Atlantic Pilotage Authority

Administration de Pilotage de l'Atlantique

Atlantic Pilotage Authority

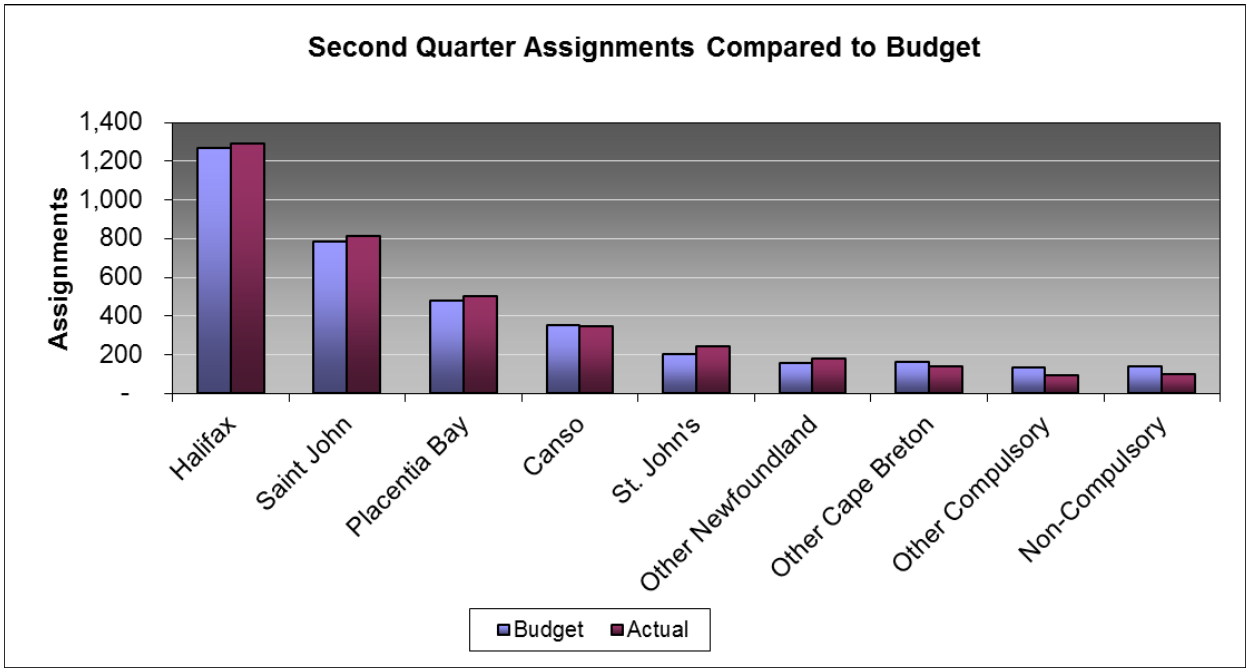
Second Quarter 2014

Management's Discussion and Analysis

August 30, 2014

TRAFFIC REVIEW

Pilotage Area	Actual Traffic through 2nd Qtr 2013	Budget Traffic through 2nd Qtr 2014	Actual Traffic through 2nd Qtr 2014	Variance from 2013	Percentage Variance from 2013	Variance from Budget 2014	Percentage Variance from Budget 2014
Halifax	1,309	1,265	1,291	-18	-1%	26	2%
Saint John	793	783	810	17	2%	27	3%
Placentia Bay	467	479	501	34	7%	22	5%
Canso	385	352	344	-41	-11%	-8	-2%
St. John's	211	203	241	30	14%	38	19%
Other Newfoundland	162	158	181	19	12%	23	15%
Other Cape Breton	162	161	139	-23	-14%	-22	-14%
Other Compulsory	132	135	93	-39	-30%	-42	-31%
Non-Compulsory	152	138	99	-53	-35%	-39	-28%
Total	3,773	3,674	3,699	-74	-2%	25	1%



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 down 2% from the first half of 2013 and are slightly above budget. 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 Canso have had fewer assignments than in 2013. However, this reduction was anticipated, and both ports are very close to the budgeted traffic activity with Halifax 2% over budget and Canso 2% under budget. The other two major ports are above 2013 activity levels and above budget. Overall, the Authority is 1% over budget in activity and 2% in revenues through the second quarter.

The decline in traffic in Halifax is largely due to an 8% (or 43 assignment) reduction in container ship assignments from the previous year. Thus far in 2014 tanker traffic has declined 6% (or 16 assignments) from 2013 levels with the transition of the Dartmouth Refinery to a terminal. Total revenues in the port are within 1% of the budget through June 2014.

In Saint John, NB, the Authority has had 2% more pilotage assignments in the first half of 2014 compared to 2013. The largest increase in assignments has been in general cargo vessels with 23 more assignments than this time last year. Revenues in the port are below budget as the size of the average vessel in the port has been smaller than expected.

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. Traffic and revenues from Come-by-Chance are similar to 2013 and budgeted levels. Assignments and the corresponding revenues from Whiffen Head have increased from 2013 and are over budget through June 2014.

In Canso, NS, tanker traffic has declined from 2013 levels, but has been offset by an increase in dry cargo traffic for the same period. This has left the area 2% under budget in activity and within 1% of revenues through June 2014.

FINANCIAL AND STATISTICAL REVIEW

COMPARATIVE REVIEW		
FINANCIAL AND STATISTICAL DATA		
For the quarter ended June 30, 2014		
	2014	**2013**
FINANCIAL (000'S)		
Total Revenue	$ 10,442	$ 9,990
Operating Expenses		
Salaries, Fees and Benefits	6,521	6,160
Pilot Boats	3,091	2,960
Other	1,370	1,086
Total Operating Expenses	10,982	10,206
Loss	$ (540)	$ (216)
STATISTICAL		
Pilotage Assignments	3,699	3,773
Shipping Incidents	4	3
% of incident free assignments	99.89%	99.92%
Customer Complaints Filed	43	22
% of complaint free assignments	98.84%	99.42%

The revenue for the Authority has increased as a tariff increase came into effect early in February. Overall, traffic has been down 2% from 2013 levels through June 2014.

Salaries, fees, and benefits for the first half of 2014 have increased from the same period of 2013 due primarily to overtime and short-term coverage of employees lost to illness or injury. Pilot numbers are being increased in several areas to address service issues and pending retirements. Staff numbers have increased with the addition of a Chief Operating Officer. This position, formerly Director of Operations, had remained unfilled since late 2011. Pilot boat costs have also increased as the Captain A. G. Soppitt, a new pilot boat, was launched at the beginning of the second quarter of 2013. The first half of 2014 includes depreciation and carrying costs of this new vessel. With increased operation of the newer vessels in Halifax, Saint John, and Placentia Bay, fuel costs for the Authority have also increased thus far in 2014. The increase in other expenses is largely related to increased training costs ($158 thousand more than 2013). The Authority had withheld non-essential pilot training in 2013 and scheduled it for 2014. A large portion of that training is scheduled in the first two quarters of the year to have it completed prior to the busiest part of the cruise ship season.

The tanker traffic levels in Canso have been volatile with activity based on world oil price fluctuations. It was higher than anticipated in 2013, but budgeted for a decline in 2014. The Authority is expecting activity in Halifax and Saint John to remain strong. Placentia Bay traffic has been above expectations thus far in 2014.

The Authority finished the second quarter with a significant loss year-to-date of $540 thousand. A loss of $522 thousand was budgeted for the first half as the additional investments in pilot boat costs and training were expected. The delay in having tariffs implemented resulted in a loss of revenue of $89 thousand. At the midpoint of 2014, the Authority is projecting a break-even position for the year. Cash flows are expected to remain 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 43 complaints out of a total of 3,699 assignments during the first half of 2014. The remaining 98.84% of assignments were performed without receiving a complaint from the customer. For the same period of 2013, there were 22 complaints received out of 3,773 assignments, with the remaining 99.42% 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 June 2014, the Authority had four minor shipping incidents. There were three incidents at this point in 2013.

RISK ANALYSIS

The major financial risk faced by the Authority is the variability of traffic in major ports. The activity in Canso had a short term increase in 2013 through the second and third quarters due to changes in world oil prices. This activity has not continued in 2014 and is difficult to predict. The Come-by-Chance Oil Refinery in Placentia Bay is a very large customer for the Authority and is currently for sale. Much like Halifax in 2013, the eventual sale and future use of this facility may cause a significant variation in traffic for Placentia Bay. 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 has been close to an accounting break-even position each of the last two years with a small accounting loss in 2012 and a small accounting profit for 2013. During this period, the Authority was able to maintain a strong cash flow while building two new pilot boats. The Authority will be able to absorb a weaker than anticipated 2014 due to its financial health, but will continue to take steps to return to a stronger financial position while investing to improve customer service.

Second Quarter 2014

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, 2014

ATLANTIC PILOTAGE AUTHORITY

Statement of Financial Position

Unaudited

(in thousands of Canadian dollars)		June 30, 2014	December 31, 2013
Assets			
Current			
	Cash	$ 774	$ 1,884
	Trade receivables	3,252	2,977
	Prepaid expenses	262	153
		4,288	5,014
Non-current			
	Intangible assets	268	265
	Pilot boats and equipment	10,949	11,210
		11,217	11,475
		$ 15,505	$ 16,489
Liabilities			
Current			
	Trade and other payables	$ 1,953	$ 2,237
	Bank loans	415	400
	Employee severance benefits	66	62
		2,434	2,699
Non-current			
	Bank loans	4,424	4,633
	Employee severance benefits	1,339	1,309
		5,763	5,942
		8,197	8,641
Equity			
Retained earnings		7,308	7,848
		7,308	7,848
		$ 15,505	$ 16,489

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

ATLANTIC PILOTAGE AUTHORITY

Statement of Comprehensive Income

Unaudited

		Three Months Ended June 30		Six Months Ended June 30	
(in thousands of Canadian dollars)		**2014**	2013	**2014**	2013
Revenues					
	Pilotage charges	**$ 5,702**	$ 5,486	**$ 10,390**	$ 9,944
	Other income	**41**	25	**52**	46
		5,743	5,511	**10,442**	9,990
Expenses					
	Pilots' fees, salaries and benefits	**2,506**	2,430	**4,876**	4,684
	Pilot boats, operating costs	**1,281**	1,369	**2,440**	2,391
	Pilot boat crews' salaries and benefits	**425**	381	**867**	756
	Staff salaries and benefits	**374**	344	**778**	720
	Amortization and depreciation	**330**	321	**658**	575
	Transportation and travel	**209**	182	**390**	327
	Professional and special services	**154**	142	**304**	319
	Utilities, materials and supplies	**105**	84	**216**	178
	Rentals	**78**	66	**146**	133
	Training	**58**	1	**164**	6
	Communications	**40**	26	**72**	53
	Finance costs	**37**	29	**71**	64
		5,597	5,375	**10,982**	10,206
Profit (loss) for the period		**146**	136	**(540)**	(216)
Other comprehensive loss		-	-	-	-
	Actuarial loss on employee severance benefits				
Other comprehensive loss		-	-	-	-
Comprehensive income (loss)		**$ 146**	$ 136	**$ (540)**	$ (216)

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 2014	Three Months Ended June 30 2013	Six Months Ended June 30 2014	Six Months Ended June 30 2013
Retained earnings, beginning of the period	**$ 7,162**	$ 7,304	**$ 7,848**	$ 7,656
Profit (loss) for the period	**146**	136	**(540)**	(216)
Other comprehensive loss	**-**	-	**-**	-
Total comprehensive income (loss)	**146**	136	**(540)**	(216)
Retained earnings, end of period	**$ 7,308**	$ 7,440	**$ 7,308**	$ 7,440

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	
	2014	2013	**2014**	2013
Operating Activities				
Receipts from customers	**$ 5,053**	$ 4,951	**$ 9,802**	$ 9,837
Payments to and on behalf of employees	**(2,990)**	(2,678)	**(6,107)**	(5,845)
Payments to suppliers	**(2,220)**	(2,186)	**(4,503)**	(3,695)
Finance costs paid	**(37)**	(29)	**(71)**	(64)
Other income received	**355**	25	**365**	46
Net cash provided by (used in) operating activities	**161**	83	**(514)**	279
Investing Activities				
Purchases of intangible assets	**(20)**	(27)	**(36)**	(50)
Purchases of pilot boats and equipment	**(264)**	(395)	**(366)**	(1,390)
Net cash used in investing activities	**(284)**	(422)	**(402)**	(1,440)
Financing Activities				
Proceeds from bank loan	**-**	-	**-**	1,000
Repayment of bank loan	**(102)**	(73)	**(194)**	(151)
Net cash (used in) privided by financing activities	**(102)**	(73)	**(194)**	849
Decrease in cash	**(225)**	(412)	**(1,110)**	(312)
Cash, beginning of the period	**999**	566	**1,884**	466
Cash, end of the period	**$ 774**	$ 154	**$ 774**	$ 154

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, 2013. 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 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) 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	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. 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 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 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.

(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:

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.

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 IASB has deferred the mandatory effective date and will decide upon a new date closer to the completion of the entire IFRS 9 project however early adoption is permitted. 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.

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. USE OF 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 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.