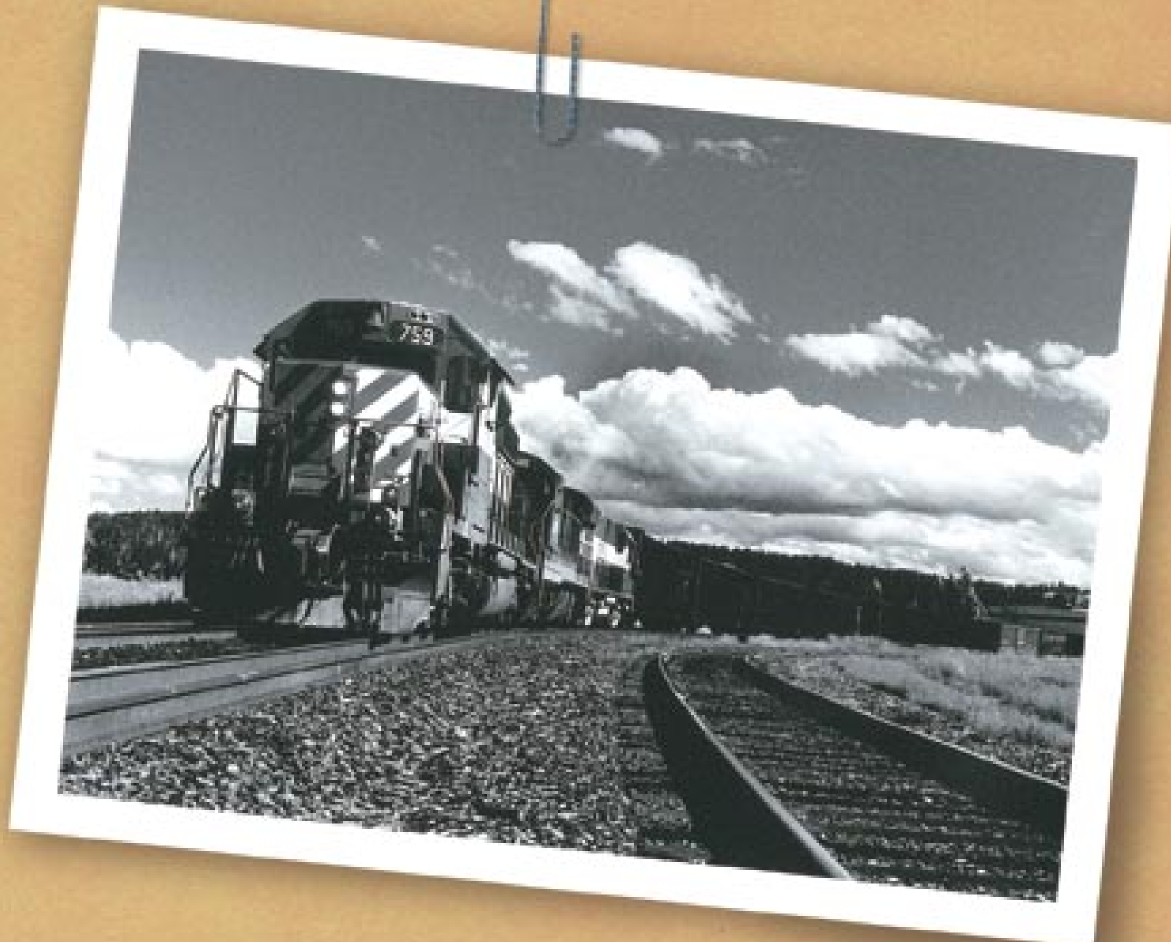
NAME
NOM

bcrc annual report

No. 2003



BCRC
BRITISH COLUMBIA RAILWAY COMPANY

CORPORATE PROFILE

The British Columbia Railway Company ("BCRC") is a commercial Crown corporation with all of its business activities operating in competition with the private sector. BCRC is mandated to operate without any government subsidies. For the 2003 year it was comprised of three principal business units:

- BC Rail, an industrial freight railway
- BCR Marine, which operates Vancouver Wharves; and
- BCR Properties, managing the railway's real estate portfolio.

BC Rail

BC Rail is Canada's third largest railway as measured by revenue and continuous track. It operates exclusively within British Columbia and has inter-line connections to all rail-served points within North America. The BC Rail network consists of 2,315 route-kilometres and 740 kilometres of industrial, yard and track sidings throughout the province.

The rail network consists of a 1,577 kilometre mainline from North Vancouver to Fort Nelson, plus branchlines to Mackenzie, Dawson Creek, Tumbler Ridge, Fort St. James and Takla.

In addition BC Rail owns the 36.8 kilometre Port Subdivision line, connecting three major railways (Burlington Northern Santa Fe — BNSF; Canadian National Railway — CN; and Canadian Pacific Railway — CP) to the important port terminals at Roberts Bank. BC Rail does not operate any of its own trains over the Port Subdivision, but maintains the track and manages all train operations over the subdivision and into port terminals for the user railways (BNSF, CN and CP) on a shared cost basis.

BC Rail is driven by a commitment to customer service and ongoing improvement to the business. Each year, advances in technology and productivity enhance existing methods of service in all areas of the business.

BC Rail plays an important role in the export economy of British Columbia as almost all of the railway's customers sell their commodities outside the province. Over 80 per cent of BC Rail's total revenue is generated by the transport of commodities such as forest products, energy and agricultural products. Car hire revenue – money earned from BC Rail cars when they travel off-line - as well as income from the operations of Roberts Bank and switching charges account for the balance of revenues.

BCR Marine

BCR Marine operates Vancouver Wharves. It is based in North Vancouver and handles mineral concentrates, pulp, sulphur, fertilizers and agri-products. The Company operated two other subsidiaries – Canadian Stevedoring and Casco Terminals – until the businesses were sold on February 25, 2003.

BCR Properties

BCR Properties manages all of the company's real estate assets, the majority of which are required for BC Rail operations. It also owns lands in the railway's important industrial parks, most of which are leased to major, long-term tenants and railway customers. In addition, BCR Properties owns a smaller number of properties (lands and buildings), which it manages for income.

MESSAGE FROM THE CHAIRMAN OF THE BOARD AND THE CHIEF EXECUTIVE OFFICER

In 2003, the British Columbia Railway Company operated its core business of industrial freight in a manner that met customer expectations and exceeded company goals for employee safety and financial results. This was achieved despite a year that saw massive flooding, rock slides and bridge wash-outs along miles of track during record rainfalls in October.

Overall, the Company followed through admirably on the strategic plan announced in 2002 to focus on being a key transportation link for the province's export-oriented rail customers. Operating income for the year was $78.5 million compared to $65.5 million in 2002. Revenues remained constant while expenses were reduced by more than $15 million.

At the same time that progress continued under the strategic plan, BC Rail and its employees experienced a year of major challenge and change.

The Company's shareholder, the Province of British Columbia, initiated a Request for Proposals ("RFP") from parties interested in assuming operation of the railway. On May 15, 2003, the now former Minister of Transportation Judith Reid formally launched the RFP process by inviting qualified private sector bidders to express their interest. CN was named the successful bidder and the change process continued through the final quarter of 2003. It is expected that CN will take the Company reins sometime in spring 2004.

In the meantime, BC Rail employees deserve considerable praise for the ability they've shown in not only continuing to run the railway safely and efficiently, but for the positive and resilient attitudes they've shown throughout a period of uncertainty and tremendous change. It was made clear by all the proponents in the RFP process, and since that time by CN, that BC Rail employees have been highly cooperative and possess an impressive level of knowledge and expertise.

Much of that skill and experience was demonstrated throughout the past year. During the record flooding of 2003, approximately a dozen spots along 160 km of track were devastated by high-flowing waters and rock falls. BC Rail emergency crews worked overtime to restore customer service at several locations. The Company's experience in bridge building came into the fore at Rutherford Creek where crews put the bridge spans back into position in record time.

BC Rail employees also provided their input into the successful 2010 Winter Olympic Bid as part of the Sea-to-Sky group working on the 2010 Bid Transportation Committee.

Safety targets for 2003 were surpassed and demonstrated a considerable improvement over the previous year, including a drop in the injury frequency rate of 6.0 in 2002 to 3.8 in 2003. The 37 percent improvement can be attributed to the hard work of BC Rail's safety committees and to the efforts of all employees who have taken to heart our stated mission of making BC Rail Canada's safest railway.

MESSAGE FROM THE CHAIRMAN OF THE BOARD AND THE CHIEF EXECUTIVE OFFICER

BC Rail's Board of Directors has also contributed significantly to the Company's ability to serve its customers and the communities of British Columbia, while helping management stay the course during this year's considerable challenges. We express profound gratitude for their commitment and service.

While 2003 will be remembered by many as a year of monumental change, it should also be remembered as a year of accomplishments for which BC Rail employees can be deservedly proud.

John McLernon
Chairman of the Board
British Columbia Railway Company

Robert Phillips
Chief Executive Officer
British Columbia Railway Company

MANAGEMENT DISCUSSION AND ANALYSIS

OVERVIEW

The British Columbia Railway Company is a competitive, commercial Crown corporation owned by the Province of British Columbia. Its current operations include an industrial freight railway, a bulk commodity terminal and management of a real estate portfolio.

The BC Rail vision, as set out in its 2003 to 2005 service plan, is "*to act as a valuable strategic advantage for our customers in moving their goods to market*", with a mission "*to build a safe, reliable, cost effective, self-sustaining, freight railway company*". The organization is committed to the following values:

- A safe and healthy work environment
- A customer-focused, market-driven approach to business
- A creative, resourceful, and entrepreneurial spirit
- Continuous improvement and innovation
- Operate profitably and achieve business targets
- Treat everyone in an honest, fair, and respectful manner
- Reward and recognize achievements of individuals and teams

In 2002, the Company set forth its 2002-2004 strategic service plan with a focus to return to its core business of a commercial freight railway. This strategy was maintained and expanded in the 2003 to 2005 service plan and implementation of the plan has resulted in significant changes to the organization over the past 2 years. During 2002, the Company discontinued its passenger services and TOFC Intermodal Service operations. In 2003, the Company sold its container terminal facility and stevedoring business to P&O Ports Canada for $105 million.

In February 2003, the Province announced that it intended to seek a third party operator for the industrial freight railway. In November 2003, British Columbia Railway Company ("BCRC") and BCR Properties signed a transaction agreement with Canadian National Railway Company (CN) under which CN will assume the operations of the Company's industrial freight railway business by aquiring the shares of BC Rail Ltd. and the partnership interests of BC Rail Partnership (collectively "BC Rail") for proceeds of $1 billion (the "Transaction").

Prior to closing, the Company will undergo a corporate restructuring to ensure that only the assets and liabilities intended to be part of the Transaction remain in BC Rail. Part of the restructuring will involve moving the rail-bed and related infrastructure from BC Rail to BCRC. As part of the Transaction, BCRC and CN will enter into a Revitalization Agreement, under which CN will lease the rail-bed and related infrastructure from BCRC for a term of 60 years. The Revitalization Agreement also gives CN the option to renew the lease for an additional 30 years and allows for further extensions of the term of the agreement beyond this point at the discretion of BCRC.

The Company will use the proceeds to repay its outstanding debt with the Province of British Columbia, to pay transaction costs, and for future corporate requirements. The balance of the proceeds will be paid to the Province as a dividend. The Transaction with CN requires review by the Competition Bureau.

MANAGEMENT DISCUSSION AND ANALYSIS

Once the investment partnership is concluded, BCR Properties Ltd., BCR Port Subdivision Ltd., BCR Marine Ltd. (Vancouver Wharves), and BCR Captive Insurance Co. Ltd. will all remain as operating companies under BCRC, a provincial Crown Corporation.

2003 RESULTS

The plans and goals as described in the 2003-2005 service plan continued to be the focus of the organization for the 2003 fiscal year resulting in operating income of $79 million. The main goals of the Company remained relatively unchanged from last year and included:

1. Revenue and yield improvement
2. Productivity improvement and cost reduction
3. Customer service
4. Safe, healthy, and productive work environment.

The Company was able to focus on ongoing operations and significantly improve its results over 2002, seeing operating income increase $13 million from 2002 levels. Consolidated net income was $66 million compared to a loss of $84 million in 2002. The Company's investment in Vancouver Wharves was written down by $119 million in 2002, which accounted for the loss in that year.

There has been a change in presentation of the Company's results in 2003. Both Vancouver Wharves and Finlay Navigation, which were reported as discontinued operations in 2002, are now being reported as continuing operations as they no longer meet the criteria for being reported as discontinued operations. For comparative purpose, the figures for 2002 have been restated.

REVENUES

Consolidated revenues from continuing operations remained relatively flat in 2003 at $364.0 million, a decrease of only $2.7 million over 2002. Coal revenue alone decreased by almost $13.7 million over 2002, however revenue in other areas successfully grew by $11.0 million to offset the loss of coal. With the return to the core business of freight rail transport, revenue from freight traffic represents the majority of total revenues. The revenues can be broken down by business unit as follows:

($ thousands)	**2003**	2002
Freight Railway	**$ 299,059**	$ 297,566
Real Estate	**14,923**	15,347
Vancouver Wharves	**42,568**	44,306
Finlay Navigation	**8,158**	9,120
Other	**(703)**	342
	$ 364,005	$ 366,681

MANAGEMENT DISCUSSION AND ANALYSIS

Freight Railway Revenues

Freight railway revenues of $299.1 million for 2003 were up $1.5 million or 1% from 2002.

($ thousands)	2003	2002
Forest Products:		
Lumber	$ 58,099	$ 56,597
Wood pulp	40,631	36,998
Woodchips	34,720	32,390
Logs & Poles	17,882	22,317
Other Forest Products	24,399	23,029
Reload	9,234	7,731
	184,965	179,062
Bulk Products:		
Coal	3,286	16,973
Sulphur	26,270	20,694
Grain	8,208	8,700
Other Bulk Products	23,253	20,911
	61,017	67,278
Other Freight Revenue:		
Car Hire	45,493	43,993
Switching	3,945	3,968
Other	3,639	3,265
	53,077	51,226
Total Freight Railway Revenues	**$ 299,059**	$ 297,566

Forest Products

Revenue from forest products was up $5.9 million or 3% from 2002 and was primarily responsible for the increase in freight revenues in 2003, helping to offset the loss of coal revenue. The Company experienced positive results across all forest product commodity groups except for logs and poles.

Lumber traffic was strong again in 2003. Volumes were up reflecting strong housing starts and increased sawmill production as an ongoing strategy by producers to lower the unit costs and counter attack the US softwood lumber duties. Woodpulp revenue rebounded this year with the increased strength of the world pulp market and the addition of a new pulp customer.

Revenue from logs and poles decreased in 2003 mainly due to decreased volumes from the Takla region. Volumes were down due to the customers' use of cheaper beetle kill wood rather than sourcing logs from the Takla. Further, the movement of logs on the Takla is significantly affected by weather conditions. The revenue in 2002 was actually higher than normal due to the cold weather which extended the winter logging season through the Spring of 2002.

Other forest products including newsprint, oriented strand board (OSB), plywood, veneer, and other miscellaneous commodities, experienced a slight increase in 2003. Unplanned wood pellet moves was the primary driver of the increase in revenue from other forest products. The wood pellet revenue came as a result of a new customer capitalizing on the growing wood pellet market.

MANAGEMENT DISCUSSION AND ANALYSIS

Finally, reload revenue also experienced positive revenue growth in 2003 mostly due to higher levels of pulp shipments.

Bulk Products

Revenue from bulk products was lower than the prior year with the cessation of coal traffic in the Spring of 2003 due to the shutdown of the Bullmoose mine. Overall revenue from bulk products decreased from $67.3 million in 2002 to $61.0 million in 2003, a decrease of $6.3 million or 9%.

Offsetting the loss of coal somewhat was the increase in sulphur revenue in 2003. Sulphur revenue was up $5.6 million or 27% over 2002 – almost entirely due to price. Yield was exceptionally high as the world price of sulphur was very strong throughout 2003.

Grain traffic was down slightly in 2003. Poor crop conditions in the 2002-2003 crop year resulted in weak shipments in the early part of the year and September volumes for the 2003-2004 crop were negatively impacted by poor weather conditions during this year's harvesting.

Finally, Other Bulk Products including concentrates, petroleum products, liquified petroleum gas (LPG) products, and other miscellaneous bulk commodities, experienced an increase in revenues for 2003. Strong gravel and contaminated soil moves were the primary drivers of this performance.

Other Freight Revenue

The most significant component of other freight revenue is car hire revenues. The company earns car hire revenue from other railways when its cars go off the BC Rail line. Car hire revenues grew again in 2003, up $1.5 million or 3%, due to increased carloads for those commodities travelling offline such as lumber, pulp and plywood shipments. Car hire revenue is earned primarily in US dollars and was negatively affected this year by the lower average US exchange rate. The increase in traffic volumes, however, more than offset the negative impact of the low US dollar.

Vancouver Wharves Revenue

Revenue from Vancouver Wharves decreased $1.7 million or 4%. The reduction in revenues is attributable to a 4.9% decrease in volumes of products handled through the terminal. In particular, the volumes of specialty agricultural products handled through the terminal declined 38.4%, largely as a result of the drought in the prairie provinces.

MANAGEMENT DISCUSSION AND ANALYSIS

EXPENSES

Consolidated expenses from continuing operations were $285.5 million for 2003, down $15.7 million or 5% from 2002. The organization saw reductions of expenses in almost every area except for fuel which was up just slightly over 2002 due to slightly higher average fuel prices in 2003 and purchased services and other which increased $10.9 million because of an increase in the environmental accrual. The most significant reductions were in labour costs which decreased $13.3 million or 11% and material supplies which decreased $3.1 million or 14%. Overall, the reductions are due to efficiencies gained in both manpower and train operations, and the consolidation of maintenance shops. Consolidated amortization of property and equipment also decreased in 2003, by $6.9 million or 13%, due to the significant write-down of Vancouver Wharves that was taken at the end of 2002 which reduced amortization expenses on its assets.

The consolidated expenses, broken down by business unit, are as follows:

($ thousands)	**2003**	2002
Freight Railway	**$ 212,323**	$ 231,783
Real Estate	**5,777**	6,044
Vancouver Wharves	**64,842**	51,623
Finlay Navigation	**7,097**	7,638
Other	**(4,535)**	4,113
	$ 285,504	$ 301,201

Freight Railway Expenses

Freight railway expenses, which were the majority of operating costs incurred in 2003, were $212.3 million down from $231.8 million in 2002.

($ thousands)	**2003**	2002
Operating expenses:		
Operations	**$ 61,709**	$ 66,967
Maintenance	**58,185**	63,052
Fuel	**22,915**	22,050
Mishaps	**5,984**	4,653
Reload	**1,091**	1,888
Other	**1,775**	5,595
	151,659	164,205
Administrative overhead	**24,745**	30,616
Amortization expense	**39,018**	36,962
Restructuring costs	**(3,099)**	-
Total Freight Railway Expenses	**$ 212,323**	$ 231,783

Operating expenses fell again in 2003, dropping $12.5 million or 8% from 2002 levels. An overall focus on operating efficiency, reducing fleet size, and increasing higher yield traffic, consistent with the 2002-2004 strategic goals, resulted in this reduction of expenses. Specifically, maintenance and operations saw the largest reductions.

MANAGEMENT DISCUSSION AND ANALYSIS

The decrease in operations costs was mainly due to lower equipment lease costs. The organization's fleet reduction strategy, in addition to reductions in lease rates due to favourable market conditions, was responsible for the lower lease costs. Labour costs were reduced as a result of fewer freight trains and relief trains operated, and fewer yard shifts required as compared to 2002. Although freight revenues increased over 2002, freight traffic volumes were down 14,000 cars or 8% over the prior year. The reduction in traffic volumes was primarily due to coal which was down over 17,000 carloads in 2003. The reduction in traffic volumes along with more efficient train operations for non-coal traffic were together responsible for the operating expense reductions.

Maintenance costs, including Engineering and Mechanical, were down $4.9 million in 2003. Engineering costs fell $3.3 million as a result of lower costs of snow removal and rock maintenance, timing of programmed maintenance costs, and lower environmental, facility and communication costs. Mechanical saw cost reductions of $1.6 million as a result of savings in several areas including lower cost of locomotive and freight car servicing primarily due to decreased utilities and shop activities resulting from the effort in previous years to consolidate shops and manpower, and lower production on the chip car reconditioning initiative and centrebeam servicing program.

The increase in operating fuel costs was primarily due to higher prices in 2003. Fuel volumes were down slightly in 2003, consistent with fewer trains and more efficient train operations. The Company benefitted from its fuel hedging program in 2003.

Administrative overhead expenses in 2003 decreased $5.9 million or 19%. Administrative costs were down across departments throughout the organization due to general cost-savings initiatives and a focus on overall efficiencies. The pension credit, calculated annually based on the actuarial valuation of the Company's pension plan assets and liabilities, increased this year by $2.6 million. Offsetting a portion of the reductions were the insurance premiums which increased in 2003 by $2.0 million.

Vancouver Wharves Expenses

Expenses for Vancouver Wharves were up $13.2 million or 26%, primarily due to the environmental liability accrual recorded during the year. Also contributing to the increase was higher maintenance and administration costs, offset by a decrease in operations costs and amortization of property and equipment due to the write-down of assets.

DISCONTINUED OPERATIONS

The results of discontinued operations relates to those business units that were discontinued or disposed of during the year. They include:

- Casco Terminals
- Canadian Stevedoring
- Passenger Services

The sale of the operations and assets of Canadian Stevedoring and Casco Terminals was completed in February 2003. The sale of the assets to P&O Ports for proceeds of $105 million resulted in a net gain before tax of $37 million of which $28 million was recognized in 2003.

MANAGEMENT DISCUSSION AND ANALYSIS

LIQUIDITY AND CAPITAL RESOURCES

One of the key strategic goals of the company has been to restructure and reduce the Company's debt. Due to it's Crown ownership, the Company is not able to obtain financing through the issuance of new equity. All capital resources, both sustaining and growth or investment capital, must be generated out of retained earnings, or where there is a shortfall, through debt.

As a result, the Company has been focused on reducing the current levels of debt to a more manageable level and improving cash flow so that it will be self-sustaining for future capital needs. Over the past 2 years, with the sale of non-core businesses such as Canadian Stevedoring and Casco Terminals and the discontinuation of such marginally profitable services as ToFC Intermodal and Passenger, the Company has made significant progress in reducing its outstanding debt and improving its free cash balances.

Operating Activities

Cash provided from operating activities was $70 million for the year ended December 31, 2003 as compared to $90 million for 2002. The reduction is due primarily to changes in non-cash working capital, particularly the reduction of accounts payable and accrued liabilities.

Investing Activities

Cash provided by investing activities was $69 million for the year ended December 31, 2003 as compared to a deficit of $32 million for 2002. The sale of Canadian Stevedoring and Casco Terminals to P&O Ports Canada contributed $105 million in net proceeds. Purchases of property and equipment were $35 million which were primarily for sustaining capital.

Financing Activities

Cash used in financing activities was $106 million for the year ended December 31, 2003 as compared to $54 million for 2002. Of the $105 million received from the sale of Canadian Stevedoring and Casco Terminals, $66 million was used to pay down long-term debt and the remaining $37 million was used to repay short-term debt. The repayment of long-term debt was completed though a defeasance of $68.5 million of long-term debt. This debt had sinking funds of $11.6 million and resulted in a loss of $8.6 million, which is presented as interest expense in the financial statements.

As a result of the continued focus on the corporate goals, the Company's cash balance grew in 2003 by almost $24 million and progress has been made towards reducing the debt and interest payments to more manageable levels.

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS RISKS

Revenue Yields

Since the de-regulation of the transportation industry in the 1980's, competitive pressures on freight traffic revenues have intensified. This is an industry-wide issue. However, the impact on regional railways such as BC Rail has been even greater than on the larger railways, primarily due to the competition with the trucking industry for "short-haul" moves within the province.

In order to mitigate this risk the Company has been extremely diligent in assessing the profitability of services and ensuring that profitable services are increased while services that are only marginal or operating at a loss are discontinued.

Market Share

A continued focus on customer service is especially important given the market conditions within which BC Rail operates. Given the fact that there are very few new traffic shippers or emerging markets for the Company to target, the Company must increase market share of traffic from existing customers. The risk of decreasing market share has been, and will continue to be addressed by improving service reliability and consistency and improving overall responsiveness to customers.

Challenging Operating Environment

BC Rail's entire railway network operates within the challenging and rugged terrain of the Province of British Columbia. In fact, for benchmarking purposes, it has been difficult to find any other railway of a similar scale that operates with a such a high proportion of its network in such extreme terrain. However, an ongoing commitment to safety and improving operational productivity and infrastructure utilization has allowed the Company to effectively manage this risk.

REPORT OF MANAGEMENT

BCRC DIRECTORS

John R. McLernon, Chair (2)
Anne M. Stewart (2)
Bev A. Briscoe (1)
Brian G. Kenning (1)
Len S. Marchand (2)
Patrick W. Rorison (3)
Jim F. Shepard (3)
Jim R. Yeates (1)
Gerry Offet (3) (4)

BCRC OFFICERS

Robert L. Phillips,
Group President and
Chief Executive Officer

Cheryl Yaremko,
Vice President Finance and
Chief Financial Officer

(1) Member of Audit, Finance and Risk Management Committee

(2) Member of Human Resources, Governance and Nominating Committee

(3) Member of Environment and Safety Committee

(4) Appointed February 2003

The accompanying consolidated financial statements of British Columbia Railway Company and all other information contained in the Annual Report are the responsibility of management. The consolidated financial statements were prepared in conformity with generally accepted accounting principles appropriate in the circumstances in a manner consistent with the previous year and, accordingly, include some amounts based on management's best judgments and estimates. The financial information contained elsewhere in this Annual Report is consistent with that in the consolidated financial statements.

Management is responsible for maintaining a system of internal accounting controls and procedures to provide reasonable assurance, at an appropriate cost/benefit relationship, that assets are safeguarded and transactions are authorized, recorded and reported properly. The internal accounting control system is augmented by a program of internal audits and appropriate reviews by management, written policies and guidelines and a written Code of Business Conduct adopted by the Board of Directors, applicable to all employees of the Company. Management believes that the Company's internal accounting controls provide reasonable assurance that assets are safeguarded against material loss from unauthorized use or disposition and that the financial records are reliable for preparing financial statements and other data and maintaining accountability for assets.

The Audit, Finance and Risk Management Committee of the Board of Directors meets with the independent auditors, management and internal auditors periodically to discuss internal accounting controls, auditing and financial reporting matters. The committee reviews with the independent auditors the scope and results of the audit effort. The committee also meets with the independent auditors without management present to ensure that the independent auditors have free access to the committee. The committee reviews the consolidated annual financial statements and recommends their approval by the Board of Directors.

The independent auditors, KPMG LLP Chartered Accountants, are appointed by the Minister of Finance to examine the financial statements of British Columbia Railway Company and conduct such tests and related procedures as they deem necessary in conformity with generally accepted auditing standards. The opinion of the independent auditors, based upon their examination of the financial statements, is contained in this Annual Report.

R. L. Phillips *President and Chief Executive Officer*

C. Yaremko *Vice-President Finance and Chief Financial Officer*

TO THE LIEUTENANT GOVERNOR IN COUNCIL
PROVINCE OF BRITISH COLUMBIA

We have audited the consolidated balance sheet of British Columbia Railway Company as at December 31, 2003 and the consolidated statement of income and deficit and cash flows for the year then ended. These consolidated 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 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 consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Vancouver, Canada

February 19, 2004

CONSOLIDATED BALANCE SHEET (in thousands of dollars)

December 31	2003	2002 *Restated (Note 2)*
ASSETS		
Current		
Cash and cash equivalents	**$ 44,782**	$ 21,046
Accounts receivable	**53,761**	54,784
Inventories and other items	**26,678**	24,061
Future income taxes	-	14,000
Discontinued operations - Note 2	-	12,803
	125,221	126,694
Property and equipment - Note 3	**901,690**	916,042
Other assets - Note 4	**93,233**	80,345
Discontinued operations - Note 2	**1,200**	64,993
	$ 1,121,344	$ 1,188,074
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Accounts payable and accrued liabilities	**$ 99,955**	$ 124,366
Short-term notes payable to the Province	-	41,517
Current obligations on long-term debt - Note 6	**4,585**	7,498
Discontinued operations - Note 2	-	13,460
	104,540	186,841
Other liabilities - Note 5	**125,944**	107,716
Long-term debt - Note 6	**489,187**	553,947
Discontinued operations - Note 2	-	4,252
	719,671	852,756
Shareholder's equity		
Share capital - Note 7	**257,688**	257,688
Contributed surplus	**277,547**	277,547
Deficit	**(133,562)**	(199,917)
	401,673	335,318
	$ 1,121,344	$ 1,188,074

Commitments - Note 8
Contingent liabilities - Note 9
Significant transaction - Note 16
See accompanying notes to the consolidated financial statements.

On behalf of the Board

John McLernon, *Director*

Brian G. Kenning, *Director*

CONSOLIDATED STATEMENT OF INCOME AND DEFICIT (in thousands of dollars)

For the years ended December 31	2003	2002 Restated (Note 2)
Revenues	$ 364,005	$ 366,681
Expenses		
Labour costs	107,091	120,377
Amortization of property and equipment	44,479	51,419
Purchased services and other	57,734	46,876
Lease expense	25,397	27,957
Materials and supplies	19,095	22,155
Fuel	26,371	25,514
Operating and other taxes	5,337	6,903
	285,504	301,201
Operating income	78,501	65,480
Non-operating expenses (income)		
Net interest expense - Note 11	37,705	31,160
Income tax recovery - Note 12 (a)	-	(13,993)
Income from continuing operations before special charges	40,796	48,313
Write-down investment in Vancouver Wharves Limited Partnership	-	118,955
Income (loss) from continuing operations	40,796	(70,642)
Income (loss) from discontinued operations - Note 2	25,559	(13,556)
Net income (loss)	66,355	(84,198)
Deficit, beginning of year	(199,917)	(115,719)
Deficit, end of year	$ (133,562)	$ (199,917)

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS (in thousands of dollars)

For the years ended December 31	2003	2002 Restated (Note 2)
Operating activities		
Income (loss) from continuing operations	$ 40,796	$ (70,642)
Adjustment for items not involving cash		
Gain on sale of assets	(1,178)	(2,231)
Amortization of property and equipment	44,479	51,419
Amortization of other assets and liabilities	(3,016)	(955)
Pension and post employment benefit income and contributions - Note 13	(4,170)	457
Future income taxes - Note 12	-	(14,000)
Write-down investment in Vancouver Wharves Limited Partnership	-	118,955
Net change in non-cash working capital - Note 14 (a)	(18,434)	28,896
Changes in other operating liabilities - Note 14 (b)	11,134	(21,984)
Cash provided by operating activities	69,611	89,915
Investing activities		
Purchase of property and equipment	(35,073)	(44,283)
Proceeds on sale of property and equipment	4,251	7,620
Proceeds from the sale of Canadian Stevedoring Company Limited - Note 2	105,051	-
Changes in other assets	(5,631)	5,076
Cash provided by (used in) investing activities	68,598	(31,587)
Financing activities		
Short-term notes repaid to the Province	(41,517)	(44,954)
Payments and interest earned on sinking funds	(5,322)	(6,838)
Sinking fund retirements	11,608	-
Repayment of long-term debt	(71,202)	(2,671)
Cash used in financing activities	(106,433)	(54,463)
Increase in cash and cash equivalents from continuing operations	31,776	3,865
Cash used in discontinued operations	(8,040)	(3,914)
Cash and cash equivalents, beginning of year	21,046	21,095
Cash and cash equivalents, end of year	$ 44,782	$ 21,046

See accompanying notes to the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

British Columbia Railway Company ("BCRC") is owned by the Province of British Columbia (the "Province") and was incorporated under the British Columbia Railway Act.

BCRC and its subsidiaries (collectively the "Company") provide industrial freight rail transportation and bulk terminal services within British Columbia.

1. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements are expressed in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles.

Basis of consolidation

These consolidated financial statements include the accounts of BCRC and all of its subsidiaries. In these notes, "Company" refers to BCRC, its subsidiaries and partnerships. All significant inter-company transactions have been eliminated.

Use of estimates

The preparation of financial statements 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 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 determination of net recoverable value of assets, useful lives for amortization and provisions for post employment benefits, contingencies, restructuring and environmental matters. Actual amounts may ultimately differ from these estimates.

Cash and cash equivalents

Cash and cash equivalents include cash and those short-term money market instruments with initial terms to maturity of three months or less.

Inventories

Inventories of material and supplies are valued at the lower of average cost and net realizable value.

Property and equipment

Road property is recorded at cost, net of government grants. Abandoned or relocated sections are removed at average unit costs. Track materials installed during planned programs are recorded at cost. Labour costs for programmed replacements are expensed as incurred. Repairs and non-programmed replacements of track structure are charged against current operations. Betterments and major track relocations are capitalized.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Property and equipment is amortized on a straight-line basis over the estimated useful lives of the assets. The cost of assets retired or disposed, less salvage value, is charged against accumulated amortization in accordance with generally accepted accounting practices for railways in Canada. No gain or loss on retirements, other than on accidental destruction of rolling stock and on disposal of land and commercial property, is included in income. The original cost of assets less estimated salvage value is amortized over the following number of years:

	Number of Years
Road and buildings:	
Tunnels	150
Grade	100
Bridges	30 - 80
Rail, ties and ballast	25 - 35
Wharves and buildings	10 - 40
Equipment:	
Locomotives	25
Freight cars	15 - 33
Handling and other equipment	3 - 20

Equipment under capital lease is amortized over its lease term. Leasehold improvements are amortized over the term of the related lease.

Revenue recognition

Rail freight revenues and associated movement costs are recognized as the service is performed. Terminal revenues are recognized when services have been substantially completed.

Foreign exchange

Transactions denominated in a foreign currency are translated at exchange rates prevailing on the date of transactions. Assets and liabilities denominated in a foreign currency at the balance sheet date are translated to equivalent Canadian amounts at the exchange rate in effect on that date.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Post employment benefits

The Company accrues its obligations under employee benefit plans and the related costs as benefits are earned, net of returns on plan assets. The Company's policies are as follows:

i) The cost of retirement benefits earned by employees is actuarially determined using the projected benefit method pro-rated on service and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.

ii) The expected interest cost on any prior service obligation is calculated using management's estimate for the long-term rate of return.

iii) The expected return on plan assets is calculated at a market-related value for the assets.

iv) Past service costs from plan amendments, experience gains and losses and any changes in assumptions are amortized on a straight-line basis over the expected average remaining service period of active employees and included in the pension expense for the year.

Income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, changes in future tax asset and liability balances are included in income. These balances are determined using enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Derivative financial instruments

Derivative financial instruments are utilized by the Company to manage its exposure to market risks relating to fuel prices. The Company's policy is to formally designate each derivative financial instrument as a hedge of anticipated fuel purchases. The Company believes the derivative financial instruments are effective as hedges, both at inception and over the term of the instrument, as it is certain that fuel consumption will be greater than the amount of fuel contracted for in the derivative financial instruments. Unrealized gains and losses on derivative instruments used as hedges are deferred and recognized in income in the period that the hedged exposure is recognized in income, which is the same period the instrument is settled.

The Company also uses foreign currency swaps to manage foreign exchange risks related to debt denominated in foreign currencies (Note 6).

Environmental expenditures and liabilities

Environmental expenditures that relate to current operations are expensed as part of operating activities or capitalized as appropriate. Expenditures that relate to an existing condition caused by past operations and which are not expected to contribute to current or future operations are expensed. Environmental liabilities related to environmental assessment and/or remedial efforts are accrued when the expenditures are considered likely and the costs can be reasonably estimated.

2. DISCONTINUED OPERATIONS

On February 25, 2003, the Company sold the assets of Canadian Stevedoring Company Limited ("CSCL", which includes the operations of Casco Terminals and Canadian Stevedoring) to P&O Ports Canada Inc. for proceeds of $105.1 million. The Company realized a net gain of $37.1 million on the sale, of which $27.7 million was recognized in 2003. The proceeds were used to repay long-term and short-term debt (Note 6 (c)).

The Company entered into a formal plan to discontinue its Passenger Services operations in March 2002. The Company ceased the operations of its passenger lines over the course of 2002, with the final run of this service occurring in October 2002. The sale of assets from this business is continuing.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

2. DISCONTINUED OPERATIONS (cont'd)

The Company's share of the assets, liabilities and revenues and expenses of its discontinued operations for the years ended December 31, 2003 and 2002 are as follows:

	CSCL		Passenger Services		Total	
	2003	2002	**2003**	2002	**2003**	2002
Balance sheet						
Current assets	**$ -**	$ 12,753	**$ -**	$ 50	**$ -**	$ 12,803
Capital assets and other	**-**	61,787	**1,200**	3,206	**1,200**	64,993
Current liabilities	**-**	(13,376)	**-**	(84)	**-**	(13,460)
Other liabilities	**-**	(4,252)	**-**	-	**-**	(4,252)
Net assets of discontinued operations	**$ -**	$ 56,912	**$ 1,200**	$ 3,172	**$ 1,200**	$ 60,084
Statement of income						
Revenues	**$ 11,007**	$ 76,604	**$ -**	$ 8,254	**$ 11,007**	$ 84,858
Expenses	**13,770**	87,140	**-**	14,146	**13,770**	101,286
Gain on disposal of assets	**-**	-	**(599)**	(7,472)	**(599)**	(7,472)
Gain on sale	**(27,723)**	-	**-**	-	**(27,723)**	-
Provision for disposition costs	**-**	4,600	**-**	-	**-**	4,600
	$ 24,960	$ (15,136)	**$ 599**	$ 1,580	**$ 25,559**	$ (13,556)

In the 2002 financial statements, Vancouver Wharves Limited Partnership ("VWLP") was presented as a discontinued operation. In May 2003, the Board of Directors decided to cancel the sale process for VWLP. As a result, VWLP no longer qualifies for discontinued operations reporting and has been presented as a continuing operation in both the current year and the comparative period.

3. PROPERTY AND EQUIPMENT

	2003			2002		
	Cost	**Accumulated Amortization**	**Net**	Cost	Accumulated Amortization *Restated (Note 2)*	Net
Road and buildings	**$ 1,658,916**	**$ 1,018,783**	**$ 640,133**	$ 1,641,046	$ 1,011,228	$ 629,818
Equipment	**365,219**	**114,119**	**251,100**	363,555	105,670	257,885
Equipment under capital lease	**12,651**	**6,917**	**5,734**	31,226	24,548	6,678
Construction in progress	**4,723**	**-**	**4,723**	21,661	-	21,661
	$ 2,041,509	**$ 1,139,819**	**$ 901,690**	$ 2,057,488	$ 1,141,446	$ 916,042

Interest of $280,000 (2002 - $322,000) was capitalized during the year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

4. OTHER ASSETS

	2003	2002 Restated (Note 2)
Accrued pension benefit asset - Note 13 (a)	**$ 39,985**	$ 30,506
Insurance deposits	**33,349**	26,441
Foreign currency contract – Note 6 (e)	**8,085**	10,842
Deferred system costs	**3,885**	3,889
Long-term debt discounts	**5,780**	6,254
Other	**2,149**	2,413
	$ 93,233	$ 80,345

Insurance deposits are funds required to be put on deposit as part of the Company's self-insurance program, calculated as the excess of the premiums paid over the actual losses incurred, plus investment income. The amounts are invested in pooled funds of short-term Canadian debt instruments.

Deferred system costs include costs incurred to develop information systems, which are being amortized over their expected useful lives of 3 to 7 years.

5. OTHER LIABILITIES

	2003	2002 Restated (Note 2)
Accrued non-pension benefit obligation – Note 13 (a)	**$ 49,959**	$ 45,082
Restructuring costs – Note 10	**9,566**	18,754
Workers' compensation actuarial liability	**12,883**	16,337
Environmental liability accrual – Note 9	**46,529**	20,500
Other	**7,007**	7,043
	$ 125,944	$ 107,716

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

6. LONG-TERM DEBT

(a) Long-term debt outstanding, less current maturities, consists of the following:

		2003	2002
Sinking fund bonds, notes and debentures payable to the Province of British Columbia:			
8.00%	due August 2005	$ -	$ 44,000
10.99%	due August 2005	-	24,490
6.00%	due June 2008	**50,000**	50,000
5.875%	due July 2009	**158,085**	160,842
8.00%	due June 2026	**50,000**	50,000
6.15%	due November 2027	**25,000**	25,000
5.70%	due June 2029	**175,000**	175,000
5.75%	due January 2039	**50,000**	50,000
		508,085	579,332
Other long-term debt		**279**	372
Capital lease obligations – Note 6 (f)		**9,417**	12,036
		517,781	591,740
Less:			
Sinking funds		**24,009**	30,295
Current portion		**4,585**	7,498
		489,187	553,947
Foreign currency contract - Note 6 (e)		**(8,085)**	(10,842)
Net long-term debt outstanding after hedging		**$ 481,102**	$ 543,105

(b) The sinking fund bonds, notes and debentures payable to the Province are unsecured.

(c) In March 2003, $68.5 million of outstanding long-term debt, together with related sinking fund investments of $11.6 million, was removed from the Company's balance sheet under a defeasance agreement with the Province. The Province has unconditionally relieved the Company of any further obligations regarding these securities. The loss on the debt defeasance of $8.6 million is included in interest expense (Note 11).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

6. LONG-TERM DEBT (cont'd)

(d) Sinking fund requirements for the next five years are as follows:

2004	$ 3,862
2005	3,862
2006	3,862
2007	3,862
2008	3,862

(e) The 5.875% note is a French franc 636,959,470 note subject to swap agreements which hedge the Company against foreign exchange changes arranged by the Company's fiscal agent on the Company's behalf. The French franc has a fixed conversion rate to the euro of 6.55957 (1 euro = 6.55957 French francs). The note is included in long-term debt at the closing exchange rate as at the balance sheet date. The value of the foreign currency contract is included in other assets (Note 4). The note after hedging is valued at C$150 million.

(f) The effective interest rate for assets under capital leases recorded in the property and equipment accounts as at December 31, 2003 is 13.13%. The future minimum lease payments are as follows:

2004	$ 1,944
2005	1,944
2006	1,944
2007	1,944
2008	1,944
Thereafter	8,604
Total minimum lease payments	18,324
Less:	
Maintenance costs	3,657
Imputed interest	5,250
Net liability	$ 9,417

7. SHARE CAPITAL

Authorized: 10,000,000 common shares with a par value of $100 each.
Issued and outstanding: 2,576,885 common shares held by the Province.
As all of the issued and outstanding common shares of the Company are held by the Province, earnings per share data has not been provided.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

8. COMMITMENTS

The following is a schedule of future minimum payments at December 31, 2003, required under non-cancelable operating leases:

2004	$ 21,975
2005	17,656
2006	10,480
2007	4,905
2008	430
Thereafter	-
Total minimum lease payments	$ 55,446

At December 31, 2003, the Company had outstanding commitments to acquire material and equipment amounting to $5.4 million (2002 - $12.2 million).

The Company has a contract with a diesel fuel supplier that requires the Company to purchase monthly and annual minimum volumes. The Company currently purchases in excess of these required minimums. In the event that there is a significant change in the Company's operations, the contract allows for amendment of the volume guarantees.

9. CONTINGENT LIABILITIES

(a) The Company is contingently liable with respect to pending litigation and claims arising in the normal course of business. In the opinion of management, any liability that may arise would not have a material adverse effect on future income as sufficient provisions have been made.

(b) On June 14, 2002, the Attorney General of Canada commenced legal proceedings in the B.C. Supreme Court against BCR Marine Ltd., BC Rail Ltd., BCR Properties Ltd., British Columbia Wharves Ltd., and BCR Marine Ltd., CSCL and BCRC carrying on business as VWLP and VWLP alleging that those entities are responsible for soil and groundwater contamination on a site adjacent to the VWLP operation. The Attorney General has not filed a Statement of Claim or quantified the damages claimed.

(c) Canada Customs and Revenue Agency ("CCRA") is auditing the fair market value of the assets of Vancouver Wharves Ltd. as at April 1, 1999 with respect to the formation of VWLP. The Company cannot determine at this time the merits of the position of CCRA, or what adjustments will result.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

9. CONTINGENT LIABILITIES (cont'd)

(d) The risk of environmental liability is inherent in the operation of the Company's business with respect to both current and past operations. As a result, the Company incurs significant costs, on an ongoing basis, associated with environmental regulatory compliance and clean-up requirements.

The Company accrues for both anticipated expenditures on existing environmental remediation programs over a 10 year horizon and contingent liabilities in relation to specific sites where the expected costs can be reasonably estimated.

The Company believes it has identified the costs likely to be incurred over the next several years, based on known information. However, ongoing efforts to identify potential environmental concerns associated with the Company's properties may lead to future environmental investigations, which may result in the identification of additional environmental costs and liabilities, the magnitude of which cannot be reasonably estimated.

(e) The Company leases a portion of its property used in its operations in North Vancouver from Canada Lands Company Limited ("CLCL"). The Company received a notice of default on its lease from CLCL on February 6, 2003. The current lease with CLCL expires April 11, 2004 and CLCL has advised the Company that based on the alleged defaults under the lease, it has no right to renew the lease. The Company is currently assessing whether the allegations in the notice of default are factually correct and has no indication of what outcome or cost will arise as a result of this notice. In the event that the lease is not renewed, the Company is reviewing plans to reconfigure the site and continue operations.

10. RESTRUCTURING COSTS

During 2001, the Company approved its Strategic Plan to reorganize its operations. The reorganization involves closing redundant offices, eliminating non-strategic lines of business, and implementing changes in systems, personnel, and business processes. The estimated cost of $100 million was fully recorded in the 2001 financial year.

The accrual for restructuring costs was reassessed in 2003 resulting in a $3.1 million reversal of the accrual.

As at December 31, 2003, $17.5 million of the amounts accrued for this restructuring in 2001 remain and will be expended over the next three years. Of this amount, $9.6 million is classified as long-term (Note 5).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

11. NET INTEREST EXPENSE

		2003		2002
				Restated (Note 2)
Interest on long-term debt and short-term notes to the Province	**$**	**32,749**	$	38,930
Interest on capital lease obligations		**932**		1,221
Other interest expense		**332**		1,846
Loss on debt defeasance - Note 6 (c)		**8,633**		-
		42,646		41,997
Less:				
Sinking fund earnings		**1,457**		1,918
Interest earned on temporary investments		**1,643**		1,417
Interest capitalized		**280**		322
Interest allocated to discontinued operations		**1,561**		7,180
		4,941		10,837
Net interest expense	**$**	**37,705**	$	31,160

12. INCOME TAXES

(a) Income tax expense (recovery) is comprised as follows:

		2003		2002
Current	**$**	**-**	$	7
Future		**-**		(14,000)
	$	**-**	$	(13,993)

(b) As at December 31, 2003, the Company had available tax losses carried forward aggregating $258 million. The tax losses available to be carried forward expire as follows:

2004	**$**	**13,000**
2005		**32,000**
2006		**44,000**
2007		**59,000**
2008		**77,000**
2009		**31,000**
2010		**2,000**
Total	**$**	**258,000**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

13. EMPLOYEE BENEFITS

(a) The Company has defined benefit and defined contribution pension plans and other retirement and post employment benefit plans which cover most of its employees. The amounts presented in this note are actuarially determined projections.

	Pension Plans		Other Plans	
	2003	2002	**2003**	2002
		Restated (Note 2)		*Restated (Note 2)*
Reconciliation of accrued benefit asset (liability)				
Opening balance	**$ (415,511)**	$ (489,781)	**$ (53,377)**	$ (36,617)
Current service cost	**(10,728)**	(15,726)	**(1,464)**	(795)
Benefits paid	**36,009**	34,092	**1,858**	1,425
Interest cost	**(29,203)**	(33,642)	**(4,762)**	(2,578)
Settlements	**167**	-	-	-
Curtailments	**47**	-	**349**	-
Plan amendments	-	(2,624)	-	-
Actuarial gains (losses)	**(50,482)**	92,170	**(16,227)**	(14,812)
Ending balance	**(469,701)**	(415,511)	**(73,623)**	(53,377)
Reconciliation of plan assets				
Opening balance	**536,058**	572,883	-	-
Actual return on plan assets	**53,580**	(4,807)	-	-
Employer contributions	**3,899**	2,052	**1,858**	1,425
Employee contributions	**14**	22	-	-
Settlements	**(263)**	-	-	-
Benefits	**(36,009)**	(34,092)	**(1,858)**	(1,425)
Ending balance	**557,279**	536,058	-	-
Fund status – surplus (deficit)	**87,578**	120,547	**(73,623)**	(53,377)
Unamortized transitional asset	**(83,313)**	(93,417)	-	-
Unamortized net actuarial loss	**33,079**	534	**23,664**	8,295
Other	**2,641**	2,842	-	-
Accrued benefit asset (liability)	**$ 39,985**	$ 30,506	**$ (49,959)**	$ (45,082)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

13. EMPLOYEE BENEFITS (cont'd)

(b) Significant actuarial assumptions adopted in measuring the Company's accrued benefit obligations are as follows as of December 31:

	Pension Plans		Other Plans	
	2003	2002	**2003**	2002
Discount rate for liabilities	**6.50%**	7.25%	**6.50%**	7.25%
Expected long-term rate of return on plan assets	**7.00%**	7.00%	-	-
Salary escalation rate	**0% to and including 2005; 3.5% from 2006**	0% to and including 2005; 3.5% from 2006	-	-

The weighted average rate of increase in the per capita cost of future covered health care benefits was assumed to be 8.80% grading down to 4.60% in 2010.

The plan asset portfolio currently comprises equity investments and debt. Equity investments are 50%-70% of the portfolio and include Canadian, International, and Real Estate investments. Debt is 30%-50% of the portfolio and comprises short-term debt, bonds and mortgages. Asset mix is reviewed periodically and may vary in the future.

(c) The Company's net benefit plan expense (income) is as follows:

	Pension Plans		Other Plans	
	2003	2002 *Restated (Note 2)*	**2003**	2002 *Restated (Note 2)*
Current service cost	**$ 10,714**	$ 15,704	**$ 1,464**	$ 795
Interest cost	**29,203**	33,642	**4,762**	2,578
Expected return on plan assets	**(35,951)**	(38,653)	-	-
Amortization of transitional asset	**(9,682)**	(9,969)	**1,077**	(218)
Settlement loss (gain)	**137**	-	**(568)**	-
Other	-	55	-	-
	$ (5,579)	$ 779	**$ 6,735**	$ 3,155

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

14. STATEMENT OF CASH FLOWS – SUPPLEMENTAL INFORMATION

(a) The components of changes in non-cash working capital balances relating to operations are as follows:

	2003	2002 Restated (Note 2)
Accounts receivable	$ 1,023	$ 7,121
Inventories and other items	(2,617)	4,113
Accounts payable and accrued liabilities	(16,840)	17,662
	$ (18,434)	$ 28,896

(b) The components of changes in other operating liabilities are as follows:

	2003	2002 Restated (Note 2)
Restructuring costs	$ (14,895)	$ (29,484)
Environmental liability accrual	26,029	7,500
	$ 11,134	$ (21,984)

(c) The following interest was paid (received) in the current year:

	2003	2002 Restated (Note 2)
Interest paid to third parties	$ 44,721	$ 40,720
Interest received from third parties	(3,109)	(3,123)
	$ 41,612	$ 37,597

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

15. FINANCIAL INSTRUMENTS

(a) Fair Values

The Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, short-term notes, long-term debt, and foreign currency contracts. The carrying amounts approximate fair value due to their immediate or short-term maturity, except as disclosed in the following table:

	2003		2002	
	Carrying Value	**Fair Value**	Carrying Value	Fair Value
Bonds, notes and debentures	**$ (508,085)**	**$ (540,270)**	$ (579,332)	$ (669,651)
Sinking funds	**24,009**	**25,815**	30,295	31,794
Foreign currency contracts	**8,085**	**8,546**	10,842	11,576

(b) The Company has no unrecognized losses in relation to its fuel hedging instruments as at December 31, 2003.

16. SIGNIFICANT TRANSACTION

On November 25, 2003, BCRC and BCR Properties signed an agreement with Canadian National Railway (CN), under which CN will assume the operations of the Company's industrial freight railway business by aquiring the shares of BC Rail Ltd. and the partnership interests of BC Rail Partnership (collectively "BC Rail") for proceeds of $1 billion (the "Transaction").

Prior to closing, the Company will undergo a corporate restructuring to ensure that only the assets and liabilities intended to be part of the Transaction remain in BC Rail. Part of this restructuring will involve moving the railbed and related infrastructure from BC Rail to BCRC. CN will assume certain intercompany debt owing by BC Rail to BCRC.

As part of the Transaction, BCRC and CN will enter into a Revitalization Agreement, under which CN will lease the railbed and related infrastructure from BCRC for a term of 60 years. The Revitalization Agreement also gives CN the option to renew the lease for an additional 30 years and allows for further extensions of the term of the agreement beyond this at the discretion of BCRC.

The Company will use the proceeds to repay its outstanding debt with the Province, pay transaction costs and for future corporate requirements. The balance of the proceeds will be paid to the Province as a dividend.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (tabular amounts in thousands of dollars)

16. SIGNIFICANT TRANSACTION (cont'd)

As at December 31, 2003 the consolidated financial statements included the following assets, liabilities, revenues and expenses for BC Rail:

	2003
Balance sheet	
Current assets	$ 87,695
Capital assets and other	834,761
Current liabilities	(83,592)
Other liabilities	(82,977)
Net assets	$ 755,887
Statement of income	
Revenues	$ 296,093
Expenses	211,302
	$ 84,791

All of the tax losses available to be carried forward disclosed in Note 12 relate to BC Rail.

17. COMPARATIVE FIGURES

Certain of the comparative figures have been restated to conform with the current year's financial statement presentation.

CORPORATE GOVERNANCE

Sound corporate governance principles are essential to the success of every commercial enterprise. British Columbia Railway Company ("BCRC") is committed to these principles to foster its continued success.

A Code of Conduct for all BCRC employees, officers, agents and directors was introduced in 1995 and, as amended, remains in effect today. The Code emphasizes the importance of honesty, fair dealing, faithful performance of contract and integrity. The Board of Directors adopted Standards of Ethical Conduct for Directors and Officers in 1999 and, as amended, remain in effect today. The Standards recognize the additional responsibilities and duties that directors and officers have to BCRC. The implementation of the Standards of Ethical Conduct includes the appointment by the Board of Directors of an Ethics Advisor to provide advice to directors and officers on the application and interpretation of the standards.

In accordance with present guidelines for corporate governance, all members of the Board are independent and unrelated, having no other affiliation with BCRC. The roles of the Chair and the CEO are separate, with no overlap of responsibilities.

BCRC will continue to review its governance practices to ensure that they are consistent with the Code and that they contribute to the sound direction and management of BCRC. The Board of Directors carries out its duties with the primary objective of enhancing shareholder value. The Board has the authority and duty to supervise management of the Company's business affairs. Management reviews and revises the objectives for the Company with the Board, which considers and approves them and monitors progress towards their achievement.

The business plan and forecast are reviewed and approved by the Board prior to the start of each fiscal year. The approval of the business plan and budget establishes the authority of senior management to take the actions indicated in the business plan and their responsibility for implementation. Other material matters not reflected in the budget, including raising capital, acquisitions and divestitures require approval of the Board. Through reports distributed to the Board, and at quarterly directors' meetings, management reviews with the Board the progress of business units in meeting the business plan and budgets.

The Board regards the selection and compensation of senior management as an important element of meeting the Company's objectives. It has delegated this function to an independent Human Resources, Governance and Nominating Committee consisting of three directors. The committee, with the assistance of independent consultants, considers compensation for senior management, which is designed to reward effort, reflect the Company's performance in relation to current objectives and to be consistent with market rates of compensation.

The Board recognizes the importance of maintaining effective internal, financial and other controls, sound management information systems and timely, consistent financial reporting. The Board has delegated the overseeing of management's performance of these functions to a three-member Audit, Finance and Risk Management Committee whose members have been selected for their ability and experience with these functions. The committee meets at least twice annually with the Company's auditors to review annual planning for the audit of the Company's accounts, to monitor the progress of the audit and to

CORPORATE GOVERNANCE

review the auditor's report and recommendations. The committee has direct access to the Company's internal audit staff. The committee also approves all other financial information prepared by management for public release.

The Board recognizes the imperative of safe and environmentally responsible operations. To oversee management's responsibilities in these matters, the Board established a two member Environment and Safety Committee whose members are experienced in the operation of heavy industry. Subsequent to the year end, this Committee was expanded to three directors. The Committee meets as required, but at least twice annually, to review the safety performance of the Company's operations and to assess the progress of the programs to manage the impact of the Company's operations on its surrounding environment.

Each of the above three Committees annually review their Terms of Reference. Quarterly, each Committee obtains a Certification of Compliance from management with respect to the business being conducted in a manner which complies with all legislation, regulations, standards, policies and procedures.

Management has primary responsibility for establishing objectives for the Company. The objectives are designed to exploit opportunities available to the Company and to diminish the risks to which its business is subject so as to enhance returns to the shareholder. Management regularly reviews the objectives to ensure that they are in keeping with the state of the Company's development and the markets in which it operates. In pursuit of these objectives, management prepares an annual business plan and a three-year strategic plan, including financial forecasts.

CONSOLIDATED FIVE-YEAR REVIEW

			FISCAL YEAR		
For the years ended December 31	**2003**	2002	2001	2000	1999
Income Statement (thousands)		*(Note 2)*	*(Note 2)*	*(Note 2)*	*(Note 2)*
Revenues	**$ 364,005**	$ 366,681	$ 356,301	$ 388,894	$ 377,486
Expenses	**285,504**	301,201	315,274	356,215	308,505
Operating income	**78,501**	65,480	41,027	32,679	68,981
Financing costs and income taxes	**37,705**	17,167	30,352	30,377	25,182
Income from continuing operations before special charges	**40,796**	48,313	10,675	2,302	43,799
Special charges	**-**	(118,955)	(88,274)	-	(614,324)
Income (loss) from discontinued operations	**25,559**	(13,556)	(29,308)	(9,023)	(11,534)
Net income (loss)	**$ 66,355**	$ (84,198)	$(106,907)	$ (6,721)	$(582,059)
Rate of Return (income from continuing operations before special charges)					
On shareholder's equity	**11.1%**	12.8%	2.3%	0.4%	5.3%
Other Financial Highlights					
Capital additions of continuing operations (millions)	**$ 35**	$ 44	$ 57	$ 117	$ 170
Total assets (millions)	**$ 1,121**	$ 1,188	$ 1,308	$ 1,348	$ 1,361
Operating ratio of continuing operations	**78%**	82%	88%	92%	82%
Debt to equity ratio	**1.21**	1.77	1.54	1.18	1.22
Employees (number)	**1,351**	1,618	1,953	1,999	2,088

CONSOLIDATED FIVE-YEAR REVIEW

		FISCAL YEAR			
For the years ended December 31	**2003**	2002	2001	2000	1999
Traffic and Operating Statistics		*(Note 2)*	*(Note 2)*	*(Note 2)*	*(Note 2)*
BC Rail Business Unit					
Revenue ton-miles (millions)	**4,523**	4,695	4,865	5,058	5,106
Gross ton-miles (millions)	**8,121**	8,205	8,696	8,914	9,090
Net : gross ton-miles	**36:64**	36:64	36:64	36:64	36:64
Revenue tons (thousands)	**12,875**	14,283	13,988	15,273	16,177
Carloadings	**151,063**	164,848	168,120	184,125	193,627
Revenue tons per carload	**85**	87	83	83	84
Revenue ton-miles per BC Rail employee (thousands)	**3,473**	3,059	2,900	2,882	2,685
Number of locomotives at year-end	**119**	121	125	129	127
Number of freight cars at year-end	**9,246**	9,002	9,186	9,563	9,538
BCR Marine Business Unit					
Vancouver Wharves Limited Partnership					
Tonnage shipped (thousands)	**3,502**	3,681	4,046	4,292	3,463
Tons handled per employee	**20,449**	22,175	22,603	20,321	15,552
Canadian Stevedoring Company Limited (Note 1)					
Tonnage handled (thousands)	**903**	7,550	9,633	10,041	8,816
Tons handled per employee	**2,352**	13,726	17,030	15,763	14,645
BCR Properties Business Unit					
Leased square feet (thousands)	**536**	536	536	309	1,663
Revenue per employee (thousands)	**$ 653**	$ 877	$ 914	$ 1,192	$ 1,489

Note 1: On February 25, 2003, Canadian Stevedoring Company Limited was sold to P&O Ports Canada Inc.

Note 2: Certain of the comparative figures have been restated to conform with the current year's financial statement presentation.