

BRITISH COLUMBIA

FERRY CORPORATION

2002/03

ANNUAL REPORT



BC FERRIES

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.

A NOTE ABOUT FORMAT This annual report has been produced in both electronic and printed versions. BC Ferries has tried to ensure that the electronic version will display well on any computer screen and will also produce a consistent printed document with any computer equipment. However, if this does not occur with your equipment, we regret that we are unable to produce customized electronic documents. If you would like to comment on the report, please contact us. Contact information is included on the back cover of the report.

Extensive information about the British Columbia Ferry Corporation and the transportation system it operates is available at www.bcferrries.com.

TABLE OF CONTENTS

CORPORATE PROFILE	4
CHAIR'S MESSAGE	5
PRESIDENT'S MESSAGE	8
YEAR IN REVIEW	11
STATEMENT OF CORPORATE GOVERNANCE PRACTICES	29
MANAGEMENT DISCUSSION AND ANALYSIS	31
MANAGEMENT REPORT	47
AUDITORS' REPORT	48
FINANCIAL STATEMENTS	49

THE BRITISH COLUMBIA FERRY CORPORATION WAS ESTABLISHED UNDER THE *FERRY CORPORATION ACT* OF the Province of British Columbia. On January 1, 1977, it commenced operation of the ferry service that was initiated by the provincial government in 1960 to provide marine vehicle and passenger transportation services along the coast of British Columbia. On April 2, 2003, the British Columbia Ferry Corporation was converted from a Crown corporation to an independent, regulated company under the *Company Act*, and renamed British Columbia Ferry Services Inc. This conversion was recognized in the new *Coastal Ferry Act*, which took effect April 1, 2003, and coincidental to this, the *Ferry Corporation Act* was repealed.

BC Ferries is an integral part of British Columbia's coastal transportation system. The ferry service links Vancouver Island to the mainland of British Columbia, and also connects many isolated coastal communities to either Vancouver Island or the mainland. Ferry service is also provided from Prince Rupert, on the north coast of the province, to the Queen Charlotte Islands, and to Port Hardy on the northern end of Vancouver Island. In addition, the Discovery Coast Passage offers summer service between Port Hardy and Bella Coola on the central coast, with additional ports of call en route. Its services are supported by 38 vessels traveling between 48 terminals, on 25 routes.

BC Ferries' workforce consists of unionized and management employees. All unionized employees are members of the B.C. Ferry and Marine Workers' Union. The workforce includes 2,800 full-time workers, augmented by 1,700 casual (on-call) employees.

During the 2002/03 fiscal year, BC Ferries carried 21.6 million passengers and 8.3 million vehicles, generating \$490 million in revenue. All costs and revenues, including the statutory contribution of a portion of provincial motor fuel tax revenue and the federal contract revenue, are detailed in the financial statements and associated notes in this annual report.

CHAIR'S MESSAGE

THE 2002/03 FISCAL YEAR SAW THE COMPLETION OF THE FIRST PHASE OF A SIGNIFICANT TRANSFORMATION OF the British Columbia Ferry Corporation.

Following a process that began the year prior, the provincial government and BC Ferries' Board of Directors undertook a core review of the Corporation in 2002/03. The process was initiated to examine every aspect of the Crown corporation in order to determine how best to remodel delivery of ferry services in the province of British Columbia.

In many respects, change for the Corporation was inevitable. As a Crown corporation, BC Ferries was very much dependent upon government for everything from rate-setting to vessel construction and spending priorities. Capital investments were approved within the short-term rotation of government fiscal priorities rather than adhering to a long-term business model that is required for a service of this magnitude. In addition, each decision was directly influenced by the politics of the day.

This problem, which has been well chronicled in independent reports about the ferry system, seriously inhibited the Corporation's ability to operate in a businesslike manner. With a major capital replacement program needed to upgrade or replace older vessels in the fleet and improve terminal infrastructure, a new model was required to access outside financing to make these necessary investments.

The provincial government and BC Ferries' Board of Directors examined a variety of potential solutions for the coastal ferry system. Every option was seriously considered: from retaining status quo for the taxpayer-supported Crown corporation model to outright privatization of the service. The option that was selected is the optimal solution. It is best described as a commercial model governed by an independent authority that meets the objective of creating a modern, safe and reliable ferry system that will provide improved service and greater customer choice while protecting British Columbia taxpayers from further financial risk and debt burden.

Implementing a new structure for the delivery of ferry service has been the first important step towards revitalizing British Columbia's ferry system. The next step is to guide the long-term direction of BC Ferries as it evolves into an independent, commercially focused entity, creating value for the shareholder and exceeding the expectations of customers and communities.



David L. Emerson
CHAIR

BOARD OF DIRECTORS¹

David Emerson, CHAIR
Doug Allen
Peter Armstrong
Mark Cullen²
Jim Cutt

¹The directors were appointed September 17, 2001 with the exception of David Emerson (July 31, 2001), Ray Whitehead (June 24, 1998), and Doug Allen (March 28, 2003).

Tom Harris
Elizabeth Harrison, QC³
Maureen Macarenko
Ray Whitehead⁴

²Chair, Audit and Finance Committee

³Chair, Governance Committee

⁴Chair, Safety, Health & Environment Committee

EXECUTIVE MANAGEMENT

Doug Allen
INTERIM PRESIDENT AND
CHIEF EXECUTIVE OFFICER
Appointed October 16, 2002

Captain Mike Carter
EXECUTIVE VICE PRESIDENT,
OPERATIONS

Rob Clarke, CGA
EXECUTIVE VICE PRESIDENT,
FINANCE AND CHIEF FINANCIAL OFFICER

Mike Corrigan
EXECUTIVE VICE PRESIDENT,
BUSINESS DEVELOPMENT AND CUSTOMER SERVICE
Appointed March 3, 2003

Derek Johnston
VICE PRESIDENT,
HUMAN RESOURCES

Mark Stefanson
VICE PRESIDENT,
COMMUNICATIONS

Shirley Thompson
ACTING CORPORATE SECRETARY
Appointed February 10, 2003

PRESIDENT'S MESSAGE

DURING THIS PAST YEAR, BC FERRIES HAS MAINTAINED AN IMPRESSIVELY HIGH STANDARD OF SAFETY AND service delivery while undergoing significant corporate change.

October of 2002 marked the departure of BC Ferries' former President and CEO after three years with the Corporation. I was pleased to take on the role as Interim President and CEO while an executive search was launched by the Board of Directors to fill the position permanently.

In December 2002, the provincial government announced that BC Ferries would become an independent, self-financing commercial company and less than four months later, BC Ferries was transformed from a Crown corporation to a private company, British Columbia Ferry Services Inc. This transformation entailed a very significant restructuring of the company and its relationship with government and customers. Credit for the successful transformation is due to the Board of Directors, management and other employees of the company, the provincial Cabinet and other members of the Legislative Assembly, senior officials in various positions in government, and many others across British Columbia who played a significant role. This task was also supported by a number of business and service improvements in the company that were put in place prior to my arrival.

The *Coastal Ferry Act*, effective April 1, 2003, established a new independent regulatory framework for coastal ferry services and a new service delivery model, making BC Ferries a customer-focused and financially stable marine transportation system.

The B.C. Ferry Authority was established to govern British Columbia Ferry Services Inc. In addition, an independent regulator, the British Columbia Ferries Commissioner, is mandated to ensure rates and service levels will be fair and reasonable, as specified in a long-term contract, effective April 2, 2003, between the Province of British Columbia and British Columbia Ferry Services Inc.

The legislation also provided for the transfer of all existing British Columbia Ferry Corporation employees to the new company and set the stage for a commercial approach to the delivery of ferry services.

Closure was also brought to the fast ferry program in 2002/03 through the sale of the three PacifiCats at a public auction in Vancouver. The proceeds of US \$13.65 million from the sale were nominal in comparison with the costs incurred in building the vessels. However, after lengthy and concerted efforts to market the PacifiCat fast ferries world-wide, they are now sold and BC Ferries is appropriately refocused on the task of replacing and upgrading its conventional fleet.

Revenue continued to grow in 2002/03 compared to the previous fiscal year, with a net increase of \$16.8 million or 3.5 per cent. Expenditures, including financing costs, increased by \$9.8 million or 2.1 per cent. Total earnings (before loss on disposal of the PacifiCat fast ferries) increased by \$7.0 million or 40 per cent.

I would like to express my gratitude to the BC Ferries' Board of Directors for its vision and tremendous support, and to employees for remaining focused and dedicated to our customers throughout the transformation to the new company. I owe a special thanks to the members of the executive management team including consultant Henry Wakabayashi, all of whom worked creatively over exceedingly long hours to make the restructuring of the company a success. Finally, I would like to thank our thousands of customers who we are in business to serve.



Doug Allen

INTERIM PRESIDENT AND CEO

FIVE-YEAR TRENDS

KEY INDICATORS

Tolls, catering and other income per passenger	\$18.09	\$17.74	\$16.91	\$16.66	\$16.52
Operating and net financing expenses per passenger	\$19.42	\$19.18	\$18.45	\$20.62	\$19.38
Percentage of operating and net financing expenses recovered from tolls, catering and other income	93.1%	92.5%	91.7%	80.8%	85.2%
Cash flow/debt service ratio	22.23	18.96	29.29	0.50	0.59
Return on assets	-4.5%	-3.3%	1.5%	-43.1%	-13.0%
Full-time equivalent employees (Note 1)	3,345	3,380	3,339	3,390	3,389

OPERATIONS (figures in thousands)

Passengers carried	21,624	21,251	21,369	21,381	21,379
Passenger miles travelled	407,384	402,641	408,215	408,465	406,482
Utilization—passengers	30%	30%	31%	31%	30%
Vehicles carried	8,323	8,108	7,932	7,884	7,815
AEQs carried (Note 2)	9,126	8,890	8,709	8,668	8,579
AEQ miles travelled	162,349	163,925	156,188	155,957	154,587
Utilization—AEQs	54%	55%	54%	54%	52%

FINANCIAL (figures in \$ thousands)

Tolls, catering and other income (excluding interest income)	\$391,163	\$376,889	\$361,425	\$356,169	\$353,222
Government contracts, grants and motor fuel tax	97,620	94,659	94,957	87,063	46,040
Operating and net financing expenses (Note 3)	419,936	407,627	394,297	440,955	414,417
Cash flow from operating activities	73,832	66,793	65,221	(22,925)	(7,169)
Net investments in capital assets	58,114	54,805	55,148	114,590	166,602
Total assets	636,756	676,234	699,648	693,954	875,797
Proceeds from borrowing	—	—	—	145,151	191,731
Long-term debt and capital leases, net of sinking funds	—	15,704	18,616	21,609	957,114
Shareholder's equity (deficiency)	503,178	549,113	571,735	561,021	(206,277)

Notes:

1. Full-time equivalent employees is calculated by dividing actual labour hours worked by the standard hours in a work year (1,827).
2. AEQs - Automobile Equivalents are a standard-length traffic unit. Underheight and overheight vehicles are each one AEQ; buses and trucks are each three AEQs.
3. Financial information is presented on a consolidated basis (includes BC Ferries' wholly-owned subsidiary, Catamaran Ferries International Inc. (CFI)) except for operating revenues and expenses (BC Ferries only).

YEAR IN REVIEW

INTRODUCTION

This discussion has been structured to parallel BC Ferries' 2002/03 – 2004/05 Service Plan, which sets goals for the delivery of services. Certain performance graphs contained in this report differ from those in the Service Plan as it is management's opinion that they more accurately reflect the Corporation's operational performance. The Year in Review discusses how BC Ferries met the goals outlined in the Service Plan.

Service on most routes continued in 2002/03 with no significant change from previous years. The Corporation's efforts focused on improving on-time performance, the customer experience, addressing future demand, and replacing outdated infrastructure. System-wide, BC Ferries carried 8.3 million vehicles (up 2.7 per cent from 2001/02) and 21.6 million passengers (up 1.8 per cent from 2001/02).

GOAL 1: INCREASING CUSTOMER VALUE

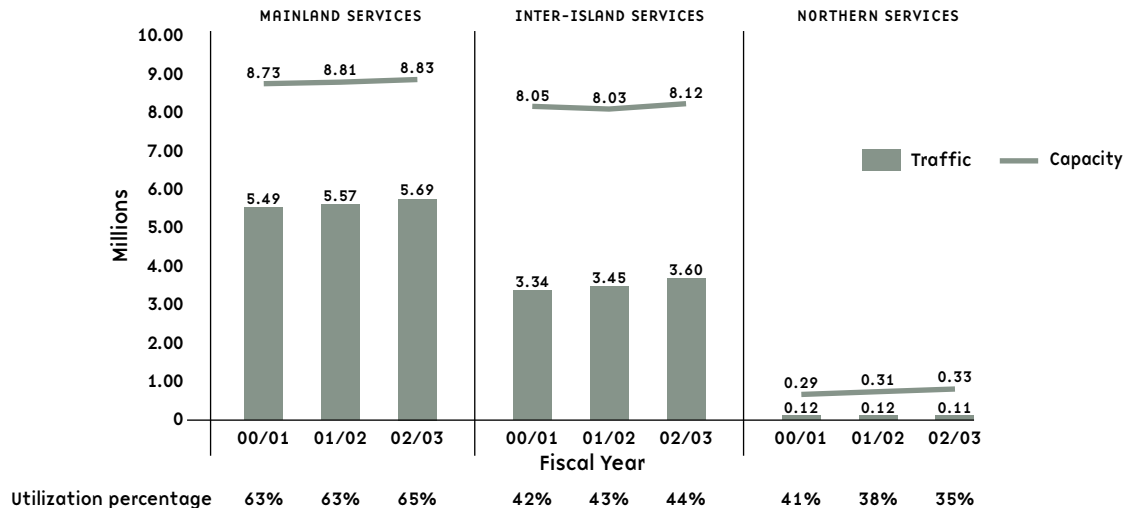
Know and understand our customers and respond to their needs with products and service-delivery methods based on customer research.

Understanding our Customers

- As part of a heightened focus on customer service, BC Ferries introduced a **Customer Satisfaction tracking** program to measure customer satisfaction on a regular and ongoing basis. The results are used to monitor areas that customers believe are performing favourably and areas that require improvement. The results will guide management's decisions as it invests in terminal and vessel improvements as well as the overall delivery of customer service.

PRODUCTIVITY MEASURES

AEQS CARRIED/CAPACITY UTILIZATION



RATIONALE/METHODOLOGY: To measure vehicular traffic carried (defined as automobile equivalents "AEQs") and measure against vehicular carrying capacity of the operational fleet. This will provide a measure of total vehicle capacity used. Total AEQs carried is divided by AEQ carrying capacity of the operating fleet in each of the three operating segments.

VARIANCE ANALYSIS:

On the Mainland Services routes vehicle traffic AEQs increased by 2.2% against a 0.1% increase in capacity resulting in a 2% increase in utilization over the previous year.

On the Inter-Island Services routes vehicle traffic AEQs increased by 4.3% against a 1.1% increase in capacity resulting in a 1% increase in utilization over the previous year.

On the Northern Services routes vehicle traffic AEQs decreased by 4.2% against a 6.4% increase in capacity resulting in a 3% decrease in utilization over the previous year.

Overall vehicle traffic AEQs increased by 2.8% against a 0.6% increase in capacity resulting in a 1.2% increase in utilization over the previous year.

- BC Ferries continues to work towards ensuring that **public consultation** is integrated with its capital planning and budgeting procedures so that the public's views are considered in the planning of terminal improvements, new ship construction, and major service plan changes. Since 1997, BC Ferries has maintained 12 ferry advisory committees to provide local advice on operational matters. These committees are organized around specific routes and are appointed in cooperation with local government. BC Ferries also consults with tourism associations, chambers of commerce, municipalities, various interest groups and aboriginal communities.

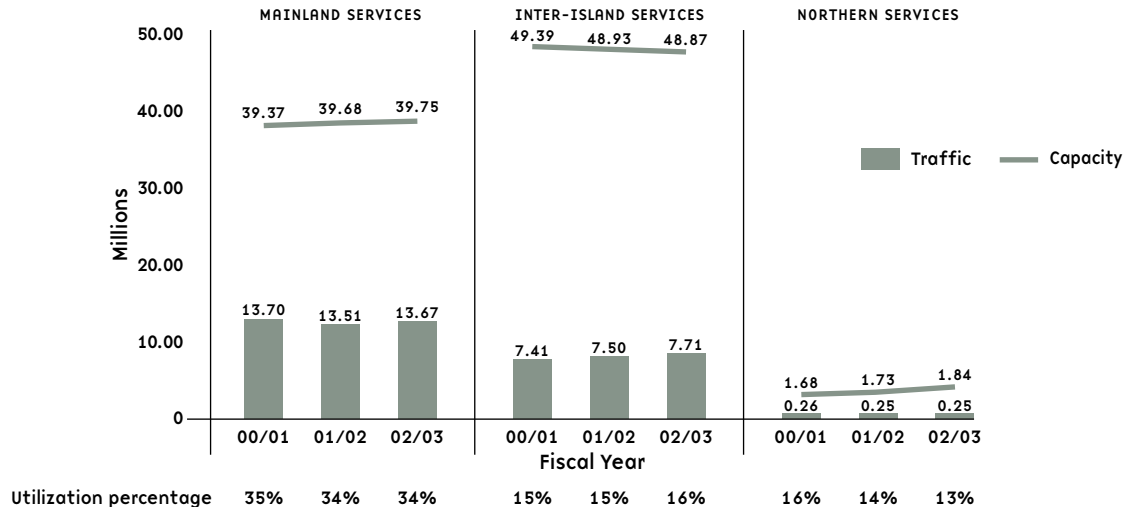
Providing Information

- **BC Ferries' internet website** at www.bcferrries.com continues to be one of the most popular travel sites in British Columbia. In 2002 the number of unique hosts accessing our web site averaged 115,000 per month (up 20 per cent from 2001/02), reaching an all-time high of 177,433 in July. New to the web site is a section on public consultation where minutes of ferry advisory committee meetings are published, along with information on consultation events, relevant documents and contacts. Online surveys conducted in 2002 showed overall high customer satisfaction with www.bcferrries.com.
- During 2002/03, a new **standardized wayfinding and messaging** program to guide customers to and through BC Ferries' major route terminals and vessels was completed at Departure Bay. The program is nearing completion at Horseshoe Bay and is being implemented at Tsawwassen and at Swartz Bay. New standards for vessel wayfinding signage have been completed and are being applied to the Queen of Coquitlam as part of its mid-life upgrade, the first of a five-year program to upgrade all "C" class vessels¹.

¹ "C" class vessels include the Queen of Cowichan, Queen of Coquitlam, Queen of Oak Bay, Queen of Surrey and Queen of Alberni. These vessels are double-ended with geared diesel propulsion systems and have controllable pitch propellers at each end.

PRODUCTIVITY MEASURES

PASSENGER TRAFFIC CARRIED/CAPACITY UTILIZATION



RATIONALE/METHODOLOGY: To measure passenger traffic carried and measure against passenger carrying capacity of the operating fleet. This will provide a measure of total passenger capacity used. Total passengers carried is divided by passenger carrying capacity of the operating fleet in each of the three operating segments.

VARIANCE ANALYSIS:

On the Mainland Services routes passenger traffic increased by 1.2% against a 0.2% increase in capacity with utilization remaining the same as the previous year.

On the Inter-Island Services routes passenger traffic increased by 2.9% against a 0.1% decrease in capacity resulting in a 1% increase in utilization over the previous year.

On the Northern Services routes passenger traffic decreased by 1.2% against a 6.0% increase in capacity resulting in a 1% decrease in utilization over the previous year.

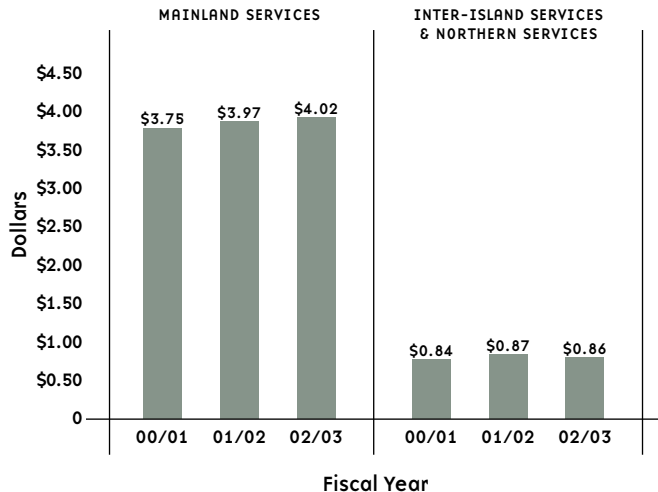
Overall passenger traffic increased by 1.8% against a 0.1% increase in capacity with overall utilization remaining the same over the previous year.

Meeting the Needs of Customers

- The **Service Recovery program**, recognized as an important element in delivering customer service, provides a process of identifying and addressing customer concerns in the event of a service failure. This program was developed and successfully introduced on the minor routes during the 2002/03 fiscal year and is being introduced as a phased program focused on delayed sailings on the major routes.
- Use of **passenger vehicle reservations**, available to customers on major routes between Vancouver Island and the Lower Mainland for a \$15 fee, increased by 35 per cent from 2001/02. As a result, the space allocated for reservations during peak periods was increased.
- In February 2003, BC Ferries and White Spot won the **Newsmaker of the Year award** for their outstanding partnership in the Food Services and Hospitality Industry. The award was based on dedication to industry advancement, visionary approach, credibility, communication, and impact of the contribution. The **White Spot** program has been expanded to the Queen of Alberni and Queen of New Westminster on Route 30 (Tsawwassen - Duke Point) and to the Queen of Surrey on Route 3 (Horseshoe Bay - Langdale). Burger sales on these routes increased by 35 per cent from the previous year. Future expansion will include the Queen of Esquimalt operating primarily on Route 2 (Horseshoe Bay - Departure Bay) and Queen of Nanaimo on Route 9 (Tsawwassen - Southern Gulf Islands).
- A "**We Proudly Brew Starbucks Coffee**" program opened in the Lantern Café on the Spirit of Vancouver Island in March 2003. Initial results indicate improved customer satisfaction, and revenue growth within the Lantern is up 20 per cent to date. This program will be expanded to the Spirit class vessel snack bars by June 2003.
- BC Ferries continues to partner with recognized British Columbia food service brands for sandwiches (**Bread Garden Café**), and pizza (**Villages Pizza**), on the Queen of Cowichan and Queen of Coquitlam operating on Route 2 (Horseshoe Bay - Departure Bay). Depending on the success of these partnerships, the program may be expanded to other major route vessels.

FINANCIAL MEASURES

RETAIL SERVICES REVENUE PER PASSENGER



RATIONALE/METHODOLOGY: To measure retail services revenue per passenger by division. Retail services revenue does not include tolls, parking and other miscellaneous revenue or subsidies and excludes cost of goods sold.

VARIANCE ANALYSIS:

Mainland Services revenue per passenger increased 1.1% over the previous year. The improvement was attributable to a 2.5% increase in food & beverage prices implemented May 1st, the continued success of programs such as White Spot, and to growth within gift shop product lines.

Northern and Inter-Island Services experienced a 0.8% decline in passenger spends. Food & beverage spends declined on the Northern Routes with liquor sales continuing to trend downwards. Gift shop passenger spends were negatively affected by a drop in contracted revenues and by the more frequent closure of the Route 9 outlet.

- The **Spirit class gift shops** will be expanded from 800 square feet to 1460 square feet during the 2003/04 refit season with a view to offering customers an improved environment and greater product choice.
- A master planning process for the **long-term development of the terminals** is underway which will enhance the travel experience for our customers through improved retail and food services and expanded green space and playgrounds..

Safety of Passengers

- The **International Safety Management (ISM) Code** of the International Maritime Organization provides for the safe operation of ships and for pollution prevention. The code includes procedures and standards (representing “best practices” in marine operations) for all safety-related activities. ISM auditors inspect all vessels and shore establishments at least once a year, and external auditors from Lloyd’s Register periodically verify both the ISM audit function and document compliance.
- Following the unfortunate events of September 11, 2001, in the United States, the Corporation carried out a security **Risk, Threat and Impact Assessment** and continues to communicate with the Royal Canadian Mounted Police (RCMP) about security risks. BC Ferries has implemented security initiatives to address the recommendations in the assessment and will upgrade fleet security in response to any notification from the RCMP of an increase in threat.
- BC Ferries is committed to providing a safe, **accident-free environment** for its employees and passengers. In order to improve the working conditions of employees, in 2002/03 vessels incorporated procedural changes to dissipate and control accumulations of vehicle exhaust on the ferries. This was accomplished by use of ongoing air sampling, which keeps crews aware of the timing and use of the needed control procedures, and through holding information sessions with diesel trucking operators using the major terminals.
- In an effort to address the financial cost and human impact of **workplace injury**, a joint union-management effort resulted in a reorganization of the safety committee structure. Safety committee members fleet-wide have now received the training necessary to facilitate an effective safety program.

- BC Ferries develops a yearly **Worksafe plan** jointly with the Workers' Compensation Board, which specifies safety testing, training, and engineering procedures designed to prevent workplace injuries.
- The Queen of Coquitlam will be the first in a five-year program to upgrade all "C" class vessels with a new **evacuation system**. The RFD Marin-Ark twin-track chute system comprises four stations, each consisting of twin chutes and four 100+ person life rafts.

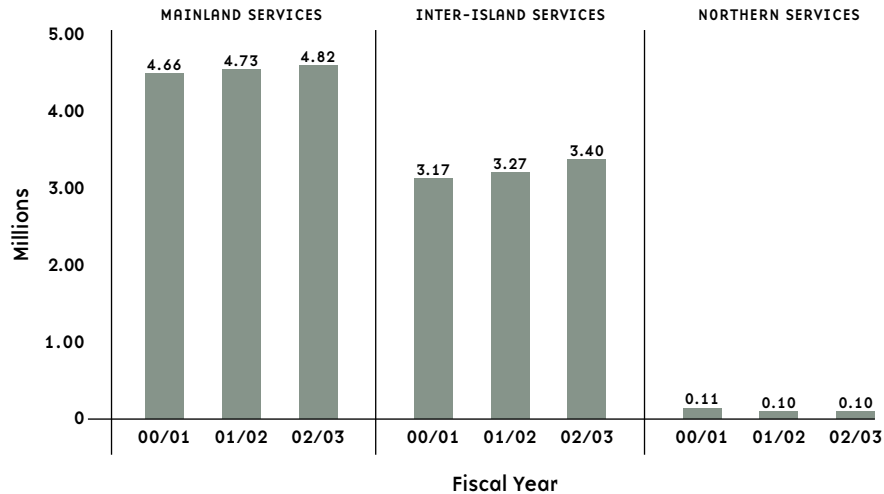
GOAL 2: MAINTAINING FINANCIAL PERFORMANCE

The Corporation will operate at break-even or better with average tariff increases no greater than inflation.

- Earnings before loss on disposal of assets held for resale for the year to March 31, 2003 of \$24.8 million was \$6.9 million favourable to budget.
- Tariff revenue was \$9.9 million favourable to budget reflecting a tariff increase of 3.8 per cent in December 2002, and increased traffic.
- In the fiscal year ended March 31, 2003, vehicle traffic totalled 8.3 million with 21.6 million passengers (up 2.7 per cent and 1.8 per cent, respectively, from 2001/02).
- The cost of fuel was \$5.1 million lower than budget. Overall, the average price of fuel rose 7.6 per cent year over year. However, this was offset by a reduction in fuel usage of 1.6 million litres and risk mitigation arising from the fuel hedging plan.
- The Corporation finished the year with no debt.
- The 2002/03 fiscal year was one of tremendous evolution for BC Ferries. The provincial government and BC Ferries' Board of Directors examined a variety of possibilities for the future of the coastal ferry system. In December of 2002, a commercial model governed by an independent authority was selected to best meet the objective of creating a modern, safe and reliable ferry system that is customer-focused and financially viable.

VEHICLE AND PASSENGER TRAFFIC

VEHICLES CARRIED



VEHICLES CARRIED:

On the Mainland Services routes vehicle traffic increased by 1.9% over the previous year.

On the Inter-Island Services routes vehicle traffic increased by 3.8% over the previous year.

On the Northern Services routes vehicle traffic decreased by 2.9% over the previous year.

Overall vehicle traffic increased by 2.7% over the previous year.

GOAL 3: IMPROVING OPERATIONAL PERFORMANCE

OPERATIONAL EFFICIENCIES

Support local economies and communities; provide basic transportation options to remote coastal communities.

Major Routes

BC Ferries' major routes connect Vancouver Island to the Lower Mainland of British Columbia with three routes: Swartz Bay-Tsawwassen, Tsawwassen-Duke Point and Departure Bay-Horseshoe Bay. A smaller route connects Horseshoe Bay to the Sunshine Coast at Langdale.

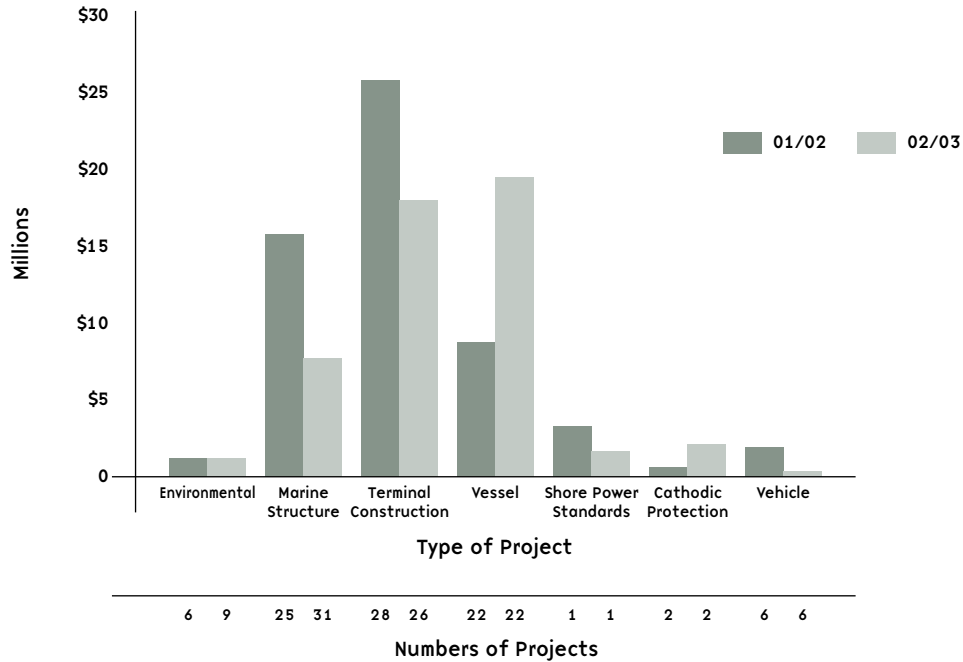
Inter-Island Routes

BC Ferries' inter-island routes connect several island or rural communities to either Vancouver Island or the Lower Mainland. These communities lie in the Strait of Georgia or in the adjacent inlets.

- The Dogwood Princess, which provided passenger-only ferry service to Gambier-Keats, needed to be replaced. On determining a private-sector operator could provide a more cost-effective service to the two islands, BC Ferries awarded the contract to Kona Winds Yacht Charters Ltd. in April 2003. The service will be provided by the M.V. Stormaway III, a 40-passenger vessel. This decision is projected to result in a savings of more than \$250,000 over five years.

CAPITAL PROJECTS

CORPORATE ENGINEERING & ASSET DEVELOPMENT CAPITAL EXPENDITURES



Mid and North Coast Routes

The Mid and North Coast routes provide ferry service to the province's north coast and Queen Charlotte Islands. The service includes Route 11 (Prince Rupert-Skidegate), Route 10 (Prince Rupert-Port Hardy) at the northern end of Vancouver Island, and Route 26 operating between Graham and Moresby Islands in the Queen Charlottes. In addition, Route 40, the Discovery Coast Passage, offers summer-only service from Port Hardy to Bella Bella, Klemtu, Ocean Falls and Shearwater on the outer mid-coast and to Bella Coola on the central coast.

- BC Ferries is developing a strategy to determine the long-term service model for Routes 10, 11 and 40.
- During 2002/03, BC Ferries negotiated an agreement with the community of Klemtu to ensure the effective operation of the dock for both BC Ferries' vessels and for other vessels delivering services to the community. The facility's day-to-day operations will be undertaken by people who live and work in the community.
- BC Ferries continues to support a car-ferry service operated by the Lax Kw'alaams Band that connects the village of Lax Kw'alaams (Port Simpson) with Prince Rupert. At the end of 2002/03 BC Ferries was completing negotiations to continue support of the service for a further four years.
- Service from Prince Rupert to Hartley Bay, Metlakatla, Kitkatla and Oona River was initiated in 2000/01 to provide scheduled transportation to several communities located south of Prince Rupert. In accordance with the original agreement, BC Ferries provided a small increase in funding to allow for the acquisition of a purpose-built vessel able to accommodate a greater volume of deck cargo. The service is operated by a company formed cooperatively among several of the communities being served.
- In accordance with the Kincolith Extension Development Agreement between the Province and the Nisga'a Nation, ferry service between Prince Rupert and Kincolith was discontinued in December 2002, with the completion of a highway into the community. BC Ferries supported the service with an annual subsidy amounting to almost \$300,000 in the last year of operation.

CAPITAL

The long-term capital strategy is to replace and upgrade aging infrastructure with emphasis on alternatives that improve efficiency, reduce life-cycle costs, minimize environmental impacts, and improve customer service.

- The primary capital issues facing BC Ferries are its aging vessels and marine structures. The newly launched British Columbia Ferry Services Inc. will focus on an **asset replacement strategy** that incorporates operating and fuel efficiencies, while ensuring vessels provide improved customer value. A limited range of standardized vessels will allow the Corporation to move ships onto various routes, allow for the replacement of older, less-efficient vessels and standardization of crew training. From a maintenance perspective, standardization will reduce costs through the use of common maintenance and benchmarking standards, and through the ability to purchase components in bulk.
- Construction began on the **mid-life upgrade** for the Queen of Coquitlam operating on Route 2 (Horseshoe Bay - Departure Bay) in December 2002, with the vessel returning to service in June 2003. This is the first vessel scheduled under the five-year program to upgrade all "C" class vessels and incorporate standardization. The Queen of Cowichan is the second, scheduled to begin in December 2003 with a completion date of June 2004.
- At both Mainland and Inter-Island terminals, a number of **marine structure replacement** projects were completed. Docks were upgraded and the existing structures were cathodically protected to prevent salt water corrosion.
- **Master plans for terminals** are also underway, beginning with the largest terminal at **Tsawwassen**. The plans will include input from communities and will be designed to maximize operating efficiency and passenger flow, expand commercial opportunities and enhance the travel experience for our customers.

- The **Horseshoe Bay Terminal upgrade** improved public safety on highway approaches by reducing vehicle traffic stored on the highway as well as reducing traffic management costs. The upgrade provided better vehicle and foot passenger handling; improved customer service and on-time sailing performance (by enhancing the speed of vessel loading); reduced parking congestion in Horseshoe Bay; and replaced outdated structures with a functional passenger and administration facility.
- **Departure Bay Terminal upgrades** were undertaken in order to align with BC Ferries' long-term objectives of improving the customer experience, addressing future demand, reducing off-site roadway congestion, and upgrading outdated infrastructure.

BUSINESS PROCESSES AND SYSTEMS UPGRADES

By investing in information systems upgrades and replacements to improve management information for decision making.

- BC Ferries selected, acquired and has begun implementation of a major business initiative in support of the human resources, crew scheduling, and time collection business functions. The **CHaRTS** (Crewing, Human Resources, and Time System) program will introduce new business systems and technology to enable fundamental changes to human resource management, which will result in efficiencies in processes, cost savings, and ultimately better service to customers. The program's charter is being finalized in May 2003. Implementation of the processes and systems will be complete by April 2004.
- Several initiatives are under way specifically to enhance customer service:
 - a pilot project to confirm the business, technical, and financial feasibility of **automated ticketing** devices for foot passengers;
 - an initiative to establish and confirm the cost/benefit and feasibility of implementing a "**Smart Card**" point of sale solution.

In September 2002, the British Columbia Ferry Corporation was presented with the **Distinguished Achievement Award for Excellence in Project Management** for its successful implementation of the Oracle 11i Financial Information System (FINs) and the MRO **Maximo** maintenance management system. These key initiatives were fundamental to establishing the new financial accountability framework for BC Ferries.

WORKFORCE DEVELOPMENT/TRAINING INITIATIVES

Over the long term, BC Ferries human resource strategy is to ensure the continued sustainability of the Corporation and its business by attracting, retaining and developing high-quality employees to ensure safety, service reliability and positive customer service.

- As the Corporation made preparations to become an independent company, it took steps to prepare its managers and employees. In December 2002 and March 2003, a series of forums provided employees with opportunities to learn about the changes and to engage in dialogue with the Corporation's executive team. Managers were involved in in-depth briefings and discussions, and began **training and education in leading change**.
- A long-term human resource strategic goal is to ensure succession of certificated marine officers, whose credentials require considerable time and effort to obtain. In 2002/03, the **Marine Officer Development** program resulted in 32 new senior certificates (22 deck and 10 marine engineering) for a total of 89 new certificates obtained during the three-year program. To support officer development, ten summer positions on northern routes were specifically set aside for officers to accrue the sea service required in order to upgrade their certificates.
- A **union-management workforce** development committee continued its analysis and discussion of marine officer development, trades apprenticeship, and alternative workforce structures. Discussion was useful and cooperative, and the parties were successful in improving approaches to collaboration.

- **Customer Relationship Management** training was completed by all managers, a financial management training program was developed, and training in leading change commenced. The foundational **Supervisory Skills** program was redesigned and enhanced and a **Management Intern** program is under development as an operational management succession strategy.
- A number of other initiatives were completed, such as a **broad-based training** program on the handling of dangerous goods, standardized testing of clerical skills, development of musculoskeletal-injury worksafe training, and completion of a comprehensive review of employee development and training.

GOAL 4: MINIMIZING ENVIRONMENTAL IMPACT

WATER

To take a leadership role in the protection of the marine environment.

- BC Ferries' major environmental objective is to reduce its impact on the aquatic environment, air and land. In 2002/03, BC Ferries continued implementation of the fleet-wide sewage-handling program that began in 1999/2000. Three additional state-of-the-art CleanSea Hydroxyl Systems sewage-treatment plants were installed in smaller, inter-island ferries (the Quinsam, Klitsa and Quinitza) and three more installations are scheduled for 2003/04.

LAND

To minimize environmental impacts.

- BC Ferries continues to improve and expand its recycling programs.
- A three-year contract for monthly monitoring of the BC Ferries-owned and operated secondary sewage treatment plants at Swartz Bay, Lyall Harbour, Fulford Harbour, Sturdies Bay, and Langdale terminals was awarded to a local engineering company. This approach was taken to provide BC Ferries with assurance that the treatment plants not only meet the required criteria, but perform to the highest environmental standards.

- Storm water systems were upgraded and oily water separators were installed at Otter Bay (Pender Island and Swartz Bay terminals). This ongoing improvement program is incorporated into any significant upgrade or maintenance work at the terminals.
- A comprehensive plan for contaminated site identification and management was completed for Langdale Terminal.
- Monitoring of ground contamination at Deas Dock continues to ensure contaminants are not migrating towards the Fraser river and do not contaminate ground waters.
- Deas Basin is a potential habitat for sturgeon, a species currently at risk in the Fraser River. To assess the impact of dredging, a Benthic Assessment of Deas Basin was done prior to and after dredging.

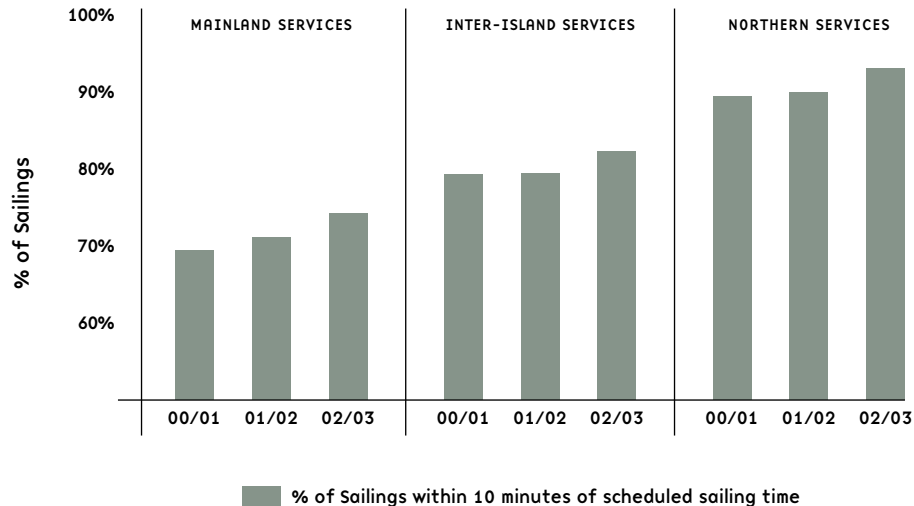
AIR

To systematically and progressively reduce greenhouse gas emissions from vessels.

- The continuous water injection experiment done in conjunction with Environment Canada was concluded, and showed that by using this technology, a significant reduction of air emissions and some reduction of fuel consumption can be achieved.
- The main engines of two vessels and the auxiliary engines of three other vessels have been replaced and now meet International Maritime Organization (IMO) emission standards.
- Further research will be done in 2003/04 to ensure BC Ferries will be able to meet the greenhouse gas emissions reduction target as prescribed by the Kyoto Protocol.
- BC Ferries continues to reduce maintenance expenses and emissions through the fleet automotive replacement program.

CUSTOMER SERVICES MEASURES

ON-TIME SAILING PERFORMANCE



RATIONALE/METHODOLOGY: To measure the number of sailings departing within 10 minutes of schedule.

This measures the number of times that a departure was made within 10 minutes of scheduled departure. This is expressed as a percentage of the total number of sailings.

VARIANCE ANALYSIS:

Mainland Services shows an on-time performance increase from 72% to 75%. This is due in part to improved loading, discharge and operational procedures on Route 1 and the end of construction in Horseshoe Bay by the end of summer 2002.

Inter-Island Service shows an increase in on-time performance from 80% to 83% due in part to the installation of new engines on some minor vessels and new schedules on Routes 8 and 17.

Northern Services shows a slight increase in on-time performance from 91% to 93%.

STATEMENT OF CORPORATE GOVERNANCE

PRACTICES

THE BRITISH COLUMBIA FERRY CORPORATION WAS ESTABLISHED UNDER THE *FERRY CORPORATION ACT* OF THE Province of British Columbia, which established the Board of Directors to govern the Corporation. This Act also sets the authority and responsibility of directors to “manage the affairs of the Corporation or supervise the management of those affairs”.

Directors are under a fiduciary duty to carry out the duties of their office honestly and in good faith in the best interests of the Corporation, and with the care, diligence and skill of a reasonable, prudent person. Directors also have specific statutory duties and obligations under other provincial and federal legislation related to employment, environmental protection, financial reporting and taxation.

The board sets the standards of conduct for the Corporation and ensures the safety of its operation, supervising the conduct of the business through the President and Chief Executive Officer, to whom it delegates the responsibility for the leadership and management of the Corporation. Certain of the board’s authorities are delegated to management, such as spending authorities, while certain powers are reserved to itself. The board retains the responsibility for managing its own affairs, including reviewing the skills and experience represented on the board, and implementing a process for assessing the effectiveness of the board governance practices.

The board exercises the responsibility for:

- appointment and evaluation of the President and Chief Executive Officer
- reviewing human resource strategies
- annual approval of the Corporation's strategic plans, annual operating and capital budgets, and major new financial or capital project proposals
- monitoring the Corporation's progress on the objectives set in the corporate strategic plan and in the operating and capital plans, including revising the direction of those plans through management in light of changing circumstances
- identifying the principal risks of the Corporation's business and taking all reasonable steps to ensure the implementation of appropriate systems to manage those risks
- monitoring through management compliance with all significant policies and procedures
- ensuring that the Corporation has in place a policy to enable management and the board to communicate effectively with the government, stakeholders and the public generally.

On April 2, 2003, the British Columbia Ferry Corporation was converted from a Crown corporation to an independent, regulated company under the *Company Act* and renamed British Columbia Ferry Services Inc. This conversion was recognized in the *Coastal Ferry Act*, which took effect April 1, 2003, and coincidental to it, the *Ferry Corporation Act* was repealed.

The *Coastal Ferry Act* establishes the B.C. Ferry Authority, an independent, no-share capital corporation that governs British Columbia Ferry Services Inc. and establishes a new regulatory framework to govern the provision of coastal ferry services in British Columbia.

MANAGEMENT DISCUSSION AND ANALYSIS

THE FOLLOWING IS A DISCUSSION OF THE CONSOLIDATED FINANCIAL CONDITION AND RESULTS OF OPERATIONS of British Columbia Ferry Corporation (the "Corporation") for the period ended March 31, 2003. This discussion should be read in conjunction with the Consolidated Financial Statements of British Columbia Ferry Corporation and notes thereto for the years ended March 31, 2003 and March 31, 2002. "Management's Discussion and Analysis" contains forward-looking statements, based on the Corporation's estimates and assumptions which are subject to risks and uncertainties. This could cause the Corporation's actual results to differ materially from the forward-looking statements contained in this discussion.

BC Ferries is one of the three largest ferry companies in the world.

COMPARISON — BC FERRIES TO OTHER MAJOR FERRY OPERATORS — 2001/02 DATA

	PASSENGERS (MILLIONS)	VEHICLES (MILLIONS)	VESSELS	TERMINALS
Washington State Ferries	25.1	10.8	29	20
BC Ferries	21.3	8.1	38	48
Scandlines	19.9	37.0	26	8
Caledonian MacBrayne	4.9	1.9	29	40
ColorLine	4.1	0.74	9	8
Moby	2.9	0.9	16	n/a
Seafrance	2.7	1.0	4	2
Blue Star Ferries	2.5	0.51	13	n/a
Hoverspeed	2.5	0.5	3	5
Minoan Lines	1.8	0.4	11	13
Alaska State Ferries	0.32	0.19	9	20

KEY PERFORMANCE DRIVERS:

Regulation

Transport Canada

- The vessel operations of BC Ferries are regulated by Transport Canada through the *Canada Shipping Act*. This Act governs crew and passenger licenses, vessel construction, vessel operation, and safety inspections. During the year, some issues arose locally relating to the predictability of Transport Canada's rulings regarding upgrades to ships or equipment. Following discussions with Transport Canada staff locally and in Ottawa, protocols were developed to improve standardization and allow pre-approval of crew and passenger levels prior to undertaking capital initiatives.

Kyoto Accord

- The Kyoto Protocol will be a significant issue for ferry operators over the next twenty years. Initial targets for Kyoto were to reduce greenhouse gas emissions to 6 per cent below 1990 levels by the period between 2008 and 2012. Canada is currently behind schedule in this implementation, and is awaiting global ratification of targets in 2003.

As the implementation of Kyoto matures through 2003/04, the prospect of adopting a "green credit" approach to reducing emissions is of particular interest. Partnership funding, pilot projects and innovation in solutions will provide increasing impetus for action as the deadlines for target achievement are implemented.

Risk

The operations of BC Ferries are subject to several risks that could adversely affect future financial results:

- Labour is the largest single cost item for BC Ferries, which has a workforce consisting of approximately 4,500 unionized and management employees. All unionized employees are members of the B.C. Ferry and Marine Workers' Union (BCFMWU).

BCFMWU held its officer elections in May, 2003 and a new executive was elected. The collective agreement between BC Ferries and BCFMWU expires on October 31, 2003 and bargaining will commence in the fall of 2003. This round of negotiations is expected to address a number of issues to ensure the collective agreement aligns with the business objectives and commercial nature of the new company.

- Fuel, the second largest single cost item for BC Ferries (after labour), is completely driven by world oil prices. The volatility of fuel prices represents a significant financial risk to the Corporation. In 2001/02, BC Ferries implemented a commodity risk management program and fuel hedging strategy. This program, which is tightly controlled, is designed to reduce the volatility of fuel prices and therefore reduce the financial exposure of the Corporation.

The Corporation manages its exposure to fuel price volatility by entering into forward contracts with certain financial intermediaries. Fuel hedging instruments are used solely for the purpose of reducing fuel price risk, not for generating trading profits.

- The Corporation does not believe it is subject to any significant concentration of credit risk. Most of the Corporation'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 Corporation manages the credit exposure related to financial instruments by limiting its exposure to a single counter-party. The Corporation may enter into interest rate agreements to manage its exposure on debt instruments.

- The ability to provide transportation services is affected by the availability of federally certified shipboard navigating and engineering officers and crew. The aging labour force and the supply of new personnel with appropriate qualifications may necessitate different policies to increase the availability of qualified employees.
- The average age of the Corporation's operating vessels is beyond the halfway point of average vessel lifespan, and many major vessels have been in service for more than 30 years. This has the potential to increase refit and maintenance costs as assets become older, while dependability is less certain. The current capital plan addresses the replacement of older assets, but will take several years to displace the oldest vessels.

Asset Management Processes

A summary of the Corporation's capital stock is as follows:

- The value of BC Ferries' assets are concentrated in vessels and terminals.
- The vessels are in a disproportionately aged condition. The average age of BC Ferries' fleet is 30 years and the median age is 32 years. Using 40 years as the economic life of a vessel, most of the vessels (33 of 38) are in the last half of their expected lives and 53 per cent of the vessels are in the last quartile of their economic lives.
- Nearly 80 per cent of the vehicle capacity of the vessels is in the last half of its economic life and 43 per cent of the vehicle capacity is in the last quartile of its economic life.
- The terminal marine structures are in a disproportionately aged condition; 80 per cent of all marine structures are beyond the midway point of their economic lives. Approximately 31 per cent of the assets and 36 per cent of their associated value are operating beyond their projected economic lives.

- The terminal shore structures are in relatively newer condition, with approximately 71 per cent still in the first half of their economic lives. The average age of the minor buildings (e.g., trailers) have reduced the percentage.
- Technical and information systems infrastructure is in a disproportionately aged condition. The Corporation recently completed a major replacement of the financial management and maintenance management systems and is currently upgrading the human resource and time collection systems.

As a result of the age and condition of the assets BC Ferries is embarking on a major asset replacement process which foresees capital expenditures of \$1.8 billion over the next twelve years. Of this sum, \$1.2 billion relates to vessel replacements. This fact is a major driver in the changes to the operating framework under which the company will operate.

TRAFFIC (EXPRESSED IN THOUSANDS):

		2003	% GROWTH FROM 2002	2002	% GROWTH FROM 2001	2001
Mainland routes	Underheight	4,332	1.8%	4,256	1.9%	4,175
	Overheight	198	2.1%	194	-2.0%	198
	Commercial	244	5.2%	232	2.7%	226
	Bus	51	0.0%	51	-8.9%	56
	Sub-total	4,825	1.9%	4,733	1.7%	4,655
	Passengers	13,668	1.2%	13,506	-1.4%	13,699
Inter-Island routes	Underheight	3,213	3.9%	3,092	3.4%	2,991
	Overheight	84	1.2%	83	0.0%	83
	Commercial	97	4.3%	93	0.0%	93
	Bus	5	0.0%	5	0.0%	5
	Sub-total	3,399	3.8%	3,273	3.2%	3,172
	Passengers	7,710	2.9%	7,496	1.2%	7,408
Northern routes	Underheight	85	-2.3%	87	-3.3%	90
	Overheight	8	0.0%	8	0.0%	8
	Commercial	5	-16.7%	6	0.0%	6
	Bus	1	0.0%	1	0.0%	1
	Sub-total	99	-2.9%	102	-2.9%	105
	Passengers	246	-1.2%	249	-5.0%	262
Total	Vehicles	8,323	2.7%	8,108	2.2%	7,932
	Passengers	21,624	1.8%	21,251	-0.6%	21,369

TRAFFIC:

Traffic on the BC Ferries' system has grown nearly 70 per cent over the past two decades. In 1981, the system transported nearly 5 million vehicles and over 12 million passengers. A sharp increase was experienced in 1986. This substantial growth can be partially attributed to the addition of Ministry of Transportation and Highways routes in October 1985 and the influx of tourists during Expo '86.

Passenger traffic increased steadily until 1996. It was at this point that overall traffic peaked at 8.4 million vehicles and 22.5 million passengers. In the last half of the 1990s, traffic declined steadily through to 2001. The decrease is related in part to deteriorating economic conditions, large multiple tariff increases in 1997 and the development of Vancouver Island's capacity to support its citizens from an economic and service perspective.

Traffic has recovered somewhat in recent years and in the fiscal year ended March 2003, vehicle traffic totalled 8.3 million with 21.6 million passengers (up 2.7 per cent and 1.8 per cent, respectively, from 2001/02).

REVENUE ANALYSIS (EXPRESSED IN THOUSANDS):

		2003	2002	2001
Tolls	Vehicles	\$ 196,480	\$ 189,904	\$ 180,224
	Passengers	119,138	115,806	112,582
	Total tolls	315,618	305,710	292,806
Catering & Other	Food	45,341	43,461	41,251
	Liquor	213	238	287
	Retail	16,208	16,675	16,293
	Other income	14,066	11,630	10,858
	Interest income	950	875	1,895
	Total catering and other	76,778	72,879	70,584
Grants	Provincial	74,243	71,706	72,519
	Federal	23,377	22,953	22,438
	Total grants	97,620	94,659	94,957
Total Revenue		\$ 490,016	\$ 473,248	\$ 458,347

TOLL REVENUE:

Toll revenues continue to increase (2.9 per cent for passengers and 3.5 per cent for vehicles) reflecting the continued growth in traffic from 2001. Of the total growth in toll revenue, \$6.1 million was attributable to an increase in traffic and \$3.8 million was due to the 3.8 per cent increase in tariff implemented December 2002.

Mainland routes contributed \$259.9 million or 82 per cent of toll revenue. Vehicle traffic and passenger traffic increased on all routes except for Route 30 (Tsawwassen - Duke Point), which declined and lost traffic to Route 2 (Horseshoe Bay - Departure Bay). When traffic for Routes 2 and 30 are combined, there is a net gain of 2.8 per cent in vehicles and 1.9 per cent in passengers. Traffic growth accounts for the majority of the overall variance (\$5.1 million), while the 3.8 per cent tariff increase implemented in December 2002 added \$3.4 million. The commercial market accounted for \$3.3 million of the overall increase.

Inter-island and northern routes contributed \$55.7 million or 18 per cent of toll revenue. Under-height traffic and passenger traffic increased on all routes with the following exceptions: Route 26 (Skidegate - Alliford Bay) declined in both vehicle and passenger traffic due to reduced traffic to Sandspit Airport, and Route 18 (Texada - Powell River) declined in both vehicle and passenger traffic due to reduced economic activity at the quarries on Texada. Traffic growth accounted for \$1.0 million of the increase while the 3.8 per cent tariff increase implemented December 2002 added \$0.4 million.

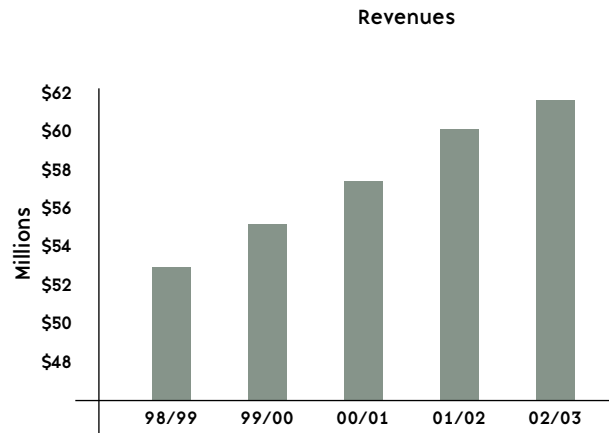
TOLL REVENUE (EXPRESSED IN THOUSANDS):

		2003	% GROWTH FROM 2002	2002	% GROWTH FROM 2001	2001
Mainland routes	Underheight	\$ 104,683	2.0%	\$ 102,640	5.8%	\$ 96,989
	Overheight	11,713	4.2%	11,237	3.1%	10,900
	Commercial	43,772	8.3%	40,428	7.5%	37,611
	Bus	3,892	-2.5%	3,992	-5.8%	4,239
	Sub-total	164,060	3.6%	158,297	5.7%	149,739
	Passengers	95,878	2.9%	93,150	3.6%	89,921
Inter-Island routes	Underheight	20,472	3.5%	19,785	5.9%	18,687
	Overheight	1,580	3.5%	1,527	0.6%	1,518
	Commercial	3,511	2.8%	3,416	6.2%	3,217
	Bus	116	16.0%	100	-8.3%	109
	Sub-total	25,679	3.4%	24,828	5.5%	23,531
	Passengers	16,820	5.6%	15,926	4.2%	15,282
Northern routes	Underheight	3,373	1.1%	3,337	-4.2%	3,484
	Overheight	1,848	-1.1%	1,868	-4.3%	1,952
	Commercial	1,396	-2.9%	1,437	6.5%	1,349
	Bus	124	-9.5%	137	-18.9%	169
	Sub-total	6,741	-0.6%	6,779	-2.5%	6,954
	Passengers	6,440	-4.3%	6,730	-8.8%	7,379
Total	Vehicles	196,480	3.5%	189,904	5.4%	180,224
	Passengers	119,138	2.9%	115,806	2.9%	112,582
		\$ 315,618	3.2%	\$ 305,710	4.4%	\$ 292,806

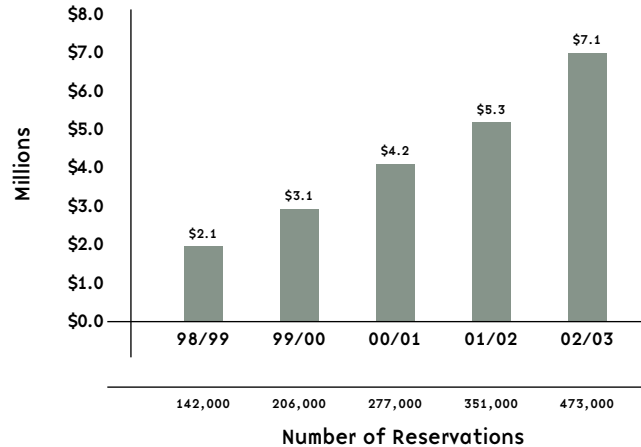
FOOD AND RETAIL:

BC Ferries provides food and beverage services with total annual sales of \$45.5 million. In addition, retail revenue from eighteen gift shops throughout the Corporation and three terminal newsstands generate an additional \$13 million. Other major sources of retail are stateroom rentals and video/vending contracts.

CATERING REVENUE TREND 1998/99 TO 2002/03



RESERVATION GROWTH 1998/99 TO 2002/03



OTHER INCOME:

Reservations and parking generate \$10 million in revenue.

During fiscal 2002/03 a three-level, 460-car parkade at Horseshoe Bay terminal was completed and went into service. The new facility features automated ticketing machines as well as a full-time ticket attendant, giving customers a variety of payment options. In addition, variable rates are available to customers, including monthly rates, through the contracted services of Imperial Parking Canada Corporation. BC Ferries also introduced a new automated parking system at Duke Point Terminal in March 2003. Customers will be able to pay for long-term parking at pre-pay ticketing machines, located inside the foot-passenger departure lounge, prior to boarding a vessel.

BC Ferries is reviewing parking options at all other major terminals with a view to maximizing value from this business segment.

Passenger-vehicle reservations are available to customers on major routes between Vancouver Island and the Lower Mainland for a \$15 fee. Revenue from reservation fees has shown steady and considerable growth since 1998/99.

The other major components of Other Income, assured loading tickets and marketing rights fees, showed significant year-on-year growth.

GRANTS:

The Corporation received revenue from the Government of Canada of \$23.4 million 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. The proceeds of this contract will continue to flow to British Columbia Ferry Services Inc. under the new framework.

In March 2000, the provincial government restructured its subsidy to BC Ferries to be based on an allocation of 1.25 cents per litre of the provincial motor fuel tax. As part of the restructuring discussed above, the provincial motor fuel tax subsidy will be replaced by a fee for service negotiated and established under the Coastal Ferry Services Contract. The grant for 2002/03 was \$74.2 million and the negotiated service fee for 2003/04 – 2007/08 has been set at a maximum of \$105.5 million.

EXPENDITURE ANALYSIS: (EXPRESSED IN THOUSANDS):

	2003	2002	2001
Salaries, wages and benefits	\$ 248,113	\$ 241,617	\$ 227,081
Fuel	45,882	48,047	53,453
Contracted services	47,052	40,995	39,598
Materials and supplies	27,863	24,849	23,375
Other expenses	21,284	21,437	20,463
Insurance, taxes and utilities	7,565	7,901	8,786
Cost of retail goods sold	22,046	22,479	21,915
Amortization	44,050	46,056	50,029
Sub-total	463,855	453,381	444,700
Interest expense	1,364	1,757	1,583
Loss on disposal	412	732	1,350
Loss from high-speed ferries	53,107	40,000	-
Total Expenditures	\$ 518,738	\$ 495,870	\$ 447,633

SALARIES, WAGES AND BENEFITS

The main drivers in increases between 2002 and 2003 are benefits, primarily actuarial valuations for Workers' Compensation Board and long term disability liabilities, Medical Service Plan premium increases, wage increases of 2 per cent implemented November 2001 and 1.8 per cent implemented November 2002, and the one-time cost of reorganization initiatives. These increases are offset by continued attention to operational and staffing efficiencies.

FUEL

The cost of fuel dropped \$2.2 million (4.5 per cent). Overall, the average price of fuel rose 7.6 per cent year over year. However this was offset by a reduction in fuel usage of 1.6 million litres (1.2 per cent) as a result of the elimination of the PacifiCats from operations and reflects the risk mitigation provided by the fuel hedging plan.

CONTRACTED SERVICES

Increases were mainly due to vessel refit and maintenance activities, including a higher level of dry-docking than in the previous year, transition and core review activities, and level-2 ship survey costs. There was also increased terminal maintenance activity which included the Skidegate pontoon and the Horseshoe Bay concrete repairs.

MATERIALS AND SUPPLIES

Increases were mainly due to vessel refit and maintenance activities reflecting the aging fleet as well as emergency work on several vessels.

AMORTIZATION

Accelerated amortization was recorded in 2001/02 due to the reclassification of assets to more accurately reflect their useful life, and the sale of the Queen of Sidney last year, offset by the completion of capital construction at Horseshoe Bay and Departure Bay terminals this year.

GOODS AND SERVICES TAX

British Columbia Ferry Corporation, as a Crown corporation, did not pay Goods and Services Tax (GST) on purchases. As a result of the conversion of the Corporation to a regulated company under the *Company Act* on April 2, 2003, British Columbia Ferry Services Inc. is required to pay GST on purchases from the date of conversion. Under the *Excise Tax Act* "charges for transporting motor vehicles or passengers on a ferry, the principal purpose of which, is to transport vehicles or passengers between parts of a road or highway system that are separated by water,"

are exempt. This treatment for GST means ferry operators are not entitled to an input tax credit in respect of purchases relating to the ferry transport operations, including capital expenditures on vessels, repairs, tickets, ticket booths etc. As a result, GST paid on purchases relating to the ferry transport operations (other than catering, gift shop and other taxable services) must be absorbed within the cost structure of British Columbia Ferry Services Inc.

LOSS FROM HIGH SPEED FERRIES

In June 1994, the Province of British Columbia (the Province) announced, as part of a ten-year capital plan for BC Ferries, the construction of three fast ferries at a budgeted cost of \$210 million. The Province's objective, by building the vessels in British Columbia, was to revitalize the shipbuilding industry and to position British Columbia as a leading international exporter of aluminium ferries.

In late 1998, the Province learned that the fast ferry project was significantly over budget. Two reviews were immediately commissioned, one dealing with the cost of the project and the other with the technical aspects of the vessels. These reviews confirmed that the cost of the project was substantially more than budgeted, that the vessels would not meet all of the initial performance specifications and that they were very well built.

BC Ferries and the government determined in March 2000 that the car-carrying aluminum catamarans PacifiCat Explorer, PacifiCat Discovery and PacifiCat Voyager should not form part of BC Ferries' ongoing fleet operations but should instead be sold. The third fast ferry, PacifiCat Voyager, was completed in August 2000, following which the Corporation's subsidiary, Catamaran Ferries International Inc. (CFI), closed its operations.

The decision to sell the three PacifiCat vessels was based upon careful assessment of the concerns of customers, residents along the route, tourism groups and the trucking industry.

The three PacifiCat vessels and ancillary equipment were disposed by international, unreserved auction on March 24, 2003 for total 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.

MANAGEMENT REPORT

THE FINANCIAL STATEMENTS OF THE BRITISH COLUMBIA FERRY CORPORATION HAVE BEEN PREPARED BY management in accordance with accounting principles that are appropriate for the Corporation and generally accepted in Canada. A precise determination of many assets and liabilities is dependent upon future events and consequently the preparation of periodic financial statements necessarily involves the use of management's judgment in establishing the estimates and approximations used. The accompanying consolidated financial statements have, in management's opinion, been properly prepared within the framework of the accounting policies summarized in the notes to the consolidated financial statements.

Management depends upon a system of internal controls in order to provide reasonable assurance, on a cost-effective basis, that financial information used in preparing financial statements is reliable. Internal auditors monitor the system of internal control and the Corporation's external auditors also independently perform such tests of the system as they consider necessary for the purpose of expressing their opinion on the financial statements.

Management is responsible for all of the information in this Annual Report. Financial information presented elsewhere in this Annual Report is consistent with that contained in the financial statements.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises this responsibility through the Audit Committee of the Board. This committee, which is comprised entirely of outside directors, meets with management, the internal auditors and the external auditors to satisfy itself that management responsibilities are properly discharged and to review the consolidated financial statements before they are presented to the Board of Directors for approval. The consolidated financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.



Doug Allen

INTERIM PRESIDENT AND CHIEF EXECUTIVE OFFICER



Robert P. Clarke, CGA

EXECUTIVE VICE PRESIDENT, FINANCE AND CHIEF FINANCIAL OFFICER

AUDITORS'**REPORT****AUDITORS' REPORT TO THE LIEUTENANT-GOVERNOR IN COUNCIL, PROVINCE OF BRITISH COLUMBIA**

We have audited the consolidated balance sheets of British Columbia Ferry Corporation as at March 31, 2003 and 2002 and the consolidated statements of earnings and retained earnings (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Corporation'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 Corporation as at March 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads "KPMG LLP". The letters are stylized and slanted to the right.

KPMG LLP
Chartered Accountants
Victoria, Canada
April 21, 2003

CONSOLIDATED BALANCE SHEETS MARCH 31, 2003 AND 2002 (COLUMNAR AMOUNTS EXPRESSED IN THOUSANDS)

	2003	2002
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 14,557	\$ 17,520
Accounts receivable and prepaid expenses	34,926	16,242
Inventories	19,305	18,248
	<hr/>	<hr/>
	68,788	52,010
Capital assets (Note 3)	567,968	624,224
	<hr/>	<hr/>
	\$ 636,756	\$ 676,234
 LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 43,849	\$ 42,147
Payable to Province (Note 4)	17,213	-
Accrued employee costs	39,281	38,409
Deferred revenue	11,941	10,029
Current portion of long-term obligations	-	2,926
	<hr/>	<hr/>
	112,284	93,511
Deferred employee obligations (Note 5)	21,294	17,906
Obligations under capital leases (Note 6)	-	15,704
	<hr/>	<hr/>
	133,578	127,121
Shareholder's equity:		
Share capital (Note 7)	6,851	6,851
Contributed surplus (Note 8)	536,957	554,170
Deficit	(40,630)	(11,908)
	<hr/>	<hr/>
	503,178	549,113
Contingent liabilities (Note 13)		
	<hr/>	<hr/>
	\$ 636,756	\$ 676,234

See accompanying notes to consolidated financial statements.

On behalf of the board:



David Emerson
DIRECTOR



Mark Cullen
DIRECTOR

CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS (DEFICIT)

YEARS ENDED MARCH 31, 2003 AND 2002 (COLUMNAR AMOUNTS EXPRESSED IN THOUSANDS)

	2003	2002
Revenue:		
Tolls	\$ 315,618	\$ 305,710
Motor fuel tax subsidy	74,243	71,706
Retail	61,762	60,374
Federal-Provincial Subsidy Agreement (Note 9)	23,377	22,953
Other income	15,016	12,505
	490,016	473,248
Expenses:		
Operations, maintenance and administration	397,759	384,846
Cost of retail goods sold	22,046	22,479
Amortization	44,050	46,056
	463,855	453,381
Earnings from operations	26,161	19,867
Interest expense	(1,364)	(1,757)
Loss on disposal and write-down of capital assets	(412)	(732)
	24,385	17,378
Earnings before the following	24,385	17,378
Loss on disposal of assets held for resale (Note 4)	(53,107)	-
Provision for write-down of high-speed ferries	-	(40,000)
	(28,722)	(22,622)
Loss for the year	(28,722)	(22,622)
Retained earnings (deficit), beginning of year	(11,908)	10,714
	\$ (40,630)	\$ (11,908)

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
 YEARS ENDED MARCH 31, 2003 AND 2002 (COLUMNAR AMOUNTS EXPRESSED IN THOUSANDS)

	2003	2002
Cash provided by (used in):		
Operations:		
Loss for the year	\$ (28,722)	\$ (22,622)
Items not involving cash:		
Amortization	44,050	46,056
Other non-cash charges	74,012	41,911
Change in non-cash operating working capital	(15,508)	1,448
	73,832	66,793
Financing:		
Principal payments of obligations under capital lease	(18,681)	(2,688)
Investing:		
Proceeds from disposal of capital assets	84	45
Purchase of capital assets	(58,198)	(54,850)
	(58,114)	(54,805)
Increase (decrease) in cash and cash equivalents	(2,963)	9,300
Cash and cash equivalents, beginning of year	17,520	8,220
Cash and cash equivalents, end of year	\$ 14,557	\$ 17,520

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2003 AND 2002 (COLUMNAR AMOUNTS EXPRESSED IN THOUSANDS)

British Columbia Ferry Corporation (the "Corporation") was incorporated under the *Ferry Corporation Act* on June 30, 1976. The Corporation's primary business activity is the provision of ferry services in British Columbia. The Minister of Finance holds the shares of the Corporation as representative of Her Majesty the Queen in Right of the Province of British Columbia.

1. TRANSITION TO BRITISH COLUMBIA FERRY SERVICES INC.:

Subsequent to the year-end, on April 1 and 2, 2003, the ownership of the Corporation's shares and other significant assets was significantly altered, and the Corporation began operations under the new name, B.C. Ferry Services Inc.

The new *Coastal Ferry Act* (the "Act") came into force on April 1, 2003. The Act established a new independent regulatory framework for coastal ferry services and a new service delivery model. The Act establishes the B.C. Ferry Authority, a corporation without share capital to govern British Columbia Ferry Services Inc. The Act also creates a new position, British Columbia Ferries Commissioner, to ensure that rates are fair and reasonable and to monitor service levels.

Service levels that fall outside the mandate of a commercial operation are to be negotiated between the provincial government and British Columbia Ferry Services Inc. on a route-by-route basis under the terms of the new Coastal Ferry Services Contract (the "Contract"). The Contract is for a period of sixty years, renegotiated after a first term of five years and each four-year term thereafter. The Contract defines the service levels to be maintained, the provision of certain provincial social policy initiatives, the routes to be operated and the fee to be provided for these services. The initial term provides for an annual fee not to exceed \$105.5 million.

On April 1, 2003, in anticipation of the transfer of share ownership to the newly established B.C. Ferry Authority, the Corporation's land and structures comprising the terminals were transferred from the Corporation to the British Columbia Transportation Financing Authority. In exchange, the Corporation received recognition of a prepayment of terminal leases for a period of sixty years.

On April 2, 2003, the Corporation converted from incorporation under the *Ferry Corporation Act* to incorporation under the *Company Act (British Columbia)*.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2003 AND 2002 (COLUMNAR AMOUNTS EXPRESSED IN THOUSANDS)

1. TRANSITION TO BRITISH COLUMBIA FERRY SERVICES INC. (CONTINUED):

British Columbia Ferry Services Inc. then amended its Memorandum and Articles to revise the number and classes of authorized shares. The new authorized share capital consists of 1,000,000 Class A voting common shares, without par value; 1 Class B voting common share, without par value; and 80,000 Class C non-voting, 8% cumulative preferred shares, with a par value of \$1,000 per share. The Class C preferred shares are convertible to Class A shares upon the sale of the outstanding Class B share by the original shareholder. Special share rights attached to the Class C shares restrict British Columbia Ferry Services Inc.'s ability to issue shares and to declare dividends.

A debenture in the amount of \$427.7 million was issued in favor of the Province of British Columbia. The debt bears interest payable semi-annually in arrears and is due March 31, 2006. The interest rate is currently 5.33% subject to adjustment under certain conditions. The debenture is secured by a registered mortgage on vessels and on the leasehold interest under the terminal lease and by a general security agreement on property.

British Columbia Ferry Services Inc. then redeemed 100% of its outstanding shares previously held by the Minister of Finance as representative of Her Majesty the Queen in Right of the Province of British Columbia in exchange for preferred shares and cash of a combined amount equal to the Corporation's equity value of \$503.2 million as at March 31, 2003.

Immediately thereafter, British Columbia Ferry Services Inc. issued one new Class B share in favor of B.C. Ferry Authority, in exchange for \$1,000.

The effect of the above transition on the balance sheet of the Corporation using the transactions noted above and assuming the new structure had been implemented on March 31, 2003 is summarized in the following table:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 YEARS ENDED MARCH 31, 2003 AND 2002 (COLUMNAR AMOUNTS EXPRESSED IN THOUSANDS)

1. TRANSITION TO BRITISH COLUMBIA FERRY SERVICES INC. (CONTINUED):

	March 31, 2003	Subsequent transition transactions	Pro forma March 31, 2003
Current assets:			
Cash and cash equivalents	\$ 14,557	\$ 427,678 (b) (427,678) (c) 1 (d)	\$ 14,558
Accounts receivable and prepaid expenses	34,926	-	34,926
Inventories	19,305	-	19,305
	68,788	1	68,789
Capital and other assets	567,968	(230,232) (a) 230,232 (a)	567,968
	\$ 636,756	\$ 1	\$ 636,757
Liabilities:			
Current liabilities	\$ 112,284	\$ -	\$ 112,284
Deferred employee obligations	21,294	-	21,294
Long-term debt	-	427,701 (b)	427,701
	133,578	427,701	561,279
Shareholders' equity:			
Common shares	6,851	(6,851) (c) 1 (d)	1
Preferred shares	-	75,477 (c)	75,477
Contributed surplus	536,957	(496,327) (c) (40,630) (e)	-
Deficit	(40,630)	40,630 (e)	-
	503,178	(427,700)	75,478
	\$ 636,756	\$ 1	\$ 636,757

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2003 AND 2002 (COLUMNAR AMOUNTS EXPRESSED IN THOUSANDS)

1. TRANSITION TO BRITISH COLUMBIA FERRY SERVICES INC. (CONTINUED):

- (a) Land and structures that comprise the terminals disposed and leased back.
- (b) Debt issued for cash.
- (c) Common shares redeemed for 75,477 Class C preferred shares and cash.
- (d) Issuance of one Class B share.
- (e) Elimination of deficit by transfer from contributed surplus.

2. SIGNIFICANT ACCOUNTING POLICIES:

(A) BASIS OF PRESENTATION:

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

The consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiary, Catamaran Ferries International Inc. ("CFI"). All significant inter-company balances and transactions have been eliminated on consolidation.

(B) CASH AND CASH EQUIVALENTS:

Cash and cash equivalents are comprised of cash and all 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:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 YEARS ENDED MARCH 31, 2003 AND 2002 (COLUMNAR AMOUNTS EXPRESSED IN THOUSANDS)

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

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) 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.

The proceeds from taxes collected under the *Motor Fuel Tax Act* are recorded in income as an operating subsidy.

(F) CONTRIBUTED SURPLUS:

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

The carrying amount was further reduced as at March 31, 2003 as described in note 8.

(G) EMPLOYEE FUTURE BENEFITS:

The Corporation 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2003 AND 2002 (COLUMNAR AMOUNTS EXPRESSED IN THOUSANDS)

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

In addition, eligible employees are entitled to specific retirement benefits as provided for under the collective agreement and terms of employment. The Corporation accrues the future obligation for these benefits over the employees' expected term of service. Actuarial valuations were 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 assets and the corresponding period of amortization, the valuation of employee future benefits, and provisions of contingencies. Actual results could differ from these estimates.

(I) TAXES:

The Corporation is exempt from federal and provincial income taxes. Grants, in lieu of taxes, are paid to municipalities within which the Corporation operates.

(J) FOREIGN CURRENCY TRANSACTIONS:

The Corporation'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 and retained earnings (deficit) during the year in which they arise.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 YEARS ENDED MARCH 31, 2003 AND 2002 (COLUMNAR AMOUNTS EXPRESSED IN THOUSANDS)

3. CAPITAL ASSETS:

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
Assets held for resale and construction-in-progress	29,109	-	29,109
	\$ 1,248,950	\$ 680,982	\$ 567,968

2002	Cost	Accumulated Amortization	Net Book Value
Ships owned	\$ 684,888	\$ 399,234	\$ 285,654
Ships under capital lease	49,759	29,937	19,822
Berths, buildings and equipment	411,416	222,931	188,485
Land	25,406	-	25,406
Assets held for resale and construction-in-progress	104,857	-	104,857
	\$ 1,276,326	\$ 652,102	\$ 624,224

In addition to the construction-in-progress referenced above, contractual commitments for capital assets under construction at March 31, 2003 totaled \$13.0 million (2002 - \$21.0 million).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 YEARS ENDED MARCH 31, 2003 AND 2002 (COLUMNAR AMOUNTS EXPRESSED IN THOUSANDS)

4. PAYABLE TO PROVINCE/LOSS ON DISPOSAL OF ASSETS HELD FOR RESALE:

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 Corporation to pay to the Province the proceeds less commissions from the auction. The amount, Cdn \$17.2 million, is classified as payable to Province in the balance sheet.

5. DEFERRED EMPLOYEE OBLIGATIONS:

	2003	2002
Accrued sick leave liability	\$ 1,307	\$ 1,579
Workers' compensation claims liability	9,308	5,094
Employee future benefits	10,679	11,233
	\$ 21,294	\$ 17,906

The workers' compensation claims liability is based on an actuarial valuation of the Corporation's claims. The increase during the year results primarily from actuarial assumptions inherent in the Worker's Compensation Board's estimate which differ from previous assumptions.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2003 AND 2002 (COLUMNAR AMOUNTS EXPRESSED IN THOUSANDS)

6. OBLIGATIONS UNDER CAPITAL LEASES:

During the year, the lessors of each of the Corporation'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 British Columbia Transportation Finance Authority ("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 back to the Corporation 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 Corporation also 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 Corporation. The exercise price is \$1 for each option.

The Corporation 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2003 AND 2002 (COLUMNAR AMOUNTS EXPRESSED IN THOUSANDS)

7. SHARE CAPITAL:

	2003	2002
Authorized:		
1,000,000 Shares without par value with a maximum consideration of \$100,000,000		
Issued:		
68,512 Shares	\$ 6,851	\$ 6,851

Subsequent to the year end, on April 2, 2003, the Corporation redeemed 100% of its outstanding shares, amended its articles of incorporation to revise the number and classes of authorized shares, and issued one new Class B common share and 75,477 new Class C preferred shares (note 1).

8. CONTRIBUTED SURPLUS:

	2003	2002
Balance, beginning of year	\$ 554,170	\$ 554,170
Payment to the Province	(17,213)	-
Balance, end of year	\$ 536,957	\$ 554,170

During the year, the Province directed the Corporation to pay the Province the proceeds less commissions from the auction of the assets held for resale (note 4).

9. FEDERAL-PROVINCIAL SUBSIDY AGREEMENT:

The Corporation received revenue from the Government of Canada of \$23.4 million (2002 - \$23.0 million) pursuant to a contract for the provision of ferry and coastal freight and passenger services in the waters of British Columbia.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2003 AND 2002 (COLUMNAR AMOUNTS EXPRESSED IN THOUSANDS)

10. RISK MANAGEMENT:

(A) FUEL MANAGEMENT:

The Corporation manages its exposure to vessel fuel price volatility by entering into forward contracts with certain financial intermediaries executed by the Ministry of Finance and Corporate Relations on behalf of the Corporation. Under the new ownership structure in subsequent years (note 1), the Corporation will execute forward contracts directly. 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, 2003, the Corporation has effectively hedged approximately 15% of its projected fuel requirements for fiscal 2003/2004 and had hedged approximately 82% of the fuel consumed during the past year.

(B) CREDIT AND INTEREST RATE RISK:

The Corporation does not believe it is subject to any significant concentration of credit risk. Most of the Corporation'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 Corporation manages the credit exposure related to financial instruments by utilizing the Ministry of Finance and Corporate Relations to execute contracts, by selecting credit-worthy counter-parties and by limiting its exposure to a single counter-party.

In concert with the Ministry of Finance and Corporate Relations, the Corporation may enter into interest rate agreements to manage its exposure on debt instruments. Under the new ownership structure, in subsequent years (note 1), the Corporation will execute forward contracts and agreements directly.

(C) FAIR VALUE OF FINANCIAL INSTRUMENTS:

The carrying amounts of accounts receivable, accounts payable and accrued liabilities, and payable to Province at March 31, 2003 approximate their fair value due to their short term to maturity.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 YEARS ENDED MARCH 31, 2003 AND 2002 (COLUMNAR AMOUNTS EXPRESSED IN THOUSANDS)

11. RELATED PARTY TRANSACTIONS:

The Corporation utilizes Crown land for terminals and highway access without the payment of rent or property taxes. During the year, the Corporation 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 Corporation's subsidiary paid property taxes at the assessed values.

The Corporation engages in transactions with other 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.

Included in payable to Province is the gross proceeds less commission from the auction of the assets held for resale payable to the Province of \$17.2 million (2002: nil).

In addition, the Corporation receives, by way of provincial legislation, a motor fuel tax subsidy whereby the Corporation receives 1.25 cents per litre of the Provincial Motor Fuel Tax. Subsequent event related party transactions are described in note 1.

12. SUPPLEMENTAL CASH FLOW INFORMATION:

	2003	2002
Cash paid during the year for interest	\$ 3,365	\$ 1,803

13. CONTINGENT LIABILITIES:

The Corporation, in conducting its usual business activities, is involved in various legal proceedings and litigation, the outcome of which is indeterminable. It is the Corporation'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 Corporation. Any additional future costs or recoveries, which differ from the accrued amounts, will be recorded as expenses or revenues as determined.

14. COMPARATIVE FIGURES:

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

British Columbia Ferry Services Inc.

Fleet House

1112 Fort Street

Victoria, British Columbia V8V 4V2

Telephone: (250) 381-1401

Facsimile: (250) 381-5452

(Please note: Individual sites and offices have their own facsimile lines.)

Web site: <http://www.bcferries.com>

Reservations: (250) 386-3431 (in Victoria)

Or toll-free from anywhere in British Columbia

1-888-BCFERRY (1-888-223-3779)

Auditors

KPMG LLP

Chartered Accountants

St. Andrew's Square II

800 - 730 View Street

Victoria BC V8W 3Y7

Telephone: (250) 480-3500

Facsimile: (250) 480-3539

Web site: www.kpmg.ca

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