Atlantic Pilotage Authority

Administration de Pilotage de l'Atlantique

Atlantic Pilotage Authority

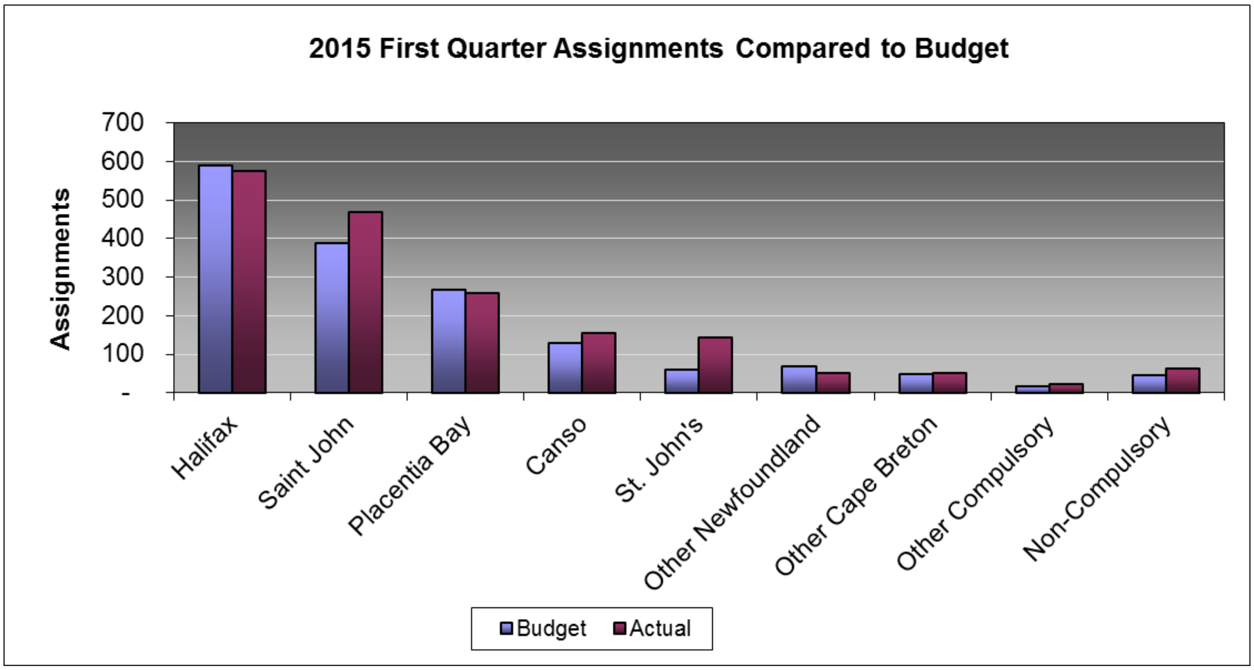
First Quarter 2015

Management's Discussion and Analysis

May 30, 2015

TRAFFIC REVIEW

Pilotage Area	Actual Traffic through 1st Qtr 2014	Budget Traffic through 1st Qtr 2015	Actual Traffic through 1st Qtr 2015	Variance from 2014	Percentage Variance from 2014	Variance from Budget 2015	Percentage Variance from Budget 2015
Halifax	585	591	576	-9	-2%	-15	-3%
Saint John	390	388	470	80	21%	82	21%
Placentia Bay	267	267	259	-8	-3%	-8	-3%
Canso	130	129	154	24	18%	25	19%
St. John's	82	61	143	61	74%	82	134%
Other Newfoundland	67	68	53	-14	-21%	-15	-22%
Other Cape Breton	49	49	52	3	6%	3	6%
Other Compulsory	20	17	22	2	10%	5	29%
Non-Compulsory	52	46	62	10	19%	16	35%
Total	1,642	1,616	1,791	149	9%	175	11%



The following discussion regarding the amount of activity in individual ports is referring to pilotage assignments only, and not the level of cargo or vessel traffic experienced by a port. There are several factors that may result in a difference between the activity reported by the Authority and that reported by another body such as a port authority. These factors include ships not subject to compulsory pilotage, ships utilizing mariners who have pilotage certificates, and the amount of cargo carried on a ship. The Authority reports on pilotage assignments performed by its pilots, but does not track the amount of cargo being carried on a vessel.

Overall, pilotage assignments traffic levels for the Authority are well above the first quarter of 2014 and the budget for 2015. The Authority has four major compulsory ports (Halifax, NS; Strait of Canso, NS; Placentia Bay, NL; and Saint John, NB) that contribute approximately 75% of its pilotage assignments each year. Of the four major ports, Halifax and Placentia Bay have had fewer assignments than in 2014. This reduction has left both areas below budget through the first quarter. Saint John and Strait of Canso have had activity well above 2014 activity levels and above budget. Overall, the Authority is 11% over budget in activity and 4% over budget for revenues through the first quarter. The reason for the discrepancy between assignments and revenue is a result of ships being smaller, with lower revenue on average, than the budgeted traffic in several ports.

The decline in traffic in Halifax, NS is largely due to a 7% (or 17 assignment) reduction in container ship assignments from the previous year. Thus far in 2015 general cargo traffic has increased 11% (or 22 assignments). Tanker traffic is similar to 2014 levels. Total activity in the port is 3% under budget with revenues under budget by 5% through March 2015.

The traffic in Placentia Bay, NL is generated primarily from two major oil industry customers. There is the Come-by-Chance Oil Refinery and the transshipment terminal at Whiffen Head. There have been more vessels at the Oil Refinery, but they have been smaller than in previous years. Activity at Whiffen Head has declined from 2014 and has also been served by smaller vessels. This combination has resulted in assignments being 3% below 2014 levels and the 2015 budget while revenues are down 6% from 2014 and are 11% below the 2015 budget.

In Saint John, NB, the Authority has had 21% more pilotage assignments in the first quarter of 2015 compared to 2014. Pilotage assignments on tankers have increased by 25% and have increased by 27% on smaller vessels, like tug and barge traffic. Revenues in the port are 15% over budget with the increased activity.

In Canso, NS, first quarter tanker traffic has increased 92% from 2014 levels due primarily to an increase in smaller tankers, including a small bunker tanker travelling between Canso to Halifax. Dry cargo traffic has declined in the area by 14% from 2014. This has left the area 19% over budget in activity, but only 2% over budget on revenues through March 2015.

FINANCIAL AND STATISTICAL REVIEW

COMPARATIVE REVIEW		
FINANCIAL AND STATISTICAL DATA		
As at March 31		
	2015	**2014**
FINANCIAL (000'S)		
Total Revenue	$ 5,091	$ 4,699
Operating Expenses		
Salaries, Fees and Benefits	3,528	3,216
Pilot Boats	1,442	1,483
Other	585	686
Total Operating Expenses	5,555	5,385
Loss/Gain	$ (464)	$ (686)
STATISTICAL		
Pilotage Assignments	1,791	1,642
Shipping Incidents	0	3
% of incident free assignments	100.00%	99.82%
Customer Complaints Filed	6	26
% of complaint free assignments	99.66%	98.42%

The revenue for the Authority has increased as a tariff increase came into effect late in February. Overall, traffic has increased by 9% from 2014 levels through March 2015, with revenues increasing 8%.

Salaries, fees, and benefits for the first quarter of 2015 have increased from the same period of 2014 as the Authority has added 8 pilots in the last 12 months to address service concerns and prepare for pending retirements. Pilot boat costs have decreased due to savings on fuel with lower prices on diesel. The decrease in other expenses is largely related to lower training costs ($92 thousand less than 2014). The Authority must schedule space in the courses required without affecting operations. The timing of the training varies from year to year. In 2014, a large portion of the training was scheduled in the first quarter of the year. The training levels for 2015 will be similar to 2014, but will be more heavily weighted to later in the year. The Authority strives to have training scheduled prior to, or soon after, the busiest part of the cruise ship season.

While the Authority has been building up its workforce, the revenue base has been negatively impacted by a move to smaller vessels in several ports. Placentia Bay is a large revenue generator for the Authority and an area where significant investment has been made in pilot boats and in increasing the number of pilots. Maintenance shutdowns of the offshore facilities and dry docking of shuttle tankers will have a negative effect on revenues generated from Whiffen Head in 2015. The tanker traffic levels in Canso have increased, but it is due to an increase in smaller, lower revenue vessels. The Authority also had a large increase in traffic in St. John’s, NL, but these vessels are much smaller than the average vessel in other areas. The traffic in St. John’s will decrease substantially for the remainder of 2015 as a number of the supply ship masters have gained the required experience, passed certificate examinations, and have received pilotage certificates allowing them to pilot their own vessels..

The Authority had a loss in the first quarter of $464 thousand. A loss of $586 thousand was budgeted for the quarter as additional investments in pilots, pilot boat costs and pilot training were expected. The delay in having tariffs implemented resulted in a loss of revenue of $108 thousand. It is still early in 2015, but the projection is that a small accounting profit will be achieved for the year with cash flows remaining stable.

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 is 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 6 complaints out of a total of 1,791 assignments during the first quarter of 2015. The remaining 99.66% of assignments were performed without receiving a complaint from the customer. For the same period of 2014, there were 26 complaints received out of 1,642 assignments, with the remaining 98.42% 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 2015 the Authority had no shipping incidents. There were three minor incidents reported at this point in 2014.

RISK ANALYSIS

The major financial risk faced by the Authority is the variability of traffic in major ports. The Authority has no control over the activity in each port or the type of the traffic visiting. Variations in the activity or the ship size from what was expected can result in a small budgeted profit becoming a significant actual loss. In 2014, the average ship size in the port of Saint John, NB was 12% less than budgeted. Even though traffic increased, this decline in ship size contributed to a normally profitable area having a significant loss. Thus far in 2015 the ship size in the area has rebounded somewhat from 2014, but remains well below the size of prior years.

Maintenance at facilities related to offshore oil extraction or oil refining also have a significant effect on the Authority. The Whiffen Head facility in Placentia Bay, NL is not expected to have as strong a year as budgeted due to maintenance offshore and the dry docking of its tanker fleet. The full financial effect of this is not known at this point. As noted earlier, several masters in the port of St. John’s, NL have received pilotage certificates. This will reduce revenues and related expenses in the area for the foreseeable future.

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 feasible to address short term declines in activity. A reduction in the number of pilots can have significant consequences on the shipping industry with the potential for delays during peak periods, or if the port experiences an unexpected surge in activity. The Authority has also made a significant investment in new vessels that have to be supported through tariff revenue in the ports of Placentia Bay, Halifax, and Saint John.

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 a fuel recovery charge applied to assignments in Halifax, Saint John, Placentia Bay and Canso.

The Authority had a significant loss in 2014 due primarily to costs incurred to expand its pilot numbers in an attempt to improve service levels and prepare for retirements. The Authority has now added 10 new pilots in the previous 18 months. The costs during their 2 - 3 year training period includes their salaries, courses, and transportation. This is a large investment by the Authority and will deflate the financial expectations of the entity over this period.

First Quarter 2015

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 30, 2015

ATLANTIC PILOTAGE AUTHORITY

Statement of Financial Position

Unaudited

(in thousands of Canadian dollars)		March 31, 2015	December 31, 2014
Assets			
Current			
	Cash	**$ 1,771**	$ 1,149
	Trade receivables	**3,447**	3,280
	Prepaid expenses	**102**	132
		5,320	4,561
Non-current			
	Intangible assets	**234**	248
	Pilot boats and equipment	**10,334**	10,394
		10,568	10,642
		$ 15,888	$ 15,203
Liabilities			
Current			
	Trade and other payables	**$ 3,109**	$ 1,889
	Bank loans	**425**	422
	Employee severance benefits	**272**	112
		3,806	2,423
Non-current			
	Bank loans	**4,104**	4,212
	Employee severance benefits	**1,300**	1,426
		5,404	5,638
		9,210	8,061
Equity			
Retained earnings		**6,678**	7,142
		6,678	7,142
		$ 15,888	$ 15,203

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)	**2015**	2014
Revenues		
Pilotage charges	**$ 5,081**	$ 4,688
Other income	**10**	11
	5,091	4,699
Expenses		
Pilots' fees, salaries and benefits	**2,666**	2,370
Pilot boats, operating costs	**1,096**	1,159
Pilot boat crews' salaries and benefits	**447**	442
Staff salaries and benefits	**415**	404
Amortization and depreciation	**352**	328
Transportation and travel	**200**	181
Professional and special services	**119**	150
Utilities, materials and supplies	**105**	111
Training	**14**	106
Rentals	**71**	68
Finance costs	**35**	34
Communications	**35**	32
	5,555	5,385
Loss for the period	**(464)**	(686)
Other comprehensive loss	**-**	-
Amounts not to be reclassified subsequently to net income:		
Actuarial loss on employee severance benefits		
Other comprehensive loss	**-**	-
Comprehensive loss	**$ (464)**	$ (686)

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 March 31 2015	2014
Retained earnings, beginning of the period	**$ 7,142**	$ 7,848
Loss for the period	**(464)**	(686)
Other comprehensive loss	**-**	-
Total comprehensive loss	**(464)**	(686)
Retained earnings, end of the period	**$ 6,678**	$ 7,162

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

ATLANTIC PILOTAGE AUTHORITY

Statement of Cash Flows

Unaudited

	Three months ended March 31	
	2015	2014
Operating Activities		
Receipts from customers	**$ 4,914**	$ 4,749
Payments to and on behalf of employees	**(3,398)**	(3,117)
Payments to suppliers	**(667)**	(2,283)
Finance costs paid	**(35)**	(34)
Other income received	**10**	10
Net cash provided (used in) by operating activities	**824**	(675)
Investing Activities		
Purchases of intangible assets	**(1)**	(16)
Purchases of pilot boats and equipment	**(96)**	(102)
Net cash used in investing activities	**(97)**	(118)
Financing Activities		
Repayment of bank loan	**(105)**	(92)
Net cash used in financing activities	**(105)**	(92)
Increase (Decrease) in cash	**622**	(885)
Cash, beginning of the period	**1,149**	1,884
Cash, end of the period	**$ 1,771**	$ 999

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, 2014. 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 and other receivables and trade and other payables, classified as other financial liabilities, are measured at cost. Due to their short-term nature, the 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 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 recoverable amount.

(c) Pilot boats and equipment

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 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	10 to 25 years
Pilot boat equipment	10 years
Pilot boat generators	5 years
Pilot boat engines	5 to 10 years
Pilot boat inspections	4 to 5 years
Furniture and equipment	2 to 10 years
Leasehold improvements	10 years

Assets are tested for impairment annually. Any impairment is measured as the amount by which the carrying amount exceeds its recoverable amount and is recognized as a loss for the year. Gains or losses arising on the disposal of pilot boats and equipment are determined as the difference between the disposal proceeds and the carrying amount of the assets and are recognized in profit or loss. Gains are recognized within other income, while losses are recognized as a loss for the year in pilot boats, operating costs, or utilities, materials and supplies depending on the assets that were disposed.

(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 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.

(g) Accounting standards issued but not yet effective

Accounting standards issued but not yet effective which are expected to be relevant to the Authority include:

IFRS 9, "Financial instruments" (new) issued in November 2009, reissued in October 2010, and then amended in November 2013. IFRS 9 will eventually form a complete replacement for IAS 39 Financial Instruments: Recognition and Measurement. The mandatory effective date of IFRS 9 is January 1, 2018. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets.

IFRS 15, "Revenue from Contracts with Customers" (new) issued in May 2014. IFRS 15 will replace IAS 18 Revenue, IAS 11 Construction Contracts and other revenue related standards. The mandatory effective date of IFRS 15 is January 1, 2017.

The Authority has not early adopted either of these new or amended standards and is currently assessing the impact that these standards will have on the financial statements.

3. CHANGE IN ACCOUNTING POLICY

IFRIC 21, "Accounting for Levies Imposed by Government" effective for annual periods beginning on or after January 1, 2014. The IASB issued an interpretation to clarify that the obligating event giving rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy. This interpretation did not have a material impact on the financial statements.

IAS 36, "Impairment of assets" (revised) effective for annual periods beginning on or after January 1, 2014. The narrow-scope amendments clarify that the disclosures about the recoverable amount of impaired assets are only required where the recoverable amount of impaired assets is based on fair value less costs of disposal. This amendment did not have a material effect on the financial statements.

4. <u>USE OF ESTIMATES AND JUDGMENTS</u>

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.

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 an external 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 useful lives of pilot boats and equipment and intangible assets.