries. There can be no assurance that regulatory changes in the future will not have an adverse effect on BC Ferries.

Labour Disruption Risk

Most of BC Ferries' employees are unionized. BC Ferries' inability to renew the collective bargaining agreement to which it is bound could result in work stoppages and other labour disturbances which may have a material adverse effect on BC Ferries.

Risk of Default Under Material Contracts

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

Aboriginal Land Claims

Canadian courts have recognized that aboriginal peoples may possess rights at law in respect of land used or occupied by their ancestors where treaties have not been concluded to deal with these rights. These rights may vary from limited rights of use for traditional purposes to a right of aboriginal title and will depend upon, among other things, the nature and extent of the prior aboriginal use and occupation. The courts have encouraged the Canadian federal and provincial governments and aboriginal peoples to resolve rights claims through the negotiation of treaties. Aboriginal groups have claimed substantial portions of land in British Columbia over which they claim aboriginal title or in which they have a traditional interest and for which they are seeking compensation from various levels of government. A process is now in place within British Columbia to deal with aboriginal land claims. These negotiations will be ongoing for a number of years, depending on the commitment of the parties involved and the precedents set by the outcomes of the first settlement agreements. Under evolving jurisprudence, Canadian governments have a duty, and BC Ferries could have a duty, to consult with aboriginal groups where the rights of aboriginal peoples may be affected. BC Ferries cannot predict whether aboriginal land claims or other rights in British Columbia will affect its existing terminal facilities or its operations at these facilities. Under the Master Agreement, the Province retains its liability, to the extent any exists, for the acts and omissions of the Province that occurred prior to BC Ferries' possession of the ferry terminal properties leased under the Terminal Leases, and will reimburse BC Ferries for any damages it suffers as a result. In addition, the Province will reimburse BC Ferries for damages suffered by BC Ferries if there is a final court decision or a treaty settlement that recognizes or confers upon a First Nation a proprietary or other interest in the ferry terminal properties and that right or interest interferes with BC Ferries' quiet enjoyment of the ferry terminal properties as set out in the Terminal Leases.

Absence of Public Market

No active trading market currently exists for the Series 04-1 Bonds. BC Ferries does not intend to apply for the listing of the Series 04-1 Bonds on any securities exchange or quotation system. As a result, an active trading market may not develop for the Series 04-1 Bonds. If an active trading market does not develop, it could have an adverse effect on the market price of the Series 04-1 Bonds and on a bondholder's ability to resell the Series 04-1 Bonds.

PLAN OF DISTRIBUTION

Under an agreement dated May 19, 2004 (the "Underwriting Agreement") between BC Ferries and CIBC World Markets Inc., BMO Nesbitt Burns Inc., RBC Dominion Securities Inc. and TD Securities Inc., as underwriters (collectively, the "Underwriters"), BC Ferries has agreed to sell and the Underwriters have agreed to purchase on May 27, 2004 or such later date as may be agreed upon by the parties, but in any event no later than June 25, 2004, all but not less than all of \$250,000,000 principal amount of the Series 04-1 Bonds, at an aggregate price of \$249,867,500 or \$999.47 per \$1,000 principal amount of the Series 04-1 Bonds, payable in cash to BC Ferries against delivery of the Series 04-1 Bonds. The Underwriters will be paid an aggregate fee of \$1,875,000 on account of services rendered to BC Ferries in connection with the offering, issue and sale of the Series 04-1 Bonds. The Underwriters have agreed to pay certain expenses of BC Ferries in connection with the offering. The obligations of the Underwriters under the Underwriting Agreement are several as to their respective underwriting commitments. The obligations of the Underwriters under the Underwriting Agreement may be terminated upon the occurrence of certain stated events. The Underwriters are, however, obligated to take up and pay for all of the Series 04-1 Bonds if any of the Series 04-1 Bonds are purchased under the Underwriting Agreement.

The Series 04-1 Bonds have not been and will not be registered under the United States Securities Act of 1933, as amended (the "1933 Act") and may not be offered or sold within the United States except in compliance with the registration requirements of such Act or pursuant to an exemption therefrom and in compliance with any applicable state securities laws. In connection with the offering contemplated hereby, a portion of the Series 04-1 Bonds may be sold in the United States to U.S. persons who are "qualified institutional buyers" (as defined in Rule 144A under the 1933 Act) in reliance on Rule 144A under the 1933 Act. Any such sales will be made by U.S. affiliates of the Underwriters. Until 40 days after the commencement of the offering, an offer or sale of the Series 04-1 Bonds within the United States by a dealer (whether or not

participating in the offering) may violate the registration requirements of the 1933 Act if such offer or sale is made otherwise than pursuant to Rule 144A.

In connection with this offering, the Underwriters may over-allot or effect transactions which stabilize or maintain the market price of the Series 04-1 Bonds at a level above that which might otherwise prevail in the open market. Such transactions, if commenced, may be discontinued at any time.

The interest rates, offering prices and redemption features of the Series 04-1 Bonds have been determined by negotiation between BC Ferries and the Underwriters.

There is no market through which the Series 04-1 Bonds may be sold and purchasers may not be able to resell Series 04-1 Bonds purchased under this prospectus.

CIBC World Markets Inc., BMO Nesbitt Burns Inc., RBC Dominion Securities Inc. and TD Securities Inc. are affiliates of Canadian chartered banks which have agreed to make certain credit facilities available to BC Ferries under the Credit Facility. Accordingly, BC Ferries may be considered to be a “connected issuer” of CIBC World Markets Inc., BMO Nesbitt Burns Inc., RBC Dominion Securities Inc. and TD Securities Inc. within the meaning of applicable Canadian securities legislation. The decision of CIBC World Markets Inc., BMO Nesbitt Burns Inc., RBC Dominion Securities Inc. and TD Securities Inc. to underwrite a portion of the Series 04-1 Bonds offered hereby was made independently of such banks and such banks have had no influence as to the determination of the terms of the distribution. CIBC World Markets Inc., BMO Nesbitt Burns Inc., RBC Dominion Securities Inc. and TD Securities Inc. will not receive any benefit in connection with this offering other than a portion of the Underwriters’ fee payable by BC Ferries. See “Capital Markets Platform — Credit Facility”.

ELIGIBILITY FOR INVESTMENT

Subject to compliance with the prudent investment standards and general investment provisions and restrictions of the statutes referred to below (and, where applicable, the regulations made under those statutes) and, in certain cases, subject to the satisfaction of additional requirements relating to investment or lending policies, standards, procedures and goals and, in certain cases, subject to the filing of such policies, standards, procedures or goals, the Series 04-1 Bonds would not, if the date hereof were the date of issue, be precluded as investments under the following statutes:

<i>Insurance Companies Act</i> (Canada);	<i>an Act respecting trust companies and savings</i>
<i>Trust and Loan Companies Act</i> (Canada);	<i>companies</i> (Québec) (for a trust company
<i>Pension Benefits Standards Act, 1985</i> (Canada);	<i>investing its own funds and deposits it receives</i>
<i>Pension Benefits Act</i> (Ontario);	<i>and a savings company investing its funds);</i>
<i>an Act respecting insurance</i> (Québec) (in respect	<i>Supplemental Pension Plans Act</i> (Québec);
<i>of insurers other than guarantee funds);</i>	<i>Employment Pension Plans Act</i> (Alberta);
	<i>Loan and Trust Corporations Act</i> (Alberta); and
	<i>Financial Institutions Act</i> (British Columbia).

In the opinion of McCarthy Tétrault LLP and Farris, Vaughan, Wills & Murphy, provided that on the date hereof BC Ferries is a Tax Exempt Corporation described in paragraph 149(1)(d.1) of the Tax Act, the Series 04-1 Bonds, if issued on the date hereof: (i) would be qualified investments under the Tax Act and the regulations thereunder for a trust governed by a registered retirement savings plan, registered retirement income fund, registered education savings plan or deferred profit sharing plan (other than a trust governed by a deferred profit sharing plan for which any employer is BC Ferries or a corporation that does not deal at arm’s length with BC Ferries within the meaning of the Tax Act); and (ii) would not be a prohibited investment for a registered pension plan under the Tax Act and the regulations thereunder.

Further, in the opinion of such counsel, the Series 04-1 Bonds, if issued on the date hereof, would not be foreign property for the purposes of the Tax Act and the regulations thereunder.

BC Ferries has received an advance income tax ruling from CRA that, provided the facts and other statements set out therein are accurate, BC Ferries is a Tax Exempt Corporation. This ruling is non-binding in respect of a holder of the Series 04-1 Bonds. This ruling is also subject to a proposed amendment to

subsection 149(1.3) of the Tax Act announced by the Department of Finance on December 20, 2002, the essential elements of which are now included in a February 27, 2004 release from the Department of Finance of draft amendments to the Tax Act. BC Ferries has received a non-binding opinion from CRA that proposed subsection 149(1.3), if amended as proposed on December 20, 2002, will not cause BC Ferries to cease to be a Tax Exempt Corporation.

CANADIAN FEDERAL INCOME TAX CONSIDERATIONS

In the opinion of McCarthy Tétrault LLP, counsel to BC Ferries, and Farris, Vaughan, Wills & Murphy, counsel to the Underwriters, the following is a summary, as of the date hereof, of the principal Canadian federal income tax considerations generally applicable under the Tax Act to a holder of Series 04-1 Bonds who acquires the Series 04-1 Bonds pursuant to this offering and who, at all relevant times, for purposes of the Tax Act, holds the Series 04-1 Bonds as capital property and deals at arm's length with BC Ferries (a "Holder"). Generally, the Series 04-1 Bonds will be considered to be capital property to a holder provided that the holder does not hold the Series 04-1 Bonds in the course of carrying on a business and has not acquired them in one or more transactions considered to be an adventure in the nature of trade. Series 04-1 Bonds held by certain "financial institutions" (as defined in the Tax Act) will generally not be capital property to such holders and will be subject to special rules in the Tax Act applicable to securities held by financial institutions. These rules are not discussed in this summary and holders of Series 04-1 Bonds to whom these rules may be relevant should consult their own tax advisors.

This summary is based on the current provisions of the Tax Act, the regulations thereunder (the "Regulations"), all specific proposals to amend the Tax Act and Regulations publicly announced by or on behalf of the Minister of Finance (Canada) prior to the date hereof (the "Tax Proposals"), and counsel's understanding of the current published administrative and assessing practices of CRA in effect as of the date hereof. The summary is not exhaustive of all possible Canadian federal income tax considerations and, except as mentioned above, does not anticipate any changes in law or administrative practice, nor does it take into account provincial, territorial or foreign tax considerations, which may differ significantly from those discussed herein.

This summary is not exhaustive of all possible Canadian federal tax considerations applicable to an investment in Series 04-1 Bonds. This summary is of a general nature only and is not intended to be, nor should it be construed to be, legal or tax advice to any particular holder of Series 04-1 Bonds, and no representations with respect to the income tax consequences to any particular holder of Series 04-1 Bonds are made. Accordingly, prospective purchasers should consult their own tax advisors for advice based upon their particular circumstances with respect to the tax consequences of acquiring, holding and disposing of the Series 04-1 Bonds, including the application and effect of the income and other tax laws of any country, province, state or local tax authority.

Residents of Canada

This portion of the summary is applicable to a Holder who, for purposes of the Tax Act and any applicable tax treaty or convention, and at all relevant times, is resident or is deemed to be resident in Canada (a "Resident Holder"). Certain holders whose Series 04-1 Bonds might not otherwise qualify as capital property may be entitled to obtain such qualification in certain circumstances by making the irrevocable election permitted by subsection 39(4) of the Tax Act.

On October 31, 2003, the Department of Finance released, for public consultation, draft proposed amendments (the "October 31st Proposals") to the Tax Act that would require, for taxation years commencing after 2004, that there be a "reasonable expectation of profit" from a business or property for a taxpayer to realize a loss from the business or property, and that make it clear that profit in this sense does not include capital gains. The October 31st Proposals could, among other things, adversely affect a Resident Holder who has borrowed funds in connection with the acquisition of Series 04-1 Bonds. This summary does not address any special considerations for such Resident Holder and any such Resident Holder should consult his or her own tax advisors in this regard.

Interest on Series 04-1 Bonds

A Resident Holder that is a corporation, partnership, unit trust or trust of which a corporation or partnership is a beneficiary will be required to include in its income for a taxation year any interest on a Series 04-1 Bond that accrues or is deemed to accrue to the Resident Holder to the end of the taxation year or becomes receivable or is received by the Resident Holder before the end of the year, except to the extent that such amount was included in its income for a preceding taxation year.

Any other Resident Holder, including an individual, will be required to include in income for a taxation year any interest on a Series 04-1 Bond received or receivable by such Resident Holder in the year (depending upon the method regularly followed by the Resident Holder in computing income), except to the extent that such amount was otherwise included in its income for the year or a preceding taxation year.

Where a Resident Holder is required to include in income interest on a Series 04-1 Bond that accrued before the Series 04-1 Bond was acquired by the Resident Holder, the Resident Holder will be entitled to a deduction in computing income of an equivalent amount. The adjusted cost base to the Resident Holder of the Series 04-1 Bond will be reduced by the amount which is so deductible.

Disposition of Series 04-1 Bonds

On a disposition or deemed disposition of a Series 04-1 Bond, including a redemption or purchase by BC Ferries, a Resident Holder will generally be required to include in income as interest the amount of interest accrued or deemed to have accrued on the Series 04-1 Bond up to the date of the disposition, to the extent that such amount has not otherwise been included in the Resident Holder's income for the year or a preceding taxation year. In addition, any premium paid by BC Ferries to a Resident Holder as a result of BC Ferries' exercise of its right to redeem a Series 04-1 Bond before the maturity thereof will normally be deemed to be interest received by the Resident Holder at the time of the redemption to the extent that it can reasonably be considered to relate to, and does not exceed the value at the time of the redemption of, the interest that would have been paid or payable by BC Ferries on the Series 04-1 Bond for a taxation year ending after the redemption.

In general, a disposition or deemed disposition of a Series 04-1 Bond will give rise to a capital gain (or capital loss) to the extent that the proceeds of disposition, net of any amount included in the Resident Holder's income as interest and any reasonable costs of disposition, exceed (or are less than) the Resident Holder's adjusted cost base of the Series 04-1 Bond immediately before the disposition.

Where a disposition gives rise to a capital gain to a Resident Holder, one-half of the amount of the gain (a "taxable capital gain") realized by the Resident Holder in a taxation year generally must be included in the Resident Holder's income in that year. A capital gain realized by an individual (other than certain specified trusts) may give rise to alternative minimum tax.

Where a disposition gives rise to a capital loss to a Resident Holder:

- to the extent that the loss is not a business investment loss to the Resident Holder (see summary below), one-half of the amount of the loss (an "allowable capital loss") realized by the Resident Holder in a taxation year is generally deducted from taxable capital gains realized by the Resident Holder in that year. Allowable capital losses in excess of taxable capital gains may be carried back and deducted in any of the three preceding taxation years or carried forward and deducted in any subsequent taxation year against net taxable capital gains realized in such years to the extent and under the circumstances described in the Tax Act; and
- the loss may qualify as a "business investment loss" of the Resident Holder provided that the disposition is to a person with whom the Resident Holder deals at arm's length and that BC Ferries is at that time a "small business corporation," all for purposes of the Tax Act. The part of the capital loss qualifying as a business investment loss, however, may be reduced if an amount was previously deducted pursuant to the capital gains exemption in respect of a disposition by the Resident Holder of any capital property.

One-half of a business investment loss (an "allowable business investment loss") realized by the Resident Holder in a taxation year may generally be deducted against other income realized by the Resident Holder in that year.

Allowable business investment losses in excess of income may be carried back and deducted against taxable income in any of the three preceding taxation years or carried forward and deducted against taxable income in any of the seven subsequent taxation years, to the extent and under the circumstances described in the Tax Act. Proposed changes in the Canadian federal budget of March 23, 2004, if enacted as proposed, should extend the carry forward period from seven years to ten years. Generally, allowable business investment losses not deducted during this period may thereafter be carried forward and deducted against taxable capital gains pursuant to the provisions summarized above applicable in respect of allowable capital losses. **Resident Holders for whom these rules may be relevant should consult their own tax advisors.**

Additional Refundable Tax

A Resident Holder that is a “Canadian-controlled private corporation” (as defined in the Tax Act) may be liable to pay an additional refundable tax of 6 $\frac{2}{3}$ % percent on certain investment income, including interest and taxable capital gains.

Non-Residents of Canada

This portion of the summary is applicable to a Holder who, for purposes of the Tax Act and any applicable tax treaty or convention, and at all relevant times, is not resident or deemed to be resident in Canada, does not use or hold and is not deemed to use or hold the Series 04-1 Bonds in carrying on a business in Canada (a “Non-Resident Holder”). Special rules, which are not discussed below, may apply to a non-resident that is an insurer which carries on business in Canada and elsewhere.

Interest on Series 04-1 Bonds

Interest paid or credited or deemed to be paid or credited on a Series 04-1 Bond to a Non-Resident Holder should not be subject to Canadian non-resident withholding tax.

Disposition of Series 04-1 Bonds

Other than withholding taxes on interest or deemed interest, from which a Non-Resident Holder should be exempt as described above, no taxes on income (including taxable capital gains) will be payable under the Tax Act by a Non-Resident Holder in respect of the disposition or deemed disposition of a Series 04-1 Bond, including on a redemption or a purchase by BC Ferries.

A Non-Resident Holder will not be subject to tax under the Tax Act on any capital gain realized on a disposition or deemed disposition of a Series 04-1 Bond, including on a redemption or a purchase by BC Ferries.

MATERIAL CONTRACTS

The only material contracts entered into by BC Ferries during the past two years or to which BC Ferries will become a party on or before closing, other than in the ordinary course of business, are as follows:

- (a) the Coastal Ferry Services Contract referred to under “Coastal Ferry Services Contract”;
- (b) the Master Agreement and Terminal Leases referred to under “Terminal Leases”;
- (c) the Indenture and Series Supplement in respect of the Series 04-1 Bonds referred to under “Capital Markets Platform” and “Details of the Offering”;
- (d) the Acknowledgement Agreement referred to under “Capital Markets Platform — Acknowledgement Agreement”;
- (e) the credit agreement creating the Credit Facility referred to under “Capital Markets Platform — Credit Facility”; and
- (f) the Underwriting Agreement referred to under “Plan of Distribution”.

Copies of the foregoing documents may be examined during normal business hours at the offices of BC Ferries located at 1112 Fort Street, Victoria, British Columbia, Canada V8V 4V2.

LEGAL MATTERS

The matters referred to under “Eligibility for Investment” and “Canadian Federal Income Tax Considerations” and certain other legal matters relating to the issue and sale of the Series 04-1 Bonds offered hereunder will be passed upon on behalf of BC Ferries by McCarthy Tétrault LLP and on behalf of the Underwriters by Farris, Vaughan, Wills & Murphy. Mrs. Elizabeth J. Harrison, who became Chair of the Board of Directors of BC Ferries on March 31, 2004, is a partner of Farris, Vaughan, Wills & Murphy.

LEGAL PROCEEDINGS

Except as described below, BC Ferries is not the subject of any material legal proceedings nor is it aware of any threatened material litigation involving BC Ferries or its assets.

BC Ferries operates the Tsawwassen ferry terminal located in Delta, British Columbia. BC Ferries leases the terminal and causeway from the Province. BC Ferries is a defendant in a British Columbia Supreme Court action commenced in February 2002 by the Tsawwassen First Nation (“TFN”) and others for alleged nuisances and violations of littoral rights, claimed to impact the TFN reserve and foreshore areas as a result of the existence and operation of the Tsawwassen ferry terminal and causeway, and due to the Roberts Bank coal terminal, container facility (Deltaport) and its causeway owned and operated by Vancouver Port Authority (“VPA”), another of the defendants. The action seeks damages from the defendants and an injunction to require the two causeways be removed or altered to stop causing the alleged harm. The trial is set to commence on February 14, 2005. The Province, which originally constructed the ferry terminal and causeway, the Government of Canada, which approved of the VPA causeway and port construction and which the TFN has alleged breached fiduciary duties, the BCTFA and B.C. Rail Ltd. are also defendants. BC Ferries believes the claims against it are without merit and the litigation will not have a material impact on its business.

BC Ferries, along with the Province, the Government of Canada, the VPA, BCTFA and B.C. Rail Ltd., is a defendant in another British Columbia Supreme Court action commenced in December 2003 by the TFN and others claiming, among other things, infringement of aboriginal title and rights and seeking various declarations, including a declaration that the Crown (provincial and federal) unlawfully issued various leases, permits, titles and tenures within the TFN’s claimed territory. The action further seeks to have these leases, permits, titles and tenures quashed. The action also seeks an accounting for all profits, rents and other benefits acquired by the defendants as a result of their use of the TFN’s claimed territory. These claims, if successful, could impact the Tsawwassen ferry terminal and certain other BC Ferries facilities in the Gulf Islands. BC Ferries is unable to determine what impact this action may have on its business at this time.

BC Ferries, along with the Province, the Government of Canada and others, is a defendant in a British Columbia Supreme Court action commenced in December 2003 by the Snuneymuxw First Nation (the “Nanaimo Band”) and others claiming, among other things, infringement of aboriginal title and rights and seeking various declarations, including a declaration that the actions of the defendants in authorizing various activities (including the construction of the Duke Point ferry terminal) within the Nanaimo Band’s claimed territory constitute nuisance, breach of fiduciary duty and negligence. The action further seeks declarations that BC Ferries is in trespass on the band’s lands and that the defendants wrongfully received revenues from the infringement of aboriginal rights or title. These claims, if successful, could impact the Duke Point ferry terminal. BC Ferries is unable to determine what impact this action may have on its business at this time.

In addition, BC Ferries is aware of several recent actions commenced by various aboriginal groups which if successful could have an impact on BC Ferries’ facilities, despite the fact that BC Ferries is not named as a defendant in these actions. See “Risk Factors — Aboriginal Land Claims”.

BC Ferries is currently involved in a formal binding arbitration process with the union representing its employees. A decision from the arbitrator is not expected until June 2004. See “Business of BC Ferries — Human Resources”.

AUDITORS, TRUSTEE AND PAYING AGENT

The auditors of BC Ferries are KPMG LLP, 800-730 View Street, Victoria, British Columbia, V8W 3Y7.

Computershare Trust Company of Canada is the Trustee under the Indenture and the Supplemental Indenture in respect of the Series 04-1 Bonds. Registers for the registration and transfer of the Series 04-1 Bonds will be kept at the principal office of the Trustee in the City of Vancouver. The Trustee is also the paying agent for the Series 04-1 Bonds.

PURCHASER'S STATUTORY RIGHTS

Securities legislation in certain of the provinces of Canada provides purchasers with the right to withdraw from an agreement to purchase securities within two business days after receipt or deemed receipt of a prospectus and any amendment. In several of the provinces of Canada, securities legislation further provides a purchaser with remedies for rescission or, in some jurisdictions, damages where the prospectus and any amendment contains a misrepresentation or is not delivered to the purchaser, provided that such remedies for rescission or damages are exercised by the purchaser within the time limit prescribed by the securities legislation of the purchaser's province. The purchaser should refer to any applicable provisions of the securities legislation of his or her province for the particulars of these rights or consult with a legal advisor.

AUDITORS' REPORT

**To the Board of Directors,
British Columbia Ferry Services Inc.**

We have audited the consolidated balance sheets of British Columbia Ferry Services Inc. as at March 31, 2004 and 2003 and the consolidated statements of earnings and retained earnings and cash flows for each of the years in the three-year period ended March 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 2004 and 2003 and the results of its operations and its cash flows for each of the years in the three-year period ended March 31, 2004 in accordance with Canadian generally accepted accounting principles.

Victoria, Canada
April 28, 2004
(except note 18, which is as of May 19, 2004)

(Signed) KPMG LLP
Chartered Accountants

BRITISH COLUMBIA FERRY SERVICES INC.
CONSOLIDATED BALANCE SHEETS
(expressed in thousands)

	As at March 31,	
	2004	2003
Assets		
Current assets:		
Cash and cash equivalents	\$ 17,939	\$ 14,557
Accounts receivable	5,857	27,506
Prepaid expenses	5,717	7,420
Inventories	23,570	19,305
	53,083	68,788
Capital assets (note 2)	551,474	567,968
Deferred financing costs	1,190	—
Long-term land lease (note 3)	24,040	—
	\$629,787	\$636,756
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 37,262	\$ 43,849
Interest payable on long-term debt	61	—
Payable to Province (note 4)	—	17,213
Accrued employee costs	36,276	39,281
Deferred revenue	13,003	11,941
Current portion of deferred employee obligations	2,415	2,665
	89,017	114,949
Deferred employee obligations (note 5)	15,644	18,629
Long-term debt (note 6)	427,701	—
	532,362	133,578
Shareholders' equity:		
Share capital (note 7)	75,478	6,851
Contributed surplus (note 8)	—	536,957
Retained earnings (deficit)	21,947	(40,630)
	97,425	503,178
Commitments (notes 2 and 12)		
Contingent liabilities (notes 16 and 17)		
Subsequent event (note 18)		
	\$629,787	\$636,756

On behalf of the Board:

(Signed) GRAHAM M. WILSON
Director

(Signed) ELIZABETH J. HARRISON, QC
Director

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.
CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS
(expressed in thousands)

	Years ended March 31,		
	2004	2003	2002
Revenue:			
Tolls	\$323,023	\$315,618	\$305,710
Ferry service fees (note 9)	105,806	—	—
Federal-Provincial Subsidy Agreement (note 10)	23,975	23,377	22,953
Retail	63,206	61,762	60,374
Other income	17,721	14,866	12,329
Motor fuel tax subsidy	—	74,243	71,706
	<u>533,731</u>	<u>489,866</u>	<u>473,072</u>
Expenses:			
Operations	261,387	250,583	248,441
Maintenance	79,361	75,586	72,518
Administration	70,298	71,590	63,887
Cost of retail goods sold	23,298	22,046	22,479
Amortization	47,355	44,050	46,056
	<u>481,699</u>	<u>463,855</u>	<u>453,381</u>
Earnings from operations	52,032	26,011	19,691
Gain on foreign exchange	190	150	176
Interest expense	(22,672)	(1,364)	(1,757)
Loss on disposal and write-down of capital assets	(1,565)	(412)	(732)
Earnings before the following	27,985	24,385	17,378
Loss on disposal of high speed ferries (note 4)	—	(53,107)	—
Provision for write-down of high speed ferries (note 4)	—	—	(40,000)
Net earnings (loss)	27,985	(28,722)	(22,622)
Retained earnings (deficit), beginning of year	(40,630)	(11,908)	10,714
Transfer from contributed surplus (note 8)	40,630	—	—
Preferred share dividend (note 7)	(6,038)	—	—
Retained earnings (deficit), end of year	<u>\$ 21,947</u>	<u>\$ (40,630)</u>	<u>\$ (11,908)</u>

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(expressed in thousands)

	Years ended March 31,		
	2004	2003	2002
Cash provided by (used in):			
Operations:			
Net earnings (loss)	\$ 27,985	\$(28,722)	\$(22,622)
Items not involving cash:			
Amortization	47,355	44,050	46,056
Loss on disposal of high speed ferries	—	53,107	—
Provision for write-down of high speed ferries	—	—	40,000
Other non-cash charges	3,227	20,905	1,911
Change in non-cash operating working capital	(9,092)	(15,508)	1,448
	69,475	73,832	66,793
Financing:			
Proceeds from issuance of long-term debt	427,701	—	—
Proceeds from issuance of share	1	—	—
Redemption of shares	(427,701)	—	—
Payment to the Province (notes 4 and 8)	(17,213)	—	—
Dividends paid on preferred shares	(6,038)	—	—
Deferred financing costs incurred	(1,190)	—	—
Principal payments of obligations under capital lease (note 11)	—	(18,681)	(2,688)
	(24,440)	(18,681)	(2,688)
Investing:			
Proceeds from disposal of assets	17,996	84	45
Purchase of capital assets	(59,649)	(58,198)	(54,850)
	(41,653)	(58,114)	(54,805)
Increase (decrease) in cash and cash equivalents	3,382	(2,963)	9,300
Cash and cash equivalents, beginning of year	14,557	17,520	8,220
Cash and cash equivalents, end of year	\$ 17,939	\$ 14,557	\$ 17,520

Supplemental cash flow information (note 15)

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(columnar dollars expressed in thousands)

British Columbia Ferry Services Inc. (the “Company”) was incorporated under the *Company Act (British Columbia)* by way of conversion on April 2, 2003. The Company’s primary business activity is the provision of coastal ferry services in British Columbia.

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

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

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

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

1. SIGNIFICANT ACCOUNTING POLICIES:

(a) *Basis of presentation:*

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

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Deas Pacific Marine Inc. (“DPMI”), Catamaran Ferries International Inc. (“CFI”) and Pacific Marine Leasing Inc. (“PMLI”). All inter-company balances and transactions have been eliminated on consolidation. To date, PMLI has been inactive.

(b) *Cash and cash equivalents:*

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

(c) *Inventories:*

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

BRITISH COLUMBIA FERRY SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(columnar dollars expressed in thousands)

1. SIGNIFICANT ACCOUNTING POLICIES (continued):

(d) *Capital assets:*

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

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

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

(e) *Impairment of long-lived assets:*

In accordance with CICA Handbook Section 3063 “Impairment of Long-Lived Assets”, the Company reviews capital assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparison of their carrying amount to the future undiscounted cash flows the assets are expected to generate. If such capital assets are considered to be impaired, the impairment to be recognized equals the amount by which the carrying amount of the assets exceeds their fair market value. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(f) *Revenue recognition:*

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

(g) *Employee future benefits:*

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

In addition, eligible employees are entitled to specific retirement benefits as provided for under the collective agreement and terms of employment. The Company accrues the future obligation for these benefits over the employees’ expected term of service. Actuarial valuations are obtained for certain of the future benefit liabilities.

BRITISH COLUMBIA FERRY SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(columnar dollars expressed in thousands)

1. SIGNIFICANT ACCOUNTING POLICIES (continued): (Continued)

(h) *Use of estimates:*

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

(i) *Taxes:*

The Company is exempt from federal and provincial income taxes. Commencing for calendar year 2004, the Company will pay property taxes at assessed values. In prior years, grants in lieu of property taxes were paid to municipalities within which the Company operated.

In prior years, the Company was not assessed for, nor did it pay, GST. Effective April 2, 2003, the Company became subject to GST. The provision of vehicle and passenger ferry services is an exempt supply under the Excise Tax Act.

(j) *Foreign currency transactions:*

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

(k) *Deferred financing costs:*

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

(l) *Comparative figures:*

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

BRITISH COLUMBIA FERRY SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(columnar dollars expressed in thousands)

2. CAPITAL ASSETS:

<u>March 31, 2004</u>	<u>Cost</u>	<u>Accumulated amortization</u>	<u>Net book value</u>
Ships owned	\$ 708,087	\$440,203	\$267,884
Ships under capital lease	50,377	30,892	19,485
Berths, buildings and equipment	73,152	48,066	25,086
Berths, buildings and equipment under capital lease	404,397	202,104	202,293
Land	1,107	—	1,107
Construction-in-progress	35,619	—	35,619
	<u>\$1,272,739</u>	<u>\$721,265</u>	<u>\$551,474</u>
<u>March 31, 2003</u>	<u>Cost</u>	<u>Accumulated amortization</u>	<u>Net book value</u>
Ships owned	\$ 682,660	\$416,161	\$266,499
Ships under capital lease	50,066	30,550	19,516
Berths, buildings and equipment	461,664	234,271	227,393
Land	25,451	—	25,451
Construction-in-progress	28,609	—	28,609
Assets held for resale	500	—	500
	<u>\$1,248,950</u>	<u>\$680,982</u>	<u>\$567,968</u>

In addition to the construction-in-progress referenced above, contractual commitments for capital assets under construction at March 31, 2004 totaled \$28.4 million (March 31, 2003 — \$13.0 million).

3. LONG-TERM LAND LEASE:

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

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

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

4. PAYABLE TO PROVINCE/LOSS ON DISPOSAL OF HIGH SPEED FERRIES:

In June 1994, the Provincial government announced the PacifiCat Fast Ferry Project. Construction on the first vessel commenced in July 1996. In March 2000, after an independent inquiry and customer assessments, the Provincial government declared the Project a failed experiment and directed the Company to sell the three PacifiCat vessels.

The three PacifiCat vessels and ancillary equipment were disposed by international, unreserved auction on March 24, 2003 for gross proceeds of US \$13.65 million. The vessels had been actively marketed by an

BRITISH COLUMBIA FERRY SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(columnar dollars expressed in thousands)

4. PAYABLE TO PROVINCE/LOSS ON DISPOSAL OF HIGH SPEED FERRIES: (Continued)

international agent without success, from July 2000 through December 2002, at which time the decision was made to dispose of the vessels at auction.

The Province directed the Company to pay to the Province the proceeds less commissions from the auction. The amount, Cdn \$17.2 million, was charged to contributed surplus and classified as payable to Province in the balance sheet as at March 31, 2003 and was paid during the year ended March 31, 2004.

5. DEFERRED EMPLOYEE OBLIGATIONS:

	As at March 31,	
	2004	2003
Accrued sick leave liability	\$ 1,069	\$ 1,307
Workers' compensation claims liability	6,893	9,308
Retirement bonuses	9,464	10,082
Other employee future benefits	633	597
	18,059	21,294
Current portion of deferred employee obligations	(2,415)	(2,665)
	\$15,644	\$18,629

Prior to March 31, 2003, the Company participated in the Workers' Compensation Board deposit class coverage system, and the workers' compensation claims liability was valued with actuarial assumptions as appropriate for this 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.

Retirement bonuses are paid to all eligible employees upon retirement. The amounts of such bonuses are determined as specified in the collective agreement between the Company and the BC Ferry and Marine Workers' Union.

6. LONG-TERM DEBT:

	As at March 31,	
	2004	2003
Debenture held by the Province of British Columbia, due April 1, 2006; bears interest payable semi-annually in arrears at a rate of 5.18% (subject to adjustment under certain conditions); secured by a registered mortgage on vessels and a registrable mortgage on the leasehold interest under the terminal lease and by a general security agreement on property.	\$427,701	\$ —
	\$427,701	\$ —

BRITISH COLUMBIA FERRY SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(columnar dollars expressed in thousands)

7. SHARE CAPITAL:

(a) *Authorized:*

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

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

(b) *Issued and outstanding:*

	As at March 31,			
	2004		2003	
	Number of shares	Amount \$	Number of shares	Amount \$
Class B, common	1	\$ 1	—	\$ —
Class C, preferred	75,477	75,477	—	—
unclassified common	—	—	68,512	6,851
		\$75,478		\$6,851

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

(c) *Dividends:*

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

8. CONTRIBUTED SURPLUS:

	As at March 31,	
	2004	2003
Balance, beginning of year	\$536,957	\$554,170
Share redemption value in excess of paid up capital	(496,327)	—
Elimination of deficit	(40,630)	—
Payable to the Province	—	(17,213)
Balance, end of year	\$ —	\$536,957

Contributed surplus arose from the difference between the recorded value of certain assets received from the Province in prior years and their cost to the Company and from debt transferred to the Province. The

BRITISH COLUMBIA FERRY SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(columnar dollars expressed in thousands)

8. CONTRIBUTED SURPLUS: (Continued)

carrying amount was reduced as at March 31, 2000 by the elimination of the accumulated deficit of the Company to reflect the financial restructuring at that time.

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

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

9. FERRY SERVICE FEES:

The Company has entered into an agreement with the Province commencing April 1, 2003 to provide ferry services that would not be commercially viable under the current regulated tariff structure. In exchange for a fee, the Company provides agreed ferry service levels on specified routes and administers certain social policy initiatives on behalf of the Province. The agreement is for a period of sixty years, the details of which are renegotiated after a first term of five years and each four-year term thereafter. The initial term provides for an annual fee of approximately \$106 million.

10. FEDERAL-PROVINCIAL SUBSIDY AGREEMENT:

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

11. OBLIGATIONS UNDER CAPITAL LEASES:

During the year ended March 31, 2003, the lessors of each of the Company's capital leases, namely the charters of the Queen of Surrey and the Queen of Oak Bay, agreed to the assignment of the existing bare-boat charter agreements to the BCTFA. The Province, as the guarantor of the original leases, agreed to continue its guarantee following the assignment.

BCTFA then immediately sub-chartered each of the vessels to the Company in exchange for a one-time payment representing the present value of all remaining payments under the first term of each of the original agreements. At the same time, the Company purchased options for amounts equal to the present values of each of the vessels' buyout charge.

These options, if exercised, require BCTFA to exercise the buyout clauses available at the end of the first term of each of the original agreements and to transfer the titles to the Company. The exercise price is \$1 for each option.

The Company has declared its intention to exercise each of its options. It is anticipated that the title of the Queen of Surrey will pass, without additional payments, on January 1, 2006. It is anticipated that the title of the Queen of Oak Bay will pass, without additional payments, on January 1, 2007.

Additional interest paid due to interest rates utilized for the Queen of Surrey lease prepayment has been capitalized and will be amortized on a straight-line basis until the end of the original agreement. No additional interest was paid as part of the Queen of Oak Bay lease prepayment.

BRITISH COLUMBIA FERRY SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(columnar dollars expressed in thousands)

12. STRATEGIC RELATIONSHIP AGREEMENT:

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

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

<u>Year ended</u>	
2005	\$11,173
2006	9,927
2007	2,166
2008	<u>2,003</u>
	<u>\$25,269</u>

13. RISK MANAGEMENT:

(a) *Fuel management:*

The Company manages its exposure to vessel fuel price volatility by entering into swap agreements with certain financial intermediaries in order to add a fixed component to the inherent floating nature of fuel prices. Prior to April 1, 2003, the Company entered into forward contracts executed by the Ministry of Finance and Corporate Relations on behalf of the Company. Fuel hedging instruments are used solely for the purpose of reducing fuel price risk, not for generating trading profits. Gains and losses resulting from the contracts are recognized as a component of fuel expense. Contracts for the forecasted fuel requirements are entered for terms of up to three years forward. As at March 31, 2004, the Company has effectively hedged approximately 32% of its projected fuel requirements for the fiscal year ended March 31, 2005 and had hedged approximately 58% of the fuel consumed during the current fiscal year.

(b) *Credit and interest rate risk:*

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

The Company may enter into interest rate agreements to manage its exposure on debt instruments. As at March 31, 2004, the Company has no active interest rate agreements.

Prior to April 1, 2003, the Company utilized the Ministry of Finance and Corporate Relations to execute contracts and agreements.

(c) *Fair value of financial instruments:*

The fair values of accounts receivable, accounts payable and accrued liabilities, and interest payable on long-term debt approximate their carrying amounts due to their short term to maturity. The fair value of long term debt approximates its carrying amount as it bears interest at a rate that approximates market rate and is subject to adjustment under certain conditions.

BRITISH COLUMBIA FERRY SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(columnar dollars expressed in thousands)

14. RELATED PARTY TRANSACTIONS:

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

The Province owns the Company’s 75,477 non-voting preferred shares and holds the Company’s secured debenture of \$427.7 million, but has no voting interest in either the Company or its parent, BCFA.

Prior to April 2, 2003, the Company’s common shares were held by the Minister of Finance as representative of Her Majesty the Queen in Right of the Province of British Columbia. Prior to April 2, 2003, the Company utilized Crown land for terminals and highway access without the payment of rent or property taxes. In the year ended March 31, 2003, the Company made payments to municipalities in lieu of property taxes for terminals located within municipal boundaries of \$1.4 million (2002: \$1.4 million) and the Company’s subsidiary paid property taxes at the assessed values. In addition, prior to April 2, 2003, the Company received, by way of provincial legislation, a motor fuel tax subsidy of 1.25 cents per litre of the Provincial Motor Fuel Tax.

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

15. SUPPLEMENTAL CASH FLOW INFORMATION:

	Years ended March 31,		
	2004	2003	2002
Cash paid during the year for interest	\$ 22,420	\$3,365	\$1,803
Non-cash transactions:			
Issuance of preferred shares	75,477	—	—
Disposal of terminals, net book value	230,232	—	—
Terminal structures capital lease, net prepaid	205,888	—	—
Terminal land operating lease, net prepaid	24,344	—	—

16. CONTINGENT LIABILITIES:

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

17. COLLECTIVE AGREEMENT:

The collective agreement between the Company and the BC Ferry and Marine Workers’ Union (“BCFMWU”) expired on October 31, 2003. As a temporary measure, at the time of DPMI’s inception, the expired agreement was extended to DPMI employees who were transferred from BCFSI. DPMI now negotiates its own collective agreements separately from BCFSI.

BRITISH COLUMBIA FERRY SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(columnar dollars expressed in thousands)

17. COLLECTIVE AGREEMENT: (Continued)

On December 12, 2003, BCFSI and BCFMWU agreed to binding arbitration in regard to the BCFSI union employees. Binding arbitration is a dispute resolution process that determines the terms and conditions of the collective agreement. The decision of the Arbitrator is final and binding. It is unlikely there will be a new collective agreement until June 2004.

DPMI and BCFMWU have agreed to mediation in order to facilitate a new collective agreement. Both parties have entered into an agreement that there will be no strike or lock out activity before May 25, 2004 to allow time for the mediation process to occur.

Until new collective agreements are reached, both BCFSI and DPMI are operating under the prior collective agreement. Additional liabilities, if any, arising from the new collective agreements cannot be reasonably estimated at this time.

18. SUBSEQUENT EVENT:

Subsequent to March 31, 2004, the Company intends to complete an initial public offering of \$250,000,000, 5.74% Senior Secured Bonds, Series 04-1, due May 27, 2014. At the same time, the Company intends to establish a credit facility with a syndicate of Canadian chartered banks. The net proceeds from the sale of the bonds and draws on the credit facility will be used primarily to repay the indebtedness which is currently owed by the Company to the Province of British Columbia and to fund reserves required in connection with the Series 04-1 Bonds and the credit facility. Interest on the Series 04-1 Bonds will be payable semi-annually on May 27 and November 27 of each year until maturity, commencing November 27, 2004.

CERTIFICATE OF BC FERRIES

DATED: May 19, 2004

The foregoing constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by Part 9 of the *Securities Act* (British Columbia), by Part 9 of the *Securities Act* (Alberta), by Part XI of *The Securities Act, 1988* (Saskatchewan), by Part VII of *The Securities Act* (Manitoba), by Part XV of the *Securities Act* (Ontario), by Section 13 of the *Security Frauds Prevention Act* (New Brunswick), by Section 63 of the *Securities Act* (Nova Scotia), by Part II of the *Securities Act* (Prince Edward Island), by Part XIV of the *Securities Act* (Newfoundland and Labrador) and the respective regulations thereunder. This prospectus, as required by the *Securities Act* (Quebec) and the regulations thereunder, does not contain any misrepresentation likely to affect the value or the market price of the securities to be distributed.

(Signed) DAVID L. HAHN
President and Chief Executive Officer

(Signed) ROBERT P. CLARKE
Executive Vice President, Finance
and Chief Financial Officer

On Behalf of the Board of Directors

(Signed) ELIZABETH J. HARRISON, QC
Director

(Signed) GRAHAM M. WILSON
Director

CERTIFICATE OF THE UNDERWRITERS

DATED: May 19, 2004

To the best of our knowledge, information and belief, the foregoing constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by Part 9 of the *Securities Act* (British Columbia), by Part 9 of the *Securities Act* (Alberta), by Part XI of *The Securities Act, 1988* (Saskatchewan), by Part VII of *The Securities Act* (Manitoba), by Part XV of the *Securities Act* (Ontario), by Section 13 of the *Security Frauds Prevention Act* (New Brunswick), by Section 64 of the *Securities Act* (Nova Scotia), by Part II of the *Securities Act* (Prince Edward Island), by Part XIV of the *Securities Act* (Newfoundland and Labrador) and the respective regulations thereunder. To our knowledge, this prospectus, as required by the *Securities Act* (Quebec) and the regulations thereunder, does not contain any misrepresentation likely to affect the value or the market price of the securities to be distributed.

CIBC WORLD MARKETS INC.

By: (Signed) CLIFF INSKIP

BMO NESBITT BURNS INC.

By: (Signed) BRADLEY J. HARDIE

RBC DOMINION SECURITIES INC.

By: (Signed) JILL V. GARDINER

TD SECURITIES INC.

By: (Signed) J. LEVERSAGE

CONSENT OF KPMG LLP

We have read the prospectus of British Columbia Ferry Services Inc. (“BC Ferries”) dated May 19, 2004 relating to the issue and sale of senior secured bonds of BC Ferries. We have complied with Canadian generally accepted standards for an auditor’s involvement with offering documents.

We consent to the use in the above-mentioned prospectus of our report to the directors of BC Ferries on the consolidated balance sheets as at March 31, 2004 and 2003 and the consolidated statements of earnings and retained earnings and cash flows for each of the years in the three-year period ended March 31, 2004. Our report is dated April 28, 2004 (except as to note 18, which is as of May 19, 2004).

Victoria, Canada
May 19, 2004

(Signed) KPMG LLP
Chartered Accountants

 **BC Ferries**



