Atlantic Pilotage Authority

Administration de Pilotage de l'Atlantique

Atlantic Pilotage Authority

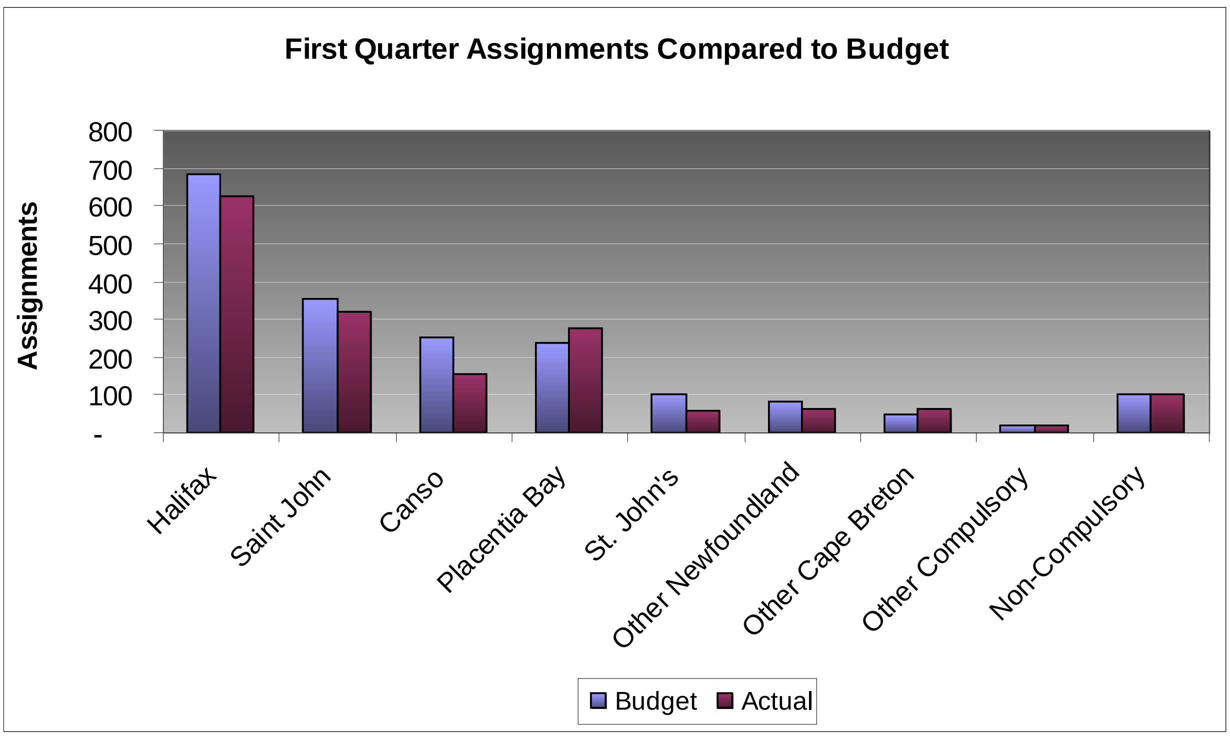
First Quarter 2012

Management's Discussion and Analysis

May 31, 2012

TRAFFIC REVIEW

Pilotage Area	Actual Traffic through 1st Qtr 2011	Budget Traffic through 1st Qtr 2012	Actual Traffic through 1st Qtr 2012	Variance from 2011	Percentage Variance 2011	Variance from Budget 2012	Percentage Variance from Budget 2012
Halifax	735	685	625	-110	-15%	-60	-9%
Saint John	364	356	320	-44	-12%	-36	-10%
Canso	247	250	157	-90	-36%	-93	-37%
Placentia Bay	251	240	274	23	9%	34	14%
St. John's	103	103	59	-44	-43%	-44	-43%
Other Newfoundland	91	82	65	-26	-29%	-17	-21%
Other Cape Breton	48	48	63	15	31%	15	31%
Other Compulsory	20	19	21	1	5%	2	11%
Non-Compulsory	118	103	101	-17	-14%	-2	-2%
Total	1,977	1,886	1,685	-292	-15%	-201	-11%



Overall traffic levels for the Authority are under budget for the first quarter of 2012. Of the four major ports, only Placentia Bay has performed better than budgeted. Of the four major ports, the sharpest decline has occurred in the Strait of Canso, NS, which is 37% under budget on assignments and 43% 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 the level of the first quarter of 2011.

The port of Halifax, NS, has also had a decline due to significant downturn in container shipping and reduced demand for oil products. Container ship assignments have declined by 21% from the first quarter of 2011. This downturn has been as a result of some container lines no longer calling at Halifax, and other lines reducing the frequency of their service. Oil tanker activity has declined even more dramatically, with assignments totaling only 52% of those in the same quarter of 2011. The increased prices for gasoline, diesel, and furnace oil, combined with a mild winter, have contributed to the weaker market for these products. There has been some offset with increased business in general and dry cargo, but the port still was under budget by 9% on assignments and 13% on revenue for the quarter.

Saint John, NB, has had a budget shortfall of 10% on assignments and 16% on revenue. Oil tanker revenue has been down by 8% from the previous year, but the decline in LNG tanker traffic and revenue is much more dramatic. The assignments for LNG tankers are less than half of the previous year, and revenues are just 40% of the first quarter of 2011.

Traffic in St. John's has been lower than anticipated as masters on regular callers in the port have acquired pilotage certificates allowing them to pilot their own vessels.

FINANCIAL AND STATISTICAL REVIEW

COMPARATIVE REVIEW FINANCIAL AND STATISTICAL DATA		
For the quarter ended March 31, 2012		
	2012	**2011**
FINANCIAL (000'S)		
Total Revenue	$ 4,464	$ 5,137
Operating Expenses		
Salaries, Fees and Benefits	2,917	2,940
Pilot Boats	1,252	1,283
Other	549	477
Total Operating Expenses	4,718	4,700
(Loss) Profit	$ (254)	$ 437
STATISTICAL		
Pilotage Assignments	1,685	1,977
Shipping Incidents	0	0
% of incident free assignments	100.00%	100.00%
Customer Complaints Filed	8	11
% of complaint free assignments	99.53%	99.44%

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 quarter 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 have also decreased as some pilot boat contractors are paid on a variable "per trip" basis, and declining traffic in those ports will result in a decreased payment to the contractor. Finally, the Authority has incurred higher legal and consultation fees as it proposed several regulation changes in the first quarter and is in negotiations to renew three separate collective agreements.

The tanker traffic lost in Canso and the container traffic in Halifax is not expected to return in the short or medium term. The Authority is expecting activity in St. John's to rebound later in the year with additional business and expects Saint John to remain steady after a slow start. Placentia Bay traffic will slow in the second and third quarter as repairs are done to offshore equipment. It is still early in 2012, but even with this disappointing quarter, the Authority is currently projecting to break-even or earn a small profit for the year. 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 8 complaints out of a total of 1.685 assignments during the first quarter 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 11 complaints received out of 1,977 assignments, with the remaining 99.4% 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 first quarter of 2012 the Authority has had no shipping incidents. There were no 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 significant declines in Halifax and Canso. The cost structures in these ports are not easily adjusted. Due to the specialized nature and training required to be a marine pilot, reducing the work force in a port is not done 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 also made a significant investment in new vessels that will be launched in the second and third 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 the establishment of a fuel charge in 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.

First 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
May 31, 2012

ATLANTIC PILOTAGE AUTHORITY

Statement of Financial Position

Unaudited

(in thousands of Canadian dollars)	March 31, 2012	December 31, 2011
Assets		
Current		
Cash	$ 3,180	$ 3,356
Trade receivables	2,272	3,008
Prepaid expenses	52	60
	5,504	6,424
Non-current		
Intangible assets	205	216
Property, pilot boats and equipment	8,767	8,447
	8,972	8,663
	$ 14,476	$ 15,087
Liabilities		
Current		
Trade and other payables	$ 1,908	$ 1,995
Bank loans	255	251
Employee severance benefits	62	297
	2,225	2,543
Non-current		
Bank loans	3,273	3,338
Employee severance benefits	1,371	1,345
	4,644	4,683
	6,869	7,226
Equity		
Retained earnings	7,607	7,861
	7,607	7,861
	$ 14,476	$ 15,087

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

ATLANTIC PILOTAGE AUTHORITY
Statement of Comprehensive Income

Unaudited

	Three Months Ended March 31	
(in thousands of Canadian dollars)	**2012**	**2011**
Revenues		
Pilotage charges	**$ 4,451**	$ 5,124
Other income	**13**	12
	4,464	5,136
Expenses		
Pilots' fees, salaries and benefits	**2,225**	2,264
Pilot boats, operating costs	**1,047**	1,044
Staff salaries and benefits	**349**	356
Pilot boat crews' salaries and benefits	**343**	315
Amortization and depreciation	**195**	219
Transportation and travel	**142**	141
Professional and special services	**165**	114
Utilities, materials and supplies	**71**	89
Rentals	**75**	68
Finance costs	**45**	48
Communications	**30**	30
Training	**31**	4
	4,718	4,692
(Loss) profit for the period	**(254)**	444
Other comprehensive loss	**-**	-
Actuarial loss on employee severance benefits		
Other comprehensive loss	**-**	-
Comprehensive (loss) income	**$ (254)**	$ 444

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

ATLANTIC PILOTAGE AUTHORITY
Statement of Changes in Equity

Unaudited

	Three Months Ended March 31	
(in thousands of Canadian dollars)	**2012**	**2011**
Retained earnings, beginning of the period	**$ 7,861**	$ 6,353
(Loss) profit for the period	**(254)**	444
Other comprehensive loss	**-**	-
Total comprehensive (loss) income	**(254)**	444
Retained earnings, end of period	**$ 7,607**	$ 6,797

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

ATLANTIC PILOTAGE AUTHORITY
Statement of Cash Flows

Unaudited

	Three months ended Marh 31	
	2012	2011
Operating Activities		
Receipts from customers	**$ 5,188**	$ 4,912
Payments to and on behalf of employees	**(3,303)**	(3,094)
Payments to suppliers	**(1,508)**	(879)
Other income received	**13**	12
Net cash provided by operating activities	**390**	951
Investing Activities		
Purchases of intangible assets	**(1)**	-
Purchases of property, pilot boats and equipment	**(503)**	(570)
Net cash used in investing activities	**(504)**	(570)
Financing Activities		
Repayment of bank loan	**(62)**	(58)
Net cash used in financing activities	**(62)**	(58)
(Decrease) increase in cash	**(176)**	323
Cash, beginning of the period	**3,356**	3,678
Cash, end of the period	**$ 3,180**	$ 4,001
Supplementary Disclosure		
Finance costs paid	**$ 45**	$ 48

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

1. GENERAL INFORMATION AND BASIS OF PRESENTATION

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 3 (b) and 3 (c) for the estimated maximum useful lives of property, pilot boats and equipment and intangible assets.