Atlantic Pilotage Authority

Administration de Pilotage de l'Atlantique

Atlantic Pilotage Authority

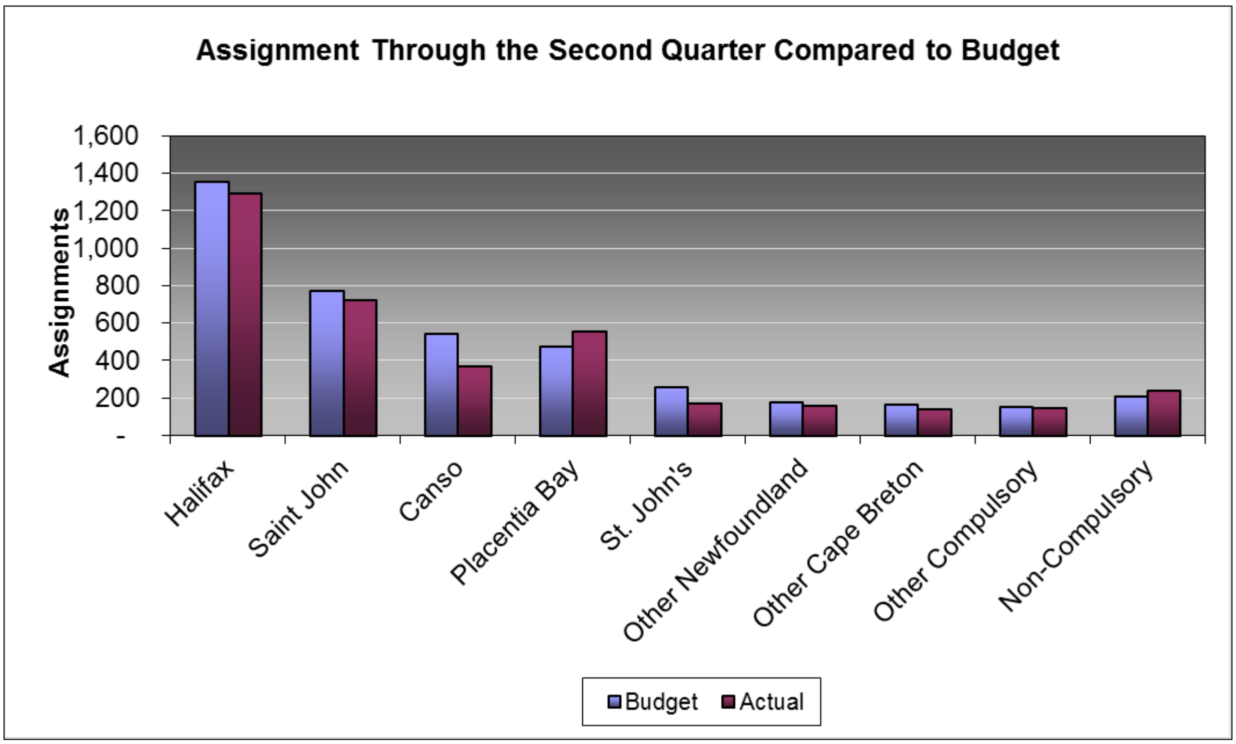
Second Quarter 2012

Management's Discussion and Analysis

August 30, 2012

TRAFFIC REVIEW

Pilotage Area	Actual Traffic through 2nd Qtr 2011	Budget Traffic through 2nd Qtr 2012	Actual Traffic through 2nd Qtr 2012	Variance from 2011	Percentage Variance 2011	Variance from Budget 2012	Percentage Variance from Budget 2012
Halifax	1,457	1,359	1,296	-161	-11%	-63	-5%
Saint John	784	776	722	-62	-8%	-54	-7%
Canso	543	546	373	-170	-31%	-173	-32%
Placentia Bay	445	479	555	110	25%	76	16%
St. John's	261	261	172	-89	-34%	-89	-34%
Other Newfoundland	189	176	157	-32	-17%	-19	-11%
Other Cape Breton	169	169	141	-28	-17%	-28	-17%
Other Compulsory	126	151	150	24	19%	-1	-1%
Non-Compulsory	230	208	240	10	4%	32	15%
Total	4,204	4,125	3,806	-398	-9%	-319	-8%



Overall, traffic levels have improved in the second quarter, but remain under budget for the year to date. The Authority has four major ports (Halifax, NS; Stait of Canso, NS; Saint John, NB; and Placentia Bay, NL) that contribute approximately 80% of its revenue. Of the four major ports, only Placentia Bay has performed better than budgeted. The sharpest decline has occurred in the Strait of Canso, NS, which is 32% under budget on assignments and 33% under budget on revenue.

The decline in Canso is because of a significant reduction in oil tanker activity in the port. The area has a transshipment terminal that supplies refineries along the eastern seaboard of the United States. With no new refineries being developed and demand for petroleum products declining, the transshipment terminal has been relying more and more on a few major customers. Last fall, one of these customers, a refinery in Pennsylvania, closed leading to a sharp reduction in shipments to and from Canso. Oil Tanker assignments and revenues for this port are less than half of that achieved in the first half of 2011.

The port of Halifax, NS, has also had a decline due to a significant downturn in container shipping for the year to date, and reduced demand for oil products in the first quarter. Container ship assignments have declined by 23% for the first half of 2012 compared to the same period last year. This downturn has been as a result of some container lines no longer calling at Halifax, some rationalization of cargo between lines, and other lines reducing the frequency of their service. Oil tanker activity has rebounded in the second quarter from a dismal first quarter, but remains 22% below last year. Overall, the port has 11% fewer assignments and 17% less revenue than the first half of 2011. When compared to budget, the assignments are 5% and revenue is 7% under budget at the end of the second quarter of 2012.

Saint John, NB, has had a budget shortfall of 7% on assignments and 10% on revenue. When compared to the first half of 2011, oil tanker assignments are down 11% and revenue is down by 7%. The LNG terminal continues to operate well below capacity, with only 19 assignments in the first half of 2012 compared to 30 in the first half of 2011. The initial prognosis for traffic at this facility had projected approximately three ships (six assignments) per week, or over 300 assignments in a calendar year. The actual activity since the facility opened in 2009 has been less than 170 assignments in total, including double assignments in the initial period for training purposes. The primary reason for this lack of productivity is the expansion of the shale gas market providing a glut of natural gas in the eastern seaboard of the United States.

Traffic in St. John’s has been reduced by 90 assignments from the first half of 2011. This reduction has been caused by masters on regular callers in the port acquiring pilotage certificates during the past year. This certificate allows them to pilot their own vessels. As an example, the Authority had 117 assignments in the first half of 2011 on cargo vessels operating in the port. This year, there have been only 9 assignments while certificated masters have piloted their own vessels on more than 100 occasions. However, the second quarter did show improvement over the first quarter, and the expectation is for an increase in traffic during the remainder of 2012 and looking forward to 2013.

FINANCIAL AND STATISTICAL REVIEW

COMPARATIVE REVIEW FINANCIAL AND STATISTICAL DATA		
For the six months ended June 30, 2012		
	2012	**2011**
FINANCIAL (000'S)		
Total Revenue	$ 9,786	$ 10,509
Operating Expenses		
Salaries, Fees and Benefits	5,962	5,999
Pilot Boats	2,708	2,707
Other	1,191	1,076
Total Operating Expenses	9,861	9,782
(Loss) Profit	$ (75)	$ 727
STATISTICAL		
Pilotage Assignments	3,806	4,204
Shipping Incidents	2	3
% of incident free assignments	99.95%	99.93%
Customer Complaints Filed	19	21
% of complaint free assignments	99.50%	99.50%

The Authority has suffered with the decline in traffic in three of its major ports. A decline in 2012 was anticipated from a very strong 2011, but not to the extent that has occurred.

Salaries, fees, and benefits for the first half of 2012 have decreased from the same period of 2011. This is due to a reduction in pilots on strength, partially offset by increased salaries in the collective agreement and by pilots advancing through the training system and earning higher salaries. Pilot boat costs are virtually the same as in 2011. Savings have been realized in some ports that have a variable cost for pilot boats because the contractors are paid on a "per trip" basis. However, these savings have been offset by increased fuel costs and pilot boat repair costs through the first two quarters. Finally, the Authority has incurred higher legal and consultation fees due to several proposed regulation amendments and through the services of a professional negotiator to assist in collective bargaining. The Authority negotiated renewals of three separate collective agreements during the first half of 2012.

The following points should be noted with respect to some of the individual ports:

- The tanker traffic lost in Canso is not expected to return in the short or medium term.
- In Halifax, the container traffic has recovered slightly in the second quarter, but there are concerns regarding the future of the oil refinery in the port. The facility is up for sale, and the owner has indicated that they will close it early in 2013. The facility may be converted to a different use, such as a marine terminal, but it is unknown what the impact on vessel traffic will be.
- The activity in St. John's has begun to improve in the second quarter and is expected to end the year with stronger traffic and revenue than experienced in the first half. Additional business is expected in the port through 2013.
- The Authority is expecting the traffic in Saint John to increase during the remainder of the year after a slow start.
- Placentia Bay traffic has slowed in the third quarter as repairs are done to two FPSO (Floating Production, Storage, and Offloading) vessels working on the Grand Banks.

Overall, the Authority had a much improved second quarter after a very weak first quarter. Revenues in the second quarter of 2012 were just 1% less than revenues in the second quarter of 2011. The current projection is that the Authority will break even or have a small profit for 2012. This will be well below the budgeted profit for the year.

The Authority developed a structured methodology for handling complaints several years ago in response to the Ministerial Review of Outstanding Pilotage Issues. The mechanism is designed to be as user friendly as possible, and the goal of the Authority is to ensure that timely feedback is provided to the complainant. The most common reason for a complaint to be submitted was due to a delay in an assignment. In some cases, the delay is caused by factors beyond the control of the Authority, such as weather or delays caused by the non-availability of port services such as tugs.

The Authority received a total of 19 complaints out of a total of 3,806 assignments during the first half of 2012. The remaining 99.5% of assignments were performed without receiving a complaint from the customer. For the same period of 2011, there were 21 complaints received out of 4,204 assignments, with the remaining 99.5% of the assignments performed without complaint. All complaints received are included in the above totals, including those submitted that involved delays not caused by the Authority.

Through the second quarter of 2012 the Authority had two minor shipping incidents. There were three incidents at this point in 2011.

Risk Analysis

The major financial risk faced by the Authority is the declining traffic in major ports. The Authority is currently dealing with a significant decline in the Strait of Canso. The cost structures in ports are not easily adjusted. Due to the specialized nature and training required to be a marine pilot, great caution is taken before reducing the work force in a port to offset short or medium term declines. A reduction can have significant consequences on industry in the form of delays and lost revenue as traffic returns to a port or at peak periods when there are more movements in a port than the average. For Halifax and Saint John, the Authority has made a significant investment in new vessels that will enter service in the third and fourth quarter of 2012.

One major financial risk faced by the Authority has been mitigated by prior action. The increasing cost of fuel, which had a significant negative impact on the cost of operating pilot boats, has been offset by increases in the fuel charge applied to assignments in Halifax, Saint John, and Placentia Bay and Canso.

From 2009 through 2011 the Atlantic Pilotage Authority had very strong financial results that offset prior losses and put the Authority in a sound financial position. The Authority will be able to absorb a weaker than anticipated 2012 due to its financial health.

Second Quarter 2012

Interim Unaudited

Condensed Financial Statements and Notes

Management's Responsibility for Financial Reporting

Management is responsible for the preparation and fair presentation of these quarterly financial statements in accordance with the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations, and for such internal controls as management determines is necessary to enable the preparation of quarterly financial statements that are free from material misstatement. Management is also responsible for ensuring all other information in this quarterly financial report is consistent, where appropriate, with the quarterly financial statements.

Based on our knowledge, these unaudited quarterly financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of the corporation, as at the date of and for the periods presented in the quarterly financial statements.

R.A. McGuinness
Chief Executive Officer

P. MacArthur, CMA
Chief Financial Officer

Halifax, Canada
August 30, 2012

ATLANTIC PILOTAGE AUTHORITY

Statement of Financial Position

Unaudited

(in thousands of Canadian dollars)	June 30, 2012	December 31, 2011
Assets		
Current		
Cash	$ 1,504	$ 3,356
Trade receivables	2,863	3,008
Prepaid expenses	182	60
Inventory	6	-
	4,555	6,424
Non-current		
Intangible assets	205	216
Property, pilot boats and equipment	9,526	8,447
	9,731	8,663
	$ 14,286	$ 15,087
Liabilities		
Current		
Trade and other payables	$ 1,561	$ 1,995
Bank loans	279	251
Employee severance benefits	198	297
	2,038	2,543
Non-current		
Bank loans	3,186	3,338
Employee severance benefits	1,276	1,345
	4,462	4,683
	6,500	7,226
Equity		
Retained earnings	7,786	7,861
	7,786	7,861
	$ 14,286	$ 15,087

The accompanying notes are an integral part of these financial statements.

ATLANTIC PILOTAGE AUTHORITY
Statement of Comprehensive Income

Unaudited

(in thousands of Canadian dollars)	Three Months Ended June 30 2012	Three Months Ended June 30 2011	Six Months Ended June 30 2012	Six Months Ended June 30 2011
Revenues				
Pilotage charges	$ 5,305	$ 5,352	$ 9,756	$ 10,476
Other income	17	21	30	33
	5,322	5,373	9,786	10,509
Expenses				
Pilots' fees, salaries and benefits	2,371	2,338	4,596	4,602
Pilot boats, operating costs	1,273	1,186	2,320	2,230
Staff salaries and benefits	319	438	668	795
Pilot boat crews' salaries and benefits	355	287	698	602
Amortization and depreciation	174	220	369	439
Transportation and travel	175	170	317	311
Professional and special services	142	107	307	221
Utilities, materials and supplies	114	108	185	197
Rentals	70	69	145	137
Finance costs	44	47	89	95
Communications	33	29	63	59
Training	73	90	104	94
	5,143	5,089	9,861	9,782
Profit (loss) for the period	179	284	(75)	727
Other comprehensive loss	-	-	-	-
Actuarial loss on employee severance benefits				
Other comprehensive loss	-	-	-	-
Comprehensive income (loss)	$ 179	$ 284	$ (75)	$ 727

The accompanying notes are an integral part of these financial statements.

ATLANTIC PILOTAGE AUTHORITY
Statement of Changes in Equity

Unaudited

(in thousands of Canadian dollars)	Three Months Ended June 30 2012	Three Months Ended June 30 2011	Six Months Ended June 30 2012	Six Months Ended June 30 2011
Retained earnings, beginning of the period	**$ 7,607**	$ 4,491	**$ 7,861**	$ 4,048
Profit (loss) for the period	**179**	284	**(75)**	727
Other comprehensive loss	**-**	-	**-**	-
Total comprehensive income (loss)	**179**	284	**(75)**	727
Retained earnings, end of period	**$ 7,786**	$ 4,775	**$ 7,786**	$ 4,775

The accompanying notes are an integral part of these financial statements.

ATLANTIC PILOTAGE AUTHORITY

Statement of Cash Flows

Unaudited

	Three months ended June 30		Six months ended June 30	
	2012	2011	**2012**	2011
Operating Activities				
Receipts from customers	**$ 4,717**	$ 5,388	**$ 9,903**	$ 10,300
Payments to and on behalf of employees	**(2,763)**	(2,869)	**(6,066)**	(5,963)
Payments to suppliers	**(2,585)**	(2,885)	**(4,093)**	(3,764)
Other income received	**17**	21	**30**	33
Net cash (used in) provided by operating activities	**(614)**	(345)	**(226)**	606
Investing Activities				
Purchases of intangible assets	**(14)**	-	**(15)**	-
Purchases of property, pilot boats and equipment	**(983)**	(256)	**(1,486)**	(826)
Net cash used in investing activities	**(997)**	(256)	**(1,501)**	(826)
Financing Activities				
Repayment of bank loan	**(63)**	(59)	**(125)**	(117)
Net cash used in financing activities	**(63)**	(59)	**(125)**	(117)
(Decrease) increase in cash	**(1,674)**	(660)	**(1,852)**	(337)
Cash, beginning of the period	**3,178**	4,001	**3,356**	3,678
Cash, end of the period	**$ 1,504**	$ 3,341	**$ 1,504**	$ 3,341
Supplementary Disclosure				
Finance costs paid	**$ 44**	$ 47	**$ 89**	$ 95

The accompanying notes are an integral part of these financial statements.

1. <u>GENERAL INFORMATION AND BASIS OF PRESENTATION</u>

The Atlantic Pilotage Authority (the Authority) was established in 1972 pursuant to the *Pilotage Act*. The principal registered address of the Authority is 2000 Barrington Street, Halifax, Nova Scotia. The objects of the Authority are to establish, operate, maintain, and administer a safe and efficient pilotage service within designated Canadian waters. The *Pilotage Act* provides that pilotage tariffs shall be fair, reasonable, and sufficient, to permit the Authority to operate on a self-sustaining financial basis. Under the *Pilotage Act*, no payment to the Authority may be made under an appropriation by Parliament to discharge an obligation or liability.

The Authority is a Crown corporation listed in Schedule III, Part I of the *Financial Administration Act* and is not subject to the provisions of the *Income Tax Act*.

The Atlantic Pilotage Authority is classified as a Government Businesses Enterprise (GBE). As a GBE, the Authority prepares its statements in accordance with International Financial Reporting Standards (IFRS), as issued by the Accounting Standards Board (AcSB).

These financial statements have been prepared in accordance with the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations. In accordance with the Treasury Board of Canada Standard, these financial statements do not include all of the financial statement disclosures required for annual financial statements and should be read in conjunction with the Authority's Canadian GAAP annual consolidated financial statements for the year ended December 31, 2011. In management's opinion, the financial statements reflect all adjustments that are necessary for a fair presentation of the results for the interim period presented.

The Authority has historically experienced greater demand for its services in the second and third quarters of the calendar year and lower demand in the first and fourth quarters. This demand pattern is principally a result of the high number of cruise vessels visiting the area during the summer and autumn months. The Authority has substantial fixed costs in its cost structure that do not meaningfully fluctuate with pilotage demand in the short term.

2. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies are as follows:

(a) Financial instruments

Trade receivables, classified as loans and receivables, and trade and other payables, classified as other financial liabilities, are initially measured at fair value and subsequently measured at amortized cost. Due to their short-term nature, the amortized cost of these financial instruments approximates their fair value.

Bank loans are classified as other financial liabilities and are initially measured at fair value. After initial recognition, bank loans are measured at amortized cost using the effective interest method.

The Authority is not party to any derivative financial instruments or hedges.

(b) Intangible assets

The Authority's intangible assets are comprised of purchased software. When the software does not form an integral part of the machinery or computer hardware to which it relates, it is separately accounted as an intangible asset. Intangibles are carried at cost less accumulated amortization and impairment losses. Amortization is charged on a straight-line basis over the estimated useful lives of the intangible assets. Estimated useful lives and amortization methods are reviewed at the end of each year.

The useful lives used in the calculation of amortization for purchased and internally developed software is 5 to 10 years.

Intangible assets are tested for impairment when events or changes in circumstances indicate that the carrying amounts may not be recoverable. Assets not in use are tested for impairment annually. Any impairment is recognized in comprehensive income and is measured as the amount by which the carrying amount exceeds its fair value.

(c) Property and equipment

Property, pilot boats and equipment are recorded at cost. The cost of pilot boats under construction includes design, project management, legal, material, direct labour, and interest on construction loans. Amounts included in pilot boats under construction are transferred to the appropriate pilot boat classifications upon completion, and depreciation commences. Depreciation of property, pilot boats and equipment is calculated on a straight-line basis and is based on the estimated useful life of the assets as follows:

Pilot boat hulls and structures	25 years
Pilot boat equipment	10 years
Pilot boat generators	5 years
Pilot boat engines	5 years
Pilot boat inspections	4 years
Furniture and equipment	4 to 10 years
Leasehold improvements	10 years

Assets that are not in use are tested for impairment annually. Any impairment is measured as the amount by which the carrying amount exceeds its fair value and is recognized in comprehensive income.

(d) Employee severance benefits

Employees are entitled to specified severance benefits as provided for under collective agreements or employment contracts, based on their years of service and final salary. The liability for these payments is estimated and recorded in the accounts as the benefits accrue to the employees.

The costs and the benefit obligation are actuarially determined using the projected unit credit method prorated on service that incorporates management's best estimate of the rate of employee turnover, retirement age, future salary and benefit levels, and other actuarial factors.

Actuarial gains and losses are recognized in the period in which they occur and are included in other comprehensive income.

(e) Pension plan

Substantially all of the employees of the Authority are covered by the Public Service Pension Plan (the "Plan"), a contributory defined benefit plan established through legislation and sponsored by the Government of Canada. Contributions are required by both the employees and the Authority to cover current service cost. Pursuant to legislation currently in place, the Authority has no legal or constructive obligation to pay further contributions with respect to any past service or funding deficiencies of the Plan. Consequently, contributions are recognized as an expense in the year when employees have rendered service and represent the total pension obligation of the Authority.

(f) Revenue recognition

Revenues from pilotage charges are recognized when pilotage services are provided.

3. Critical Accounting Estimates and Judgements

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, and revenue and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and further periods if the review affects both current and future periods.

Judgments made by management in the application of IFRS that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the current and following fiscal year are discussed as follows.

(a) Critical accounting estimates

Critical accounting estimates are estimates and assumptions made by management that may result in material adjustments to the carrying amount of assets and liabilities within the next year. Management has made the following critical accounting estimates or assumptions in preparation of these financial statements:

Employee severance benefits

The Authority engaged a third party actuary to assess the fair value of its employee severance benefits. The Authority assesses this obligation at December 31 each year.

(b) Critical accounting judgments

Critical accounting judgments are accounting policies that have been identified as being complex or involving subjective judgments or assessments.

Amortization and depreciation rates

Refer to Notes 2 (b) and 2 (c) for the estimated maximum useful lives of property, pilot boats and equipment and intangible assets.