



Building a new company with a proud tradition.

 **BC Ferries**

ANNUAL REPORTS 2003/04

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



# Contents

**British Columbia Ferry Services Inc.**

|  |    |
|--|----|
| A Message from the Chair   | 02 |
| A Message from the President and CEO   | 04 |
| Corporate Profile  | 06 |
| Our Vision, Our Mission and Our Values   | 06 |
| 2003/04 Key Accomplishments  | 08 |
| Operating Highlights   | 09 |
| Our New Business Model   | 10 |
| BC Ferries Fleet   | 26 |
| BC Ferries Routes  | 28 |
| Management’s Discussion and Analysis<br>of Financial Condition and Results of Operations | 29 |
| Consolidated Financial Statements of<br>British Columbia Ferry Services Inc.             | 37 |
| Corporate Directory  | 50 |

**B.C. Ferry Authority**

|   |     |
|---|-----|
| A Message from the Chair                                  | A1  |
| Summary of Meetings                                       | A2  |
| Legal Basis for the B.C. Ferry Authority                  | A3  |
| Skills and Experience Profile                             | A4  |
| Consolidated Financial Statements of B.C. Ferry Authority | A6  |
| Board of Directors  | A12 |



On April 2, 2003, BC Ferries became an independent company. On that day, a 43-year-old organization was given a new beginning.

We now have a clear vision to become a world-class marine transportation system, one that is both highly customer-focused and financially viable.

During our first year, we have made big strides towards our vision. We've built on our strengths and we've created new business opportunities. And we're excited about the future...

*One sailing at a time.*

## A Message from the Chair

“During the year, we set in motion the plans needed to guide our long-term direction.”

ONE YEAR AGO, the process of transforming BC Ferries by implementing a new structure for the delivery of ferry services to coastal British Columbia was implemented. That structure transformed the former Crown corporation and gave the new BC Ferries a solid business foundation and a clear vision to create a modern, safe, reliable ferry system while protecting British Columbia taxpayers from further financial burden.

During the year, we set in motion the plans needed to guide our long-term direction; making important advances toward improving customer service and corporate governance and securing the financial platform needed to modernize BC Ferries.

We provide ferry services under a 60-year contract with the Province of British Columbia, which protects coastal communities with a long-term service commitment, predictable fare increases

and regulated service levels.

To ensure proper governance, BC Ferries' operations are overseen by the BC Ferry Commissioner Martin Crilly. The Commissioner acts as an independent regulator who oversees our compliance with the Coastal Ferry Services Contract, monitors the fares, and encourages BC Ferries to be efficient and innovative.

While we are in the early stage of our corporate evolution, important first steps have successfully been taken to achieve our goal of establishing a financially viable, world-class marine transportation system with improved customer service and a renewed fleet of vessels.

I want to extend a special thank you to the previous board members who were instrumental in bringing about the transformation of this proud company—former Board chair David Emerson and former Board members Mark Cullen,

Peter Armstrong and Jim Cutt. The work of these individuals, along with members of our current board, resulted in the successful establishment of the new BC Ferries.

On behalf of the Board of Directors, I look forward to the future as we continue our pursuit of customer service excellence and financial accountability.



Elizabeth J. Harrison, Q.C.  
*Chair*

“While we are in the early stage of our corporate evolution, the important first steps have successfully been taken to achieve our goal of establishing a financially viable, world-class marine transportation system with improved customer service and a renewed fleet of vessels.”



## A Message from the President and CEO

“In our first year as an independent company, we made measurable progress in demonstrating our capability and determination to operate a world-class ferry system.”

LAST YEAR, I had the privilege of joining BC Ferries. This is a company with a solid operational background, and a proud and rich history as the vital transportation link to and from communities along British Columbia's beautiful coastline.

Since its formation in 1960, BC Ferries has grown to become one of the world's largest ferry transportation systems. In BC Ferries' first year as an independent company, the framework needed for building a customer-focused, financially viable company has successfully been established. We have also made measurable progress in demonstrating our capability and determination to operate a world-class ferry system.

Our first priority in rebuilding BC Ferries has been to better understand our customers; the residents of ferry-dependent communities and the many businesses, industries and visitors that have a direct interest in our service.

Our recent customer satisfaction survey indicates that most customers are favourably impressed with BC Ferries. Understandably, our customers also tell us

that they expect BC Ferries to maintain the highest safety standards, build new ships, improve on-time performance, provide quality food services, reduce wait times at terminals and communicate better.

We are diligently addressing each of these priorities, and I am pleased with our progress to date. I am also confident that the year ahead promises to see even more progress in these critical areas.

Over the last year, we added additional vehicle reservation services, expanded our tourism travel packages, offered off-peak pricing initiatives and upgraded our food services.

Upgrades to our Tsawwassen and Swartz Bay terminals, providing vital customer-service improvements, have also begun.

Perhaps our biggest challenge over the next year is the need to commence the replacement of our aging fleet of vessels. We expect to award a contract for the first phase of our new capital program shortly.

In May 2004, we completed two debt financings—a \$250 million bond offering and a \$355 million bank facility, which

includes revolving credit facilities totalling \$155 million. We were very pleased with the strong and positive response from the financial markets—clearly, a strong vote of confidence in our plans for BC Ferries. These enabled us to repay debts due to the Government of British Columbia.

We expect that of the approximately \$2.4 billion in capital expenditures required over the next 15 years for ship replacements and upgrades, as well as other much needed infrastructure, approximately half will be funded from external sources. Accordingly, successful completion of these offerings was an important first step in establishing BC Ferries as a high-quality, commercially viable borrower.

Net earnings in 2004 were \$28.0 million. This result was ahead of our targets and is a marked improvement over 2003 when BC Ferries reported earnings of \$24.4 million (before deducting the final costs of \$53 million associated with the disposal of the high-speed ferries). Despite this improvement, we are working to find better ways to add new revenue sources and to control our rising operating costs—most

“We added additional vehicle reservation services, expanded our tourism travel packages, offered off-peak pricing initiatives and upgraded our food services.”



significantly, the recent surge in the price of fuel and motor oil.

With respect to labour negotiations, BC Ferries and the BC Ferry & Marine Workers' Union are currently involved in a binding arbitration process to reach a new collective agreement. In the interim, our employees continue to deliver excellent service to ensure the safe passage of our customers.

BC Ferries is committed to a long-term process of progressive and ongoing improvements while maintaining stable, predictable services.

I would like to express my gratitude to our Board of Directors for their efforts in helping BC Ferries become a new independent company.

I also thank BC Ferries' employees, who are among the most knowledgeable and experienced in the industry. With their expertise and the changes underway to transform the company, BC Ferries has all of the elements necessary to be a successful commercial enterprise.

Most importantly, I thank BC Ferries' customers for their continuing support during our rebuilding process.

The year ahead is a promising one in which we will work hard to meet the expectations of our customers. I look forward to the unprecedented opportunities that our current direction will bring.

David L. Hahn  
*President and Chief Executive Officer*

# Corporate Profile

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

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

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

Our company is governed by an independent Board of Directors appointed by the B.C. Ferry Authority, which owns the single voting common share of BC Ferries. The Province of

British Columbia owns cumulative preferred shares of BC Ferries, but has no voting interest in either the B.C. Ferry Authority or BC Ferries.

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

## Our Vision

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

## Our Mission

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

## Our Values

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

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

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

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

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





# 2003/04 Key Accomplishments

## Improving our customers' experience...

- Conducted a comprehensive customer satisfaction survey. Overall, 82 per cent of passengers report being satisfied with their experience travelling with BC Ferries.
- Expanded vehicle reservations to the Sunshine Coast (Horseshoe Bay-Langdale).
- Introduced new food and beverage programs through partnerships with Starbucks, White Spot, Bread Garden, Villages Pizza and Salt Spring Coffee Co.
- Launched a series of discount pricing initiatives throughout the year to both stimulate travel and direct customers to less congested sailings.
- Developed a series of travel packages with industry partners as well as new travel products such as the 7 day/4 day Sailpass that offered "Eurail style" unlimited travel.
- Introduced an onboard entertainment program on major routes.

## Improving terminals and vessels...

- Completed a mid-life upgrade to the *Queen of Coquitlam*, the first of five C-class vessels to be renovated.
- Implemented a second C-class mid-life upgrade to the *Queen of Cowichan*.
- Initiated upgrades to Tsawwassen and Swartz Bay terminals.
- Initiated the development of a northern vessel replacement strategy to replace the current three northern vessels.
- Completed major upgrades or refits on the *Kabloke*, *Howe Sound Queen*, *Tachek* and *North Island Princess*, as well as the *Queen of Nanaimo* and the *Queen of Prince Rupert*.
- Completed major traffic management improvements at Horseshoe Bay terminal.
- Established a partnership with SNC-Lavalin to provide engineering and project management for construction and maintenance of all terminals and marine structures.

## Building a New Company...

- Completed the conversion from a Crown corporation to an independent, regulated company.
- Launched a strategic plan to chart the course for achieving customer service and commercial objectives.
- Achieved a commercial credit rating of A<sup>-</sup> and A (low), respectively, from two prominent rating companies, Standard & Poor's and Dominion Bond Rating Service, and established a successful company financing platform that supported a highly successful initial public bond offering in May 2004.
- Submitted a plan to the BC Ferry Commissioner to test for alternative service delivery that is safe, reliable and cost-effective.
- Established new aboriginal relations and expanded community relations programs.
- Initiated a new employee self-serve human resources system that fully integrates with other new financial management systems.



## Operating highlights

(Years ended March 31)

### Operating information

|   | 2004         | 2003         |
|---|--------------|--------------|
| Number of vessels <sup>(1)</sup>              | 37           | 38           |
| Mean age of vessels                           | 32 years     | 31 years     |
| Passengers carried                            | 21.4 million | 21.6 million |
| Vehicles carried                              | 8.3 million  | 8.3 million  |
| On-time performance                           | 84%          | 83%          |
| Full time equivalent employees <sup>(2)</sup> | 3,261        | 3,345        |
| Employee turnover                             | 4.1%         | 4.4%         |

### Financial results (\$ in millions)

|   |         |          |
|---|---------|----------|
| Total revenue   | \$533.7 | \$489.9  |
| Earnings from operations                                    | \$52.0  | \$26.0   |
| Earnings before 2003 loss on disposal of high-speed ferries | \$28.0  | \$24.4   |
| Net earnings (loss)   | \$28.0  | (\$28.7) |

### Financial position (\$ in millions)

|                                     |         |         |
|-------------------------------------|---------|---------|
| Total assets                        | \$629.8 | \$636.8 |
| Long-term debt <sup>(3)</sup>       | \$427.7 | nil     |
| Shareholders' equity <sup>(3)</sup> | \$97.4  | \$503.2 |

### Financial ratios

|                  |      |       |
|------------------|------|-------|
| Return on assets | 4.4% | -4.5% |
|------------------|------|-------|

<sup>(1)</sup>Number of vessels for both 2004 and 2003 include two owned vessels that are chartered to other operators.

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

<sup>(3)</sup>See Notes to Consolidated Financial Statements for detailed description of the conversion of the company and the resulting effect on capital structure.



## Our New Business Model

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

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

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

We explain our objectives, our strategies and the progress we've made to date in the following pages.



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

“We work closely with all regulatory agencies to make certain that we continue to comply with every regulation.”

SAFETY is BC Ferries’ number one priority. We have high safety and environmental standards and have long been recognized for our strong safety and environmental records.

Safety, security and environmental standards are constantly changing. So we are changing too. Not only to keep up to world standards, but to set our own higher standards.

## Stringent regulatory environment

Safety at BC Ferries is regulated by Transport Canada and by the Workers’ Compensation Board. We also comply with a number of international safety conventions, including the International Marine Organization (IMO), a United Nations organization concerned with the safety of shipping and cleaner oceans.

We voluntarily comply with the requirements of the International Safety Management (ISM) Code and manage our vessels and operations with a Safety Management System (SMS) that ensures compliance with the requirements of the Code.

Internal auditors conduct annual audits of the vessels, terminals and operational management. In addition, Lloyd’s Register conducts external audits of operational management once a year and audits our vessels every two and one-half years to ensure that our SMS meets regulatory requirements. Representatives from BC Ferries and the BC Ferry & Marine Workers’ Union work jointly on a committee to proactively address important safety issues.

## Meeting and exceeding safety standards

Passenger and crew safety is BC Ferries’ number one priority. From vessel design and operation to crew training and rescue equipment, BC Ferries puts safety first. As part of this commitment, we are conducting a comprehensive fleet-wide evacuation analysis to verify that all ships meet Transport Canada requirements that any vessel can be safely evacuated within 30 minutes.

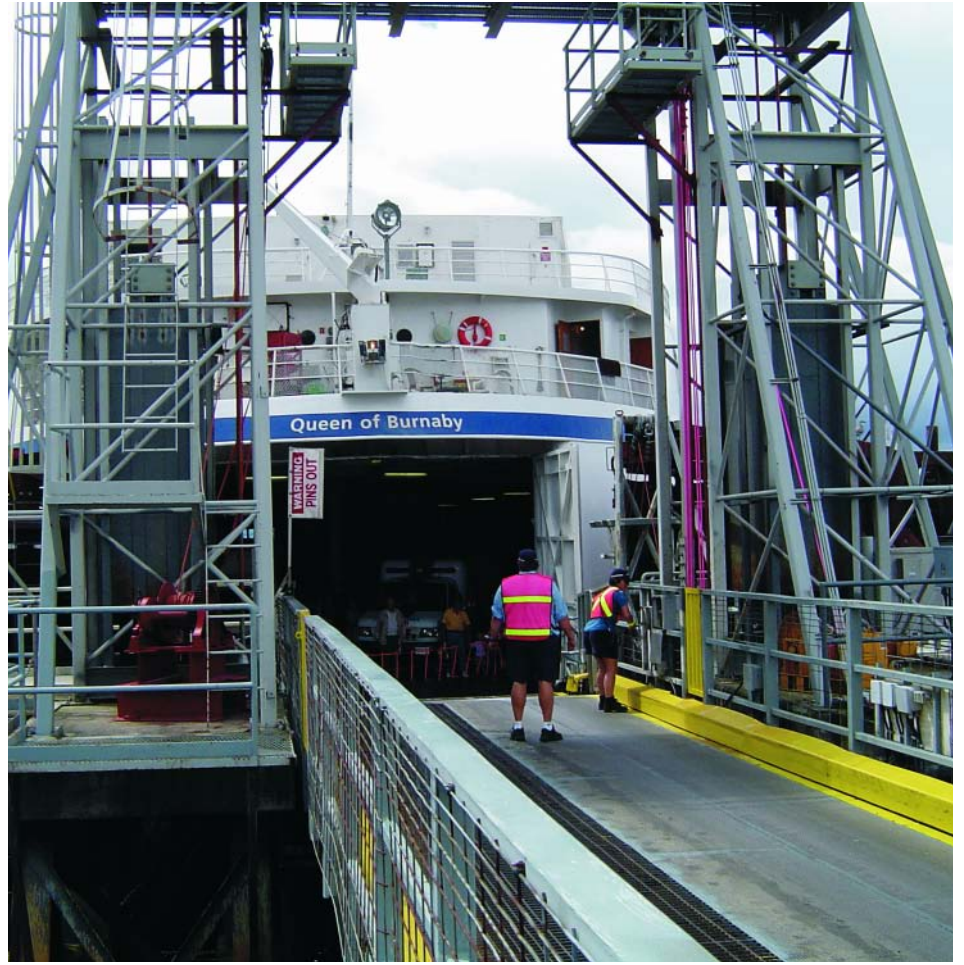
## New environmental initiatives

We carry out regular environmental audits to ensure that we remain in compliance with environmental laws and regulations.

We have recently implemented a fleet-wide sewage handling program that will upgrade, replace or install onboard sewage treatment systems during planned mid-life upgrades and regular refits of the vessels. This program ensures we meet or exceed current legislated requirements.

Canada’s ratification of the Kyoto Protocol, which requires developed nations to limit their greenhouse gas (GHG) emissions, has implications for BC Ferries’ operations. Working in partnership with the federal government, we have developed programs that, if implemented, are expected to reduce GHG emissions from BC Ferries’ operations.

Also, we have initiated programs to reduce fuel consumption and air emissions.



“We are committed to improving our customers’ experience. Adding value to that experience comes from a better understanding of our customers’ needs and expectations.”

OPPORTUNITIES for improvement exist in our customer services. While this will be a challenging undertaking, we are determined to make our customers’ overall travel experience better by improving our reliability and dependability, our choice of food and activities, and our vessels’ and terminals’ overall appearance.

### Enhancing customer travel experiences

The most visible examples of the changes we’ve made are the multi-million-dollar mid-life upgrades to the two C-class ships used on our Nanaimo-Horseshoe Bay routes. The upgraded *Queen of Coquitlam* was reintroduced into service in June 2003, and the upgraded *Queen of Cowichan* returned to service in June 2004.

These upgrades, which cost approximately \$70 million, will enable us to obtain another 20 years of safe, reliable service from these vessels. The upgrades provide a variety of service improvements that our customers have requested including:

- new food service facilities
- redesigned passenger lounges
- expanded gift shops
- expanded children’s play areas
- new study carrels
- enclosed video arcades
- new or upgraded washrooms

Three other vessels, the *Queen of Oak Bay*, the *Queen of Surrey* and the *Queen of Alberni*, will all receive mid-life upgrades over the next three years. Overall, BC Ferries spends approximately \$100 million with local shipyards each year on refits, upgrades and maintenance.

In summer 2003, we introduced an onboard entertainment program featuring a variety of musicians and entertainers to make crossings more enjoyable. Follow-up research shows that the response to this program is overwhelmingly supportive, which has led to an expanded program for summer 2004.

### A fresh, new appearance for our terminals

Renovations at our Tsawwassen and Swartz Bay terminals began in late February 2004 to improve customer service at these two major terminals.

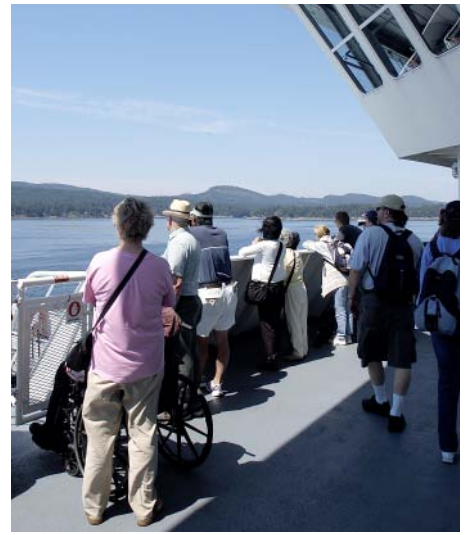
Other BC Ferries terminals also benefited from improvement projects, such as enhanced public address systems, painting, asphalt repair and landscaping, and cleaner washrooms.

### Understanding our customers

Adding value to that experience comes from a better understanding of our customers’ needs and expectations. Accordingly, we will be increasing our customer-service surveys, using standard research techniques and innovative self-service survey kiosks at some terminals.

Data from these surveys will be used to raise awareness of the importance of customer service among our employees. It will help us define new service standards and train our employees to meet those standards so that we continuously





“The most visible examples of the changes we’ve made are the multi-million-dollar mid-life upgrades to the two C-class ships used on our Nanaimo-Horseshoe Bay routes.”

improve our level of customer service.

This year, we commissioned a customer satisfaction tracking survey. While results were positive, with 82 per cent of passengers reporting being satisfied with their overall experience travelling with BC Ferries, there is still room for improvement.

### Terminal Master Plans

We are planning extensive terminal renovations to enhance our customers’ experience. In 2003, BC Ferries began the development of Terminal Master Plans for each of its terminals that map out customer service and operational improvements.

BC Ferries and an independent engineering group, SNC-Lavalin, formed a strategic relationship responsible for standards development, project management, engineering, construction and maintenance of all terminals and marine structures in BC Ferries’ system. This is a unique arrangement in which SNC-Lavalin provides their engineering and project management expertise while

BC Ferries contributes its knowledge of marine operations and terminal construction. The goal of the partnership is to deliver visible terminal improvements more rapidly on a more cost-effective basis.

### Vessel replacement

During 2003/04, we initiated a comprehensive, worldwide procurement process for the acquisition of new vessels to replace V-class vessels that are more than 40 years old. Specifically, the first vessels that must be replaced are the *Queen of Esquimalt*, the *Queen of Saanich* and the *Queen of Vancouver*. In addition, an intermediate-sized vessel is also needed to replace the *Queen of Tsawwassen*.

We are looking to our own fleet and operational experience to provide baselines for new vessel construction. For example, the double-ended C-class vessels have proven to be highly efficient, reliable and safe. These ships have delivered an acceptable level of service at a sustainable cost. The C-class will, therefore, provide the baseline for the first phase of

BC Ferries’ fleet renewal.

These initiatives are part of an approximately \$2.4 billion capital expenditure program over the next 15 years to revitalize our terminals and fleet.



# 03 | Foster a highly motivated, committed and flexible workforce

“One of the great strengths that BC Ferries can draw from is the expertise and dedication of our employees.”

ONE OF THE great strengths that BC Ferries can draw from as an independent company is the expertise and dedication of our employees. These people have consistently demonstrated their loyalty to our customers and to the company. Our staff turnover is lower than last year and we have many long-term employees, some who have worked with us for nearly 40 years.

## Striving for effective employee relations

BC Ferries is committed to effective employee relations. During the past year, we have undertaken extensive communications initiatives with our employees to keep them informed about our new direction.

We have also completed a major review of our human resources delivery system and are in the process of implementing a progressive human resources structure, approach and integrated set of practices.

## Developing our workforce

We have developed and implemented extensive workforce training and development initiatives to ensure a highly skilled, productive and engaged workforce. In 2003/04, almost 8,500 days of training were delivered to employees and over 2,500 certificates were earned through training provided to meet regulatory requirements.

As well, employee support programs such as Tuition Reimbursement, the Marine Certificate Upgrade Program and the Bridge Watchman Study Program continue to be offered to employees.

We continue to develop and implement our Human Resource Information System (CHaRTS). We recently launched the Employee Self-Service function, which enables all staff, including vessel and shore-based employees that do not work with computers in the course of their workday, to access and update their personal records, check leave balances and apply for jobs from kiosks throughout the fleet or from their homes.

Our employees continue to be our most important ambassadors for the thousands of customers welcomed aboard each day. Their support and commitment is fundamental to the company's ability to grow and succeed.

## New collective agreement

BC Ferries and the BC Ferry & Marine Workers' Union are currently involved in a binding arbitration process to reach a new collective agreement. We expect this process to conclude in the near future.



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

“The initiatives we are implementing will help us improve existing and future services and build stronger communities, too.”

**BUILDING** strong relationships with our customers and the communities that we serve is vital to our success. The initiatives we are implementing will help us improve existing and future services and build stronger communities, too.

## Meaningful public consultation

BC Ferries has an active public consultation program directed at ensuring that the company meets the needs of the communities and the customers we serve.

A minimum of twice each year, management meets with the 12 Ferry Advisory Committees, which are comprised of community volunteers. These committees discuss local service and terminal issues, share information on the day-to-day operations of specific routes, and give us input on planned terminal improvements as well as broader corporate policy issues.

In spring 2004, we initiated an intensive period of public consultation that included nine communities from Port Hardy to the Queen Charlotte Islands. This

process will assist with decisions on the terms of service, and the associated Provincial Government Service Fee that will be put in place for ferry services between Port Hardy and the Queen Charlotte Islands for the second term of the Coastal Ferry Services Contract (from 2008 to 2012). BC Ferries will strive to provide a service that meets the needs of the communities and ensures that the needs of the North Coast region are met.

## Renewed government relationships

As an independent company, our relationships with all levels of government have changed.

BC Ferries is no longer an extension of the provincial government. Consequently, we have moved proactively to reach out to local community governments to establish meaningful working relationships. Our commitment to building better relationships also means that we will consult with our stakeholders on all major projects, such as our Terminal Master Plans.

## New aboriginal relations program

The transformation of BC Ferries has also paved the way for improved relations with aboriginal communities. An aboriginal relations manager has been hired and resources committed to facilitate a positive relationship with coastal First Nations.

## Ongoing community relations

As a company grows and changes, new programs and initiatives are most successful if a company has customer trust, loyalty and respect.

We are working to establish good community relations by participating in community and special events as well as supporting our employees' community efforts in local charitable and community activities.



“We have introduced a number of pricing initiatives to help us better manage peak demand periods and we continue to look for creative ways to market our products and services.”

WITH STRONG brand recognition, market dominance and some of the most spectacular scenery worldwide, BC Ferries has the essential ingredients to grow its revenue. Our new strategic plan identifies opportunities for new partnerships, products and services to maximize our growth potential.

### Creating or shifting demand

Last year, we introduced a number of pricing initiatives to help us better manage peak demand periods. Key among these was discounted vehicle fares of 25 per cent to 50 per cent for customers travelling on less-popular sailings during holiday weekends and other peak periods.

We have also invested significantly to enhance our reservations service. In summer 2003, we responded to rising customer demand by introducing vehicle reservations on the Langdale to Horseshoe Bay route. In so doing, we gave our customers more choice and improved access to the Sunshine Coast. Also, we have recently completed improvements to our

on-line reservations and automated telephone reservation services.

### New products and services

Our customers have made it clear that they want quality food and beverage items. We took action by expanding our partnerships with Starbucks, White Spot, Bread Garden, Villages Pizza and Salt Spring Coffee Co. These leading companies enable us to provide our customers with wider selection and better overall quality.

### New travel partnerships

BC Ferries' markets are diverse and dynamic, changing in response to travel and economic conditions in the province, the country and the world. We continue to look for creative ways to price our products and bundle them with reservations to help us take advantage of new revenue sources.

Our Sail & Save program, launched in partnership with Tourism Victoria, is a successful example. This special joint promotional offer includes a round trip for a

car and two adult passengers, vehicle reservations each way and one night's accommodation for two at a selection of Victoria hotels or bed and breakfasts.

Summer 2003 witnessed our introduction of a new promotion called SailPass. This program encourages travelers to experience exciting coastal destinations. The sale package includes unlimited travel on the Northern and Southern Gulf Islands routes and one round trip on each of the major mainland routes.





“Our capital expenditure program will be managed prudently and conservatively.”

A MAJOR CORPORATE goal is to ensure that BC Ferries is financially viable and that all earnings are reinvested into service improvements such as new vessels and upgraded facilities.

Financial viability ensures that we can acquire capital on favourable terms to revitalize our aging fleet of vessels and upgrade our terminals and services.

### Improving our bottom line

In recent years, the old BC Ferries incurred substantial financial losses. To reverse this trend, we need to maximize our revenue opportunities, add new sources of revenue and reduce our cost structure.

BC Ferries' annual tariff increase took effect in January 2004. Annual, predictable rate increases are provided for in the Coastal Ferry Act, along with detailed schedules set two years in advance, to provide consumers ongoing certainty regarding fares and sailings.

The average fare increases on the three major routes of 2.8 per cent, and on the remaining routes of 4.4 per cent, will help

fund necessary improvements to vessels and terminals.

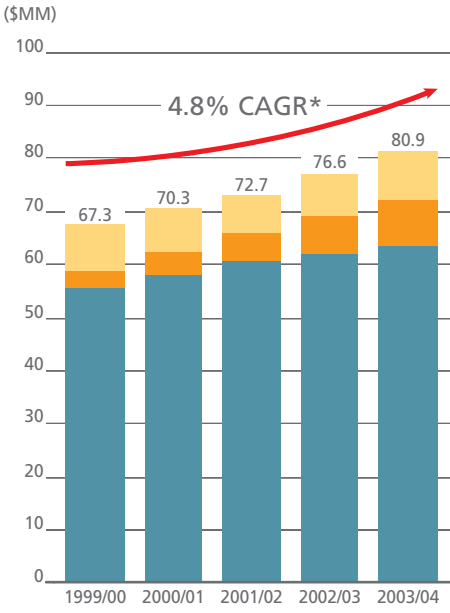
### Financing platform in place

In May 2004, we successfully completed our first bond offering, raising \$250 million from the sale of secured bonds. In addition, we established a \$355 million credit facility with a syndicate of Canadian banks.

These transactions enable us to move forward with our plans to replace and revitalize our ferry fleet, which ranks as one of the oldest in the world. Of the approximately \$2.4 billion in capital expenditures required over the next 15 years for 22 new vessels and for upgrades to existing vessels and other important initiatives, approximately half will be funded from external sources.

Our new financing platform reduces the burden of our capital program on B.C. taxpayers. Proceeds from the initial public bond offering and a portion of the credit facility were used to repay \$428 million of indebtedness to the Province of British Columbia.

Our capital expenditure program will be managed prudently and conservatively. Our plan is to phase in vessel replacement based on our financial capacity and needs and to use proven vessel technology from reputable contractors to achieve the best life-cycle value.



**Ancillary revenues**

- Concessions
- Reservations
- Other ancillary revenues

\*CAGR: Compounded Annual Growth Rate



# BC Ferries fleet

## MAJOR VESSELS

Average Vessel Age 28.9 years

PASSENGERS • 450–2052  
CREW • 21–48  
AUTOMOBILE EQUIVALENTS • 286–470



Spirit of British Columbia • 1993



Spirit of Vancouver Island • 1994



Queen of Alberni • 1976



Queen of Coquitlam • 1976



Queen of Cowichan • 1976



Queen of Esquimalt • 1963



Queen of New Westminster • 1964



Queen of Oak Bay • 1981



Queen of Saanich • 1963



Queen of Surrey • 1981



Queen of Vancouver • 1962

## INTERMEDIATE AND SMALL VESSELS

Average Vessel Age 32.2 years

PASSENGERS • 133–1128  
CREW • 4–35  
AUTOMOBILE EQUIVALENTS • 16–192



Queen of Burnaby • 1965



Queen of Nanaimo • 1964



Queen of Tsawwassen • 1960



Skeena Queen • 1996



Queen of Cumberland • 1992



Queen of Capilano • 1991



Mayne Queen • 1965



Bowen Queen • 1965



Powell River Queen • 1965



Quinsam • 1982



Quinitsa • 1977



Klitsa • 1972



Kahloke • 1973



Kwuna • 1975



Howe Sound Queen  
1964



Tachek • 1969



North Island Princess  
1958



Quadra Queen II  
1969



Tenaka • 1964



Nimpkish • 1973



Mill Bay • 1956

## NORTHERN VESSELS

Average Vessel Age 33 years

PASSENGERS • 374–650  
CREW • 22–50  
AUTOMOBILE EQUIVALENTS • 80–120



Queen of the North • 1969



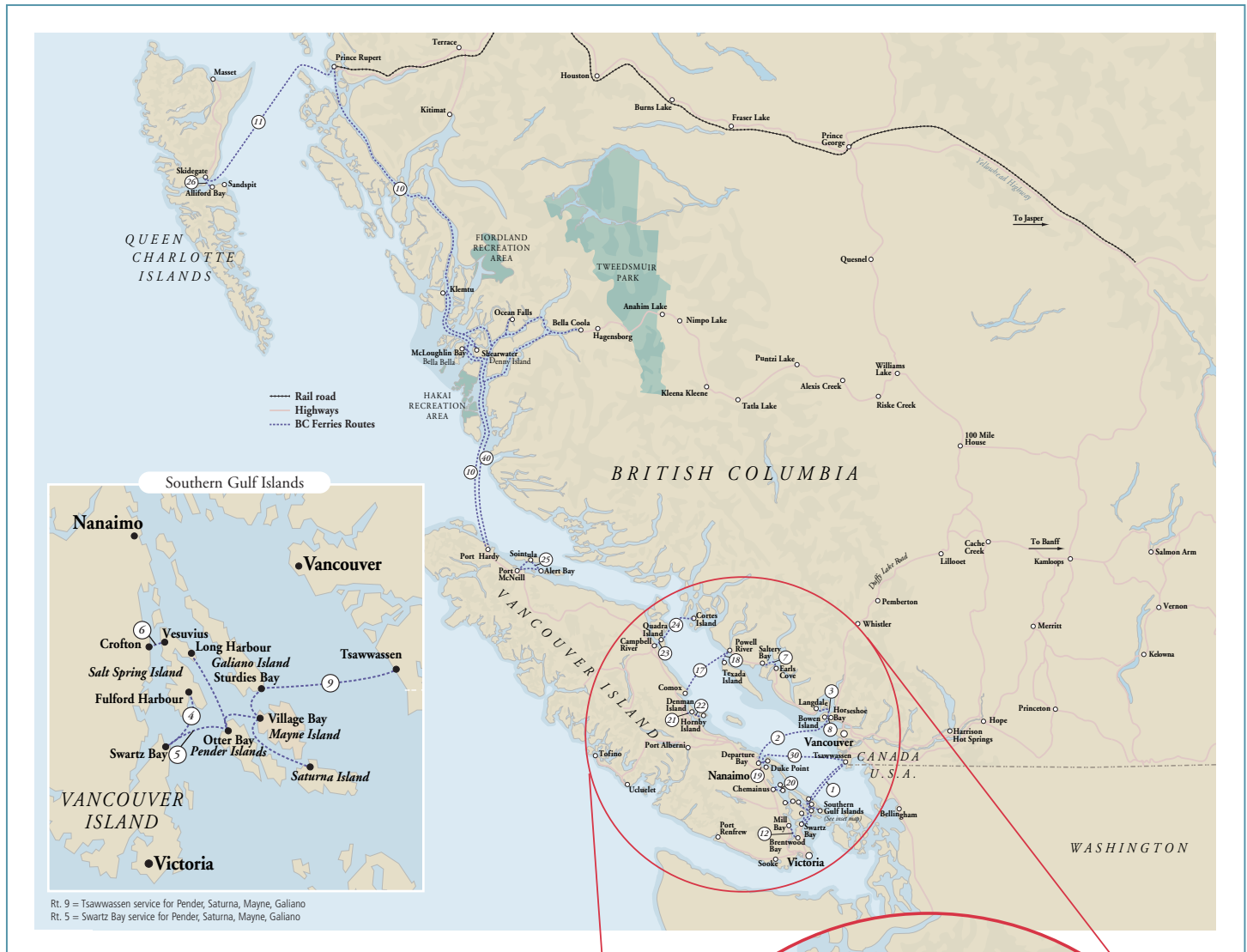
Queen of Prince Rupert • 1966



Queen of Chilliwack • 1978



# BC Ferries routes



Rt. 9 = Tsawwassen service for Pender, Saturna, Mayne, Galiano  
 Rt. 5 = Swartz Bay service for Pender, Saturna, Mayne, Galiano



“BC Ferries operates 25 regulated routes between 47 terminals. We carry more than 21 million passengers and eight million vehicles per year.”

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

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

The following is 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 for the years ended March 31, 2004, 2003 and 2002. 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.



| (in thousands)                                    | Years ended March 31, |                    |                    |
|---|-----------------------|--------------------|--------------------|
|   | 2004                  | 2003               | 2002               |
| <b>Revenue:</b>                                   |                       |                    |                    |
| 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             |
| <b>Total Revenue</b>                              | <b>533,731</b>        | <b>489,866</b>     | <b>473,072</b>     |
| <b>Expenses:</b>                                  |                       |                    |                    |
| 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             |
| <b>Total expenses</b>                             | <b>481,699</b>        | <b>463,855</b>     | <b>453,381</b>     |
| <b>Earnings from operations</b>                   | <b>52,032</b>         | <b>26,011</b>      | <b>19,691</b>      |
| 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)              |
| <b>Earnings before the following</b>              | <b>27,985</b>         | <b>24,385</b>      | <b>17,378</b>      |
| Loss on disposal of high-speed ferries            | -                     | (53,107)           | -                  |
| Provision for write-down of high-speed ferries    | -                     | -                  | (40,000)           |
| <b>Net earnings (loss)</b>                        | <b>\$ 27,985</b>      | <b>\$ (28,722)</b> | <b>\$ (22,622)</b> |

## 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.

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

## **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 routes.

## **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 are 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 comparative period). 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.

## Loss 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 \$1.0 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:

|  | (\$ millions) |
|--|---------------|
| 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                                   | 2.0           |
| 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.

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

## 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 report.

## 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 \$1.8 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 expense 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.

Early in the new fiscal year, BC Ferries intends to make an initial public offering of bonds and to enter into a Credit Facility with a syndicate of Canadian banks. The bond issue will be primarily used to repay, in part, obligations to the Province. 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.

## 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.

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

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.

# Consolidated Financial Statements of British Columbia Ferry Services Inc.

Years ended March 31, 2004, 2003 and 2002

|   |    |
|---|----|
| Auditors' Report  | 38 |
| Consolidated Balance Sheets                               | 39 |
| Consolidated Statements of Earnings and Retained Earnings | 40 |
| Consolidated Statements of Cash Flows                     | 41 |
| Notes to Consolidated Financial Statements                | 42 |

# Auditors' Report

To the Shareholders of British Columbia Ferry Services Inc.

We have audited the consolidated balance sheets of British Columbia Ferry Services Inc. as at March 31, 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. As required by the Company Act (British Columbia), we report that, in our opinion, these principles have been applied on a consistent basis.



Chartered Accountants

Victoria, Canada

April 28, 2004

(except note 18, which is as of May 19, 2004)



# Consolidated Balance Sheets

(expressed in thousands)

As at March 31,

|                               | 2004              | 2003              |
|-------------------------------|-------------------|-------------------|
| <b>Assets</b>                 |                   |                   |
| 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            |
|                               | <b>53,083</b>     | <b>68,788</b>     |
| Capital assets (note 2)       | 551,474           | 567,968           |
| Deferred financing costs      | 1,190             | -                 |
| Long-term land lease (note 3) | 24,040            | -                 |
|                               | <b>\$ 629,787</b> | <b>\$ 636,756</b> |

## 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             |
|  | <b>89,017</b>     | <b>114,949</b>    |
| Deferred employee obligations (note 5)           | 15,644            | 18,629            |
| Long-term debt (note 6)                          | 427,701           | -                 |
|  | <b>532,362</b>    | <b>133,578</b>    |
| Shareholders' equity:                            |                   |                   |
| Share capital (note 7)                           | 75,478            | 6,851             |
| Contributed surplus (note 8)                     | -                 | 536,957           |
| Retained earnings (deficit)                      | 21,947            | (40,630)          |
|  | <b>97,425</b>     | <b>503,178</b>    |
| Commitments (notes 2 and 12)                     |                   |                   |
| Contingent liabilities (notes 16 and 17)         |                   |                   |
| Subsequent event (note 18)                       |                   |                   |
|  | <b>\$ 629,787</b> | <b>\$ 636,756</b> |

See accompanying notes to consolidated financial statements.

On behalf of the Board:

[signed]  
Graham M. Wilson  
Director

[signed]  
Elizabeth J. Harrison, Q.C.  
Director

# Consolidated Statements of Earnings and Retained Earnings

(expressed in thousands)

| As at March 31,   | 2004           | 2003           | 2002           |
|---|----------------|----------------|----------------|
| <b>Revenue:</b>   |                |                |                |
| 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         |
|   | <b>533,731</b> | <b>489,866</b> | <b>473,072</b> |
| <b>Expenses:</b>  |                |                |                |
| 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         |
|   | <b>481,699</b> | <b>463,855</b> | <b>453,381</b> |
| 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                | \$ 21,947      | \$ (40,630)    | \$ (11,908)    |

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

(expressed in thousands)

| As at 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            |
|   | <b>69,475</b>    | <b>73,832</b>    | <b>66,793</b>    |
| 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)          |
|   | <b>(24,440)</b>  | <b>(18,681)</b>  | <b>(2,688)</b>   |
| Investing:  |                  |                  |                  |
| Proceeds from disposal of assets                                | 17,996           | 84               | 45               |
| Purchase of capital assets                                      | (59,649)         | (58,198)         | (54,850)         |
|   | <b>(41,653)</b>  | <b>(58,114)</b>  | <b>(54,805)</b>  |
| Increase (decrease) in cash and cash equivalents                | <b>3,382</b>     | <b>(2,963)</b>   | <b>9,300</b>     |
| Cash and cash equivalents, beginning of year                    | <b>14,557</b>    | <b>17,520</b>    | <b>8,220</b>     |
| Cash and cash equivalents, end of year                          | <b>\$ 17,939</b> | <b>\$ 14,557</b> | <b>\$ 17,520</b> |

Supplemental cash flow information (note 15)

See accompanying notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

Years ended March 31, 2004, 2003 and 2002 (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.

### (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:

| Asset class                         | Estimated useful life |
|-------------------------------------|-----------------------|
| 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.

(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.

## Notes to Consolidated Financial Statements (continued)

Years ended March 31, 2004, 2003 and 2002 (columnar dollars expressed in thousands)

(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.

### 2. Capital assets:

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

| March 31, 2003                  | Cost                | Accumulated amortization | Net book value    |
|---------------------------------|---------------------|--------------------------|-------------------|
| 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               |
|                                 | <b>\$ 1,248,950</b> | <b>\$ 680,982</b>        | <b>\$ 567,968</b> |

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 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      | \$ - |

## Notes to Consolidated Financial Statements (continued)

Years ended March 31, 2004, 2003 and 2002 (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      | 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 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.

## 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:

| Year ended |           |
|------------|-----------|
| 2005       | \$ 11,173 |
| 2006       | 9,927     |
| 2007       | 2,166     |
| 2008       | 2,003     |
|            | \$ 25,269 |

# Notes to Consolidated Financial Statements (continued)

Years ended March 31, 2004, 2003 and 2002 (expressed in thousands)

## 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.

## 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.

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.

# Corporate Directory

## Board of Directors (Appointed April 1, 2004)

Elizabeth J. Harrison, Q.C.  
Chair

Tom Harris<sup>2</sup>  
Vice Chair

Doug Allen<sup>1,2</sup>

Marilyn Baker<sup>2</sup>

Sandy Fulton<sup>1,3</sup>

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

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

Ray Whitehead<sup>3</sup>

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

1. Audit & Finance Committee

2. Governance Committee

3. Safety, Health & Environment Committee

## Board of Directors (April 2, 2003 to March 31, 2004)

David Emerson (Chair)

Doug Allen

Peter Armstrong

Mark Cullen

Jim Cutt

Elizabeth J. Harrison, Q.C.

Tom Harris

Maureen Macarenko

Ray Whitehead

Graham Wilson (Appointed April 11, 2003)

## Senior Officers of the Company

David L. Hahn  
President & CEO

Rob Clarke  
Executive Vice President, Finance & CFO

Mike Corrigan  
Executive Vice President, Business Development

Bill Cottick  
Vice President, Corporate Affairs, General Counsel  
& Corporate Secretary

Glen Schwartz\*  
Executive Vice President, Human Resources  
& Organizational Development

Mark Stefanson  
Vice President, Communications

Captain Trafford Taylor  
Executive Vice President, Operations

## Officers of the Company

Captain George Capacci\*  
Vice President, Inter Island & Northern Services

Mark Collins  
Vice President, Corporate Engineering & Asset Development

Geoff Dickson  
Vice President, Marketing & Retail Services

Blaine Ellis\*  
Vice President, Employee Relations

Alana Gallagher  
Treasurer

Captain (N) (Ret'd) David Marshall  
Vice President, Mainland Services & Operational Planning

\*George Capacci started May 17, 2004

Glen Schwartz started June 1, 2004

Blaine Ellis started July 12, 2004

# B.C. Ferry Authority

Annual Report 2003/04

|  |     |
|--|-----|
| A Message from the Chair                 | A1  |
| Summary of Meetings                      | A2  |
| Legal Basis for the B.C. Ferry Authority | A3  |
| Skills and Experience Profile            | A4  |
| Auditors' Report                         | A6  |
| Statement of Financial Position          | A7  |
| Statement of Operations                  | A8  |
| Statement of Changes in Net Assets       | A9  |
| Notes to Financial Statements            | A10 |
| Board of Directors                       | A12 |

## A Message from the Chair


An important part of the restructuring of BC Ferries was the creation of the B.C. Ferry Authority. The Authority is a corporation without share capital, which owns the only issued common voting share in the operating entity, British Columbia Ferry Services Inc.

A key element of the B.C. Ferry Authority is our independent, nine-member Board of Directors.

The Board is comprised of experienced individuals representing various BC Ferries stakeholders, with members appointed to staggered terms to provide continuity.

Commencing April 1, 2004, the directors of the B.C. Ferry Authority include four regional appointees, one director chosen by the Board from nominees received from the BC Ferry & Marine Workers' Union and two directors appointed by each of the provincial government and by the then existing Board of the Authority. The regional appointees are chosen by the Board from nominees submitted from thirteen coastal regional districts, which are designated under four appointment areas.

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

A handwritten signature in black ink, appearing to read 'E. Harrison', written in a cursive style.

Elizabeth J. Harrison, Q.C.  
Chair

## Summary of Meetings (Figure 1)

| DATE               | TYPE                        | OUTCOMES  |
|--------------------|-----------------------------|---|
| May 23, 2003       | Board of Directors          | <ul style="list-style-type: none"> <li>• Officers elected</li> <li>• Interim meeting procedures adopted</li> <li>• Draft by-laws conditionally approved</li> <li>• Committees of the Board established</li> <li>• Fiscal year-end date confirmed</li> <li>• Meeting schedule for the Board established</li> <li>• Appointment process for next Directors confirmed</li> <li>• Skills and Experience Profile for Board appointments approved</li> <li>• Governance manual amendments approved</li> <li>• 2003/04 operating budget adopted</li> </ul> |
| June 25, 2003      | Audit and Finance Committee | <ul style="list-style-type: none"> <li>• Inaugural meeting</li> </ul>   |
| June 25, 2003      | Governance Committee        | <ul style="list-style-type: none"> <li>• Terms of Reference for the Governance Committee recommended for approval to the Board</li> </ul>   |
| June 26, 2003      | Board of Directors          | <ul style="list-style-type: none"> <li>• External Auditor appointed</li> <li>• Terms of Reference for the Governance Committee approved</li> </ul>  |
| September 9, 2003  | Audit and Finance Committee | <ul style="list-style-type: none"> <li>• Adjustment of contributed surplus and deficit accounts in the amount of \$40,630,512.13 on the books of British Columbia Ferry Services Inc.</li> <li>• Directors and Officers liability insurance increased</li> </ul>  |
| September 9, 2003  | Governance Committee        | <ul style="list-style-type: none"> <li>• Code of Business Conduct for Directors considered and forwarded for legal review</li> </ul>  |
| September 12, 2003 | Board of Directors          | <ul style="list-style-type: none"> <li>• Role of Governance Committee Chair with respect to conflict of interest forms and issues of Directors confirmed</li> <li>• Appointments of new Corporate Secretary and Deputy Corporate Secretary confirmed</li> </ul>   |
| October 16, 2003   | Governance Committee        | <ul style="list-style-type: none"> <li>• By-laws recommended for adoption to the Board</li> </ul>   |
| October 17, 2003   | Board of Directors          | <ul style="list-style-type: none"> <li>• By-laws adopted</li> </ul>   |
| November 13, 2003  | Audit and Finance Committee | <ul style="list-style-type: none"> <li>• Terms of Reference for the Audit and Finance Committee recommended for approval to the Board</li> <li>• Financial Statements of the Authority for the quarter ended September 30, 2003, recommended for approval to the Board</li> </ul>   |
| November 13, 2003  | Governance Committee        | <ul style="list-style-type: none"> <li>• Terms of Reference for the Audit and Finance Committee recommended for approval to the Board</li> </ul>  |
| November 14, 2003  | Board of Directors          | <ul style="list-style-type: none"> <li>• Financial Statements of the Authority for the quarter ended September 30, 2003 approved</li> <li>• Terms of Reference for the Audit and Finance Committee approved</li> </ul>  |
| February 10, 2004  | Audit and Finance Committee | <ul style="list-style-type: none"> <li>• Financial Statements of the Authority for the quarter ended December 31, 2003, recommended for approval to the Board</li> </ul>  |
| February 10, 2004  | Governance Committee        | <ul style="list-style-type: none"> <li>• Board calendar for 2004/05 recommended for approval to the Board</li> <li>• Indemnification of Directors and Officers recommended for approval to the Board</li> </ul>   |
| February 18, 2004  | Board of Directors          | <ul style="list-style-type: none"> <li>• Financial Statements of the Authority for the quarter ended December 31, 2003 approved</li> <li>• Board calendar for 2004/05 approved</li> <li>• Directors nominated by Appointment Areas and the BC Ferry &amp; Marine Workers' Union appointed effective April 1, 2004</li> <li>• Indemnification of Directors and Officers approved</li> <li>• New fee structure for Board members adopted</li> <li>• Corporate seal adopted</li> </ul>   |
| March 2, 2004      | Governance Committee        | <ul style="list-style-type: none"> <li>• Next steps in Board appointment process discussed</li> </ul>   |
| March 29, 2004     | Governance Committee        | <ul style="list-style-type: none"> <li>• Authority appointments to the Board effective April 1, 2004 recommended for Board approval</li> <li>• The terms each Director will serve on the Board effective April 1, 2004 recommended for Board approval</li> <li>• Chair and Vice Chair appointments effective April 1, 2004 recommended for Board approval</li> <li>• Committee membership effective April 1, 2004 recommended for Board approval</li> </ul>   |
| March 30, 2004     | Board of Directors          | <ul style="list-style-type: none"> <li>• Directors appointed to the Board effective April 1, 2004</li> <li>• Terms each Director will serve on the Board effective April 1, 2004 established</li> <li>• Chair and Vice Chair effective April 1, 2004 appointed</li> <li>• Committee members effective April 1, 2004 appointed</li> <li>• Selection process used to determine Chairs and Committee members to be reviewed by Governance Committee</li> </ul>   |

# Legal Basis for the B.C. Ferry Authority

B.C. Ferry Authority (Authority) is a no-share-capital corporation created under the Coastal Ferry Act. It was established April 1, 2003, and is the owner of the single issued voting share of British Columbia Ferry Services Inc, a company incorporated under the Company Act (British Columbia) and the successor to the former Crown corporation known as British Columbia Ferry Corporation.

B.C. Ferry Authority appoints the Board of Directors of British Columbia Ferry Services Inc. Consistent with the requirements of the Coastal Ferry Act, the Authority has established by-laws specifying the rules and procedures relating to the governance, management and operation of the Authority. There have been no amendments to the by-laws of the Authority since their adoption by the Board in Fall 2003.

## Meetings of the Board

The Authority Board and its Committees met on 18 occasions during the year. A summary of the meetings is presented in Figure 1.

## Appointment of New Directors

The framework for the appointment of Directors of B.C. Ferry Authority is set out in the Coastal Ferry Act. The first Directors of B.C. Ferry Authority were the individuals who were the Directors of British Columbia Ferry Corporation on March 31, 2003. This was a transition Board and the term of office of the first Directors was one year, ending March 31, 2004.

During the year, the Authority Board managed the process for appointing the next Directors of B.C. Ferry Authority. The coastal regional districts, as well as the union representing the employees of British Columbia Ferry Services Inc., nominated qualified candidates to serve on the Board. Additional candidates were identified by the Provincial Government and the Authority Board.

Effective April 1, 2004, a new Board of Directors was constituted as follows:

- The previous Board of the Authority appointed:
  - four nominees from the 13 coastal regional districts, grouped into 4 Appointment Areas;
  - one nominee from the British Columbia Ferry & Marine Workers' Union; and,
  - two members at large.
- The Provincial Government appointed 2 members.

In selecting individuals to be the next Directors of the Board, the Authority was guided by the following principles: The Coastal Ferry Act sets out certain criteria that must be met in order for a person to qualify as a Director of B.C. Ferry Authority. As well, the Authority Board identified personal attributes and core competencies that each appointee should possess, as well as the key skills and experience that the Directors of the Authority, as a whole, should possess to ensure good governance of the Authority. These criteria are set out in the Skills and Experience Profile adopted by the Authority as part of its by-laws (see Figure 2) and represent the key considerations that were taken into account in the appointment of individuals to serve as the next Directors of the Authority.



## Skills and Experience Profile (Figure 2)

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

### Statutory Qualifications:

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

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

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

### Personal Attributes:

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

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

### Core Competencies:

All Directors should possess the following core competencies:

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

### Representation:

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

### Key Skills and Experience:

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

1. **Leadership** - experience at a senior level managing the operations of a large or complex commercial or non-profit entity.
2. **Business** - experience in operating a business in British Columbia.

3. **Board Experience** - previous experience as a member of a Board of Directors of a commercial or non-profit entity.
4. **Accounting and Finance** - an accounting or financial advisor designation or senior level experience as a Chief Financial Officer in a large or complex commercial or non-profit entity.
5. **Legal** - a law degree or experience in managing legal issues of a complex commercial nature.
6. **Transportation** - knowledge of and experience in addressing transportation issues, including environmental and safety issues.
7. **Marketing** - experience in developing and/or leading marketing or customer service initiatives.
8. **Tourism** - knowledge of and experience in the tourism industry in British Columbia, including the hospitality and retail sectors.
9. **Labour Management** - knowledge of and experience in human resources and labour relations practices in British Columbia.
10. **Regulatory** - experience working in or significant knowledge of the issues associated with a commercial entity regulated by statute.
11. **Community and Aboriginal Relations** - experience in leading consultation processes with local governments and/or aboriginal interests in British Columbia.

# Auditors' Report

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

We have audited the statement of financial position of B.C. Ferry Authority as at March 31, 2004 and the statements of operations and changes in net assets for the year then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

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

The image shows a handwritten signature in black ink that reads "KPMG LLP". The signature is written in a cursive, stylized font.

Chartered Accountants

Victoria, Canada

April 28, 2004

(except note 6, which is as of May 19, 2004)

# Statement of Financial Position

(expressed in thousands of dollars)

March 31, 2004

---

## Assets

|  |           |
|--|-----------|
| Investment in British Columbia Ferry Services Inc. | \$ 21,948 |
|--|-----------|

---

## Net Assets

|  |        |
|--|--------|
| Invested in common share of British Columbia Ferry Services Inc.           | \$ 1   |
| Accumulated undistributed earnings of British Columbia Ferry Services Inc. | 21,947 |

|                                 |  |
|---------------------------------|--|
| Contingent liabilities (note 5) |  |
| Subsequent event (note 6)       |  |

---

|           |
|-----------|
| \$ 21,948 |
|-----------|

---

See accompanying notes to financial statements.

On behalf of the Board:

[signed]  
Graham M. Wilson  
Director

[signed]  
Elizabeth J. Harrison, Q.C.  
Director

# Statement of Operations

(expressed in thousands of dollars)

Year ended March 31, 2004

---

Revenue:

|   |              |
|---|--------------|
| Distributable earnings of British Columbia Ferry Services Inc. (note 2) | \$ 21,947    |
| Contribution from Province of British Columbia                          | 1            |
|   | <hr/> 21,948 |

Expenses:

|   |       |
|---|-------|
| Administration  | 17    |
| Directors' fees   | 8     |
| Recovery from British Columbia Ferry Services Inc. (note 3) | (25)  |
|   | <hr/> |

---

|                                 |           |
|---------------------------------|-----------|
| Excess of revenue over expenses | \$ 21,948 |
|---------------------------------|-----------|

---

See accompanying notes to financial statements.

# Statement of Changes in Net Assets

(expressed in thousands of dollars)

Year ended March 31, 2004

|                                 | Earnings<br>BCFSI | Undistributed<br>value<br>of BCFSI | Total     |
|---------------------------------|-------------------|------------------------------------|-----------|
| Balance, April 1, 2003          | \$ -              | \$ -                               | \$ -      |
| Excess of revenue over expenses | 12                | 21,947                             | 21,948    |
| Balance, March 31, 2004         | \$ 1              | \$ 21,947                          | \$ 21,948 |

See accompanying notes to financial statements.

# Notes to Financial Statements

Year ended March 31, 2004 (expressed in thousands of dollars)

B.C. Ferry Authority (the "Authority") was established by the Coastal Ferry Act (British Columbia) (the "Act") on April 1, 2003 as a corporation without share capital. The Authority is governed by a board of nine directors. The inaugural board, with a term expiring on March 31, 2004, consisted of the individuals who were the directors of British Columbia Ferry Corporation as at March 31, 2003. The board of directors then appointed seven directors as follows:

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

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

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

## 1. Significant accounting policies:

### (a) Basis of presentation:

The financial statements are prepared in accordance with Canadian generally accepted accounting principles for not-for-profit entities. The Authority's investment in its wholly owned subsidiary, BCFSI, is accounted for by the equity method. Under the equity method the original cost of the investment is adjusted for the Authority's share of post-acquisition earnings or losses less dividends.

### (b) Revenue recognition:

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

### (c) Taxes:

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

### (d) Statement of cash flows:

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

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

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

|  |    |         |
|--|----|---------|
| Net earnings of British Columbia Ferry Services Inc.           | \$ | 27,985  |
| Dividends paid on 8% cumulative preferred shares               |    | (6,038) |
| Reserve for undeclared, 8% cumulative preferred share dividend |    | -       |
|  | \$ | 21,947  |

# Notes to Financial Statements (continued)

Year ended March 31, 2004 (expressed in thousands of dollars)

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

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

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

The consolidated financial position and operating results for BCFSI and its wholly-owned subsidiaries as at, and for, the year ended March 31, 2004 are summarized below:

|  |            |
|--|------------|
| Net earnings of British Columbia Ferry Services Inc. | \$ 27,985  |
| Current assets                                       | \$ 53,083  |
| Capital and other assets                             | 576,704    |
|  | <hr/>      |
|  | \$ 629,787 |
| Current liabilities                                  | \$ 89,017  |
| Deferred employee obligations                        | 15,644     |
| Long-term debt                                       | 427,701    |
|  | <hr/>      |
|  | 532,362    |
| Shareholders' equity:                                |            |
| Common share held by the Authority                   | 1          |
| Preferred shares (see (a) below)                     | 75,477     |
| Retained earnings                                    | 21,947     |
|  | <hr/>      |
|  | 97,425     |
|  | <hr/>      |
|  | \$ 629,787 |
| Revenue (including gains)                            | \$ 533,921 |
| Expenses (including losses)                          | 505,936    |
| Net earnings   | <hr/>      |
|  | \$ 27,985  |
| Cash flows from operations                           | \$ 69,475  |
| Cash flows from financing                            | (24,440)   |
| Cash flow from investing                             | (41,653)   |

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

## 5. Collective agreement of subsidiary:

The collective agreement between BCFSI and the BC Ferry and Marine Workers' Union expired on October 31, 2003. Until new collective agreements are reached, BCFSI and its wholly owned subsidiary, Deas Pacific Marine Inc., are operating under the prior collective agreement. Additional liabilities, if any, arising from the new collective agreements cannot be reasonably estimated at this time.

## 6. Subsequent event of subsidiary:

Subsequent to March 31, 2004, BCFSI 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, BCFSI 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 BCFSI 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.



# Corporate directory

## Board of Directors (Appointed April 1, 2004)

**Elizabeth J. Harrison, Q.C.**

Chair (Community-at-large appointment)

**Tom Harris<sup>2</sup>**

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

**Doug Allen<sup>1,2</sup>**

(Community-at-large appointment)

**Marilyn Baker<sup>2</sup>**

(Southern Vancouver Island appointment area)

**Sandy Fulton<sup>1</sup>**

(Province of B.C. appointment)

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

(Southern Mainland appointment area)

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

(Northern Coastal and North Island appointment area)

**Ray Whitehead**

(Organized labour appointment)

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

(Province of B.C. appointment)

1. Audit & Finance Committee

2. Governance Committee

## Board of Directors (April 1, 2003 to March 31, 2004)

**David Emerson (Chair)**

**Doug Allen**

**Peter Armstrong**

**Mark Cullen**

**Jim Cutt**

**Elizabeth J. Harrison, Q.C.**

**Tom Harris**

**Maureen Macarenko**

**Ray Whitehead**

## Officers

**Elizabeth J. Harrison, Q.C.**

Chair

**Tom Harris**

Vice Chair

**Bill Cottick**

Vice President, Corporate Affairs, General Counsel & Corporate Secretary







 **BC Ferries**

[www.bcferrries.com](http://www.bcferrries.com) • [www.bcferryauthority.com](http://www.bcferryauthority.com)