Atlantic Pilotage Authority

Administration de Pilotage de l'Atlantique

Atlantic Pilotage Authority

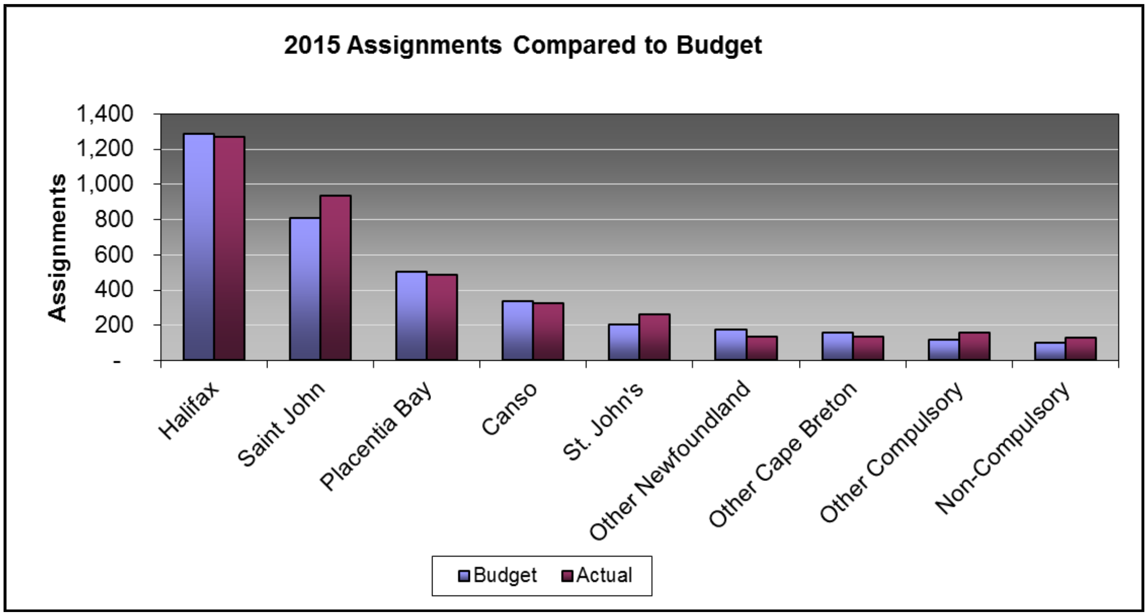
Second Quarter 2015

Management's Discussion and Analysis

August 30, 2015

TRAFFIC REVIEW

Pilotage Area	Actual Traffic through 2nd Qtr 2014	Budget Traffic through 2nd Qtr 2015	Actual Traffic through 2nd Qtr 2015	Variance from 2014	Percentage Variance from 2014	Variance from Budget 2015	Percentage Variance from Budget 2015
Halifax	1,291	1,287	1,272	-19	-1%	-15	-1%
Saint John	810	808	938	128	16%	130	16%
Placentia Bay	501	501	484	-17	-3%	-17	-3%
Canso	344	335	324	-20	-6%	-11	-3%
St. John's	241	204	262	21	9%	58	28%
Other Newfoundland	181	174	136	-45	-25%	-38	-22%
Other Cape Breton	139	157	137	-2	-1%	-20	-13%
Other Compulsory	93	120	160	67	72%	40	33%
Non-Compulsory	99	100	132	33	33%	32	32%
Total	3,699	3,686	3,845	146	4%	159	4%



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 above this point in 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, Placentia Bay and Canso have had fewer assignments than in 2014. This reduction has left each area below budget through June. Saint John has had activity well above 2014 activity levels and above budget. Overall, the Authority is 4% over budget in activity but is 2% under budget for revenues through the second 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 5% (or 21 assignment) reduction in container ship assignments from the previous year. Thus far in 2015 general cargo traffic has increased 9% (or 39 assignments). Tanker trips are similar to 2014 levels, but there have been fewer moves within the port by this class of vessel. Total activity in the port is 1% under budget with revenues under budget by 3% through June 2015.

In Saint John, NB, the Authority has had 16% more pilotage assignments through the second quarter of 2015 compared to 2014. Pilotage assignments on tankers have increased by 19% and have increased by 25% on smaller vessels, like tug and barge traffic. Revenues in the port are 11% over budget with the increased activity.

The traffic in Placentia Bay, NL is generated primarily from two major oil industry customers. There is the North Atlantic oil refinery at Come-by-Chance, and the Newfoundland Transshipment terminal at Whiffen Head. There have been more vessels at the Oil Refinery than in 2014, 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. Maintenance shutdowns offshore have decreased second quarter activity at Whiffen Head dramatically and has led to a significant financial shortfall in the area for the Authority. This maintenance is expected to continue into the 4th quarter. This combination of factors has resulted in assignments being 3% below 2014 levels and the 2015 budget while revenues are down 10% from 2014 and are 13% below the 2015 budget.

In the Strait of Canso, NS, tanker traffic has increased 18% from 2014 levels due primarily to an increase in smaller tankers, including a small bunker tanker travelling between Halifax and Canso to provide bunker fuel to ships. Dry cargo traffic has declined in the area by 22% from 2014. This has left the area 3% under budget in activity, but 12% under budget on revenues through March 2015.

FINANCIAL AND STATISTICAL REVIEW

COMPARATIVE REVIEW FINANCIAL AND STATISTICAL DATA		
As at June 30		
	2015	**2014**
FINANCIAL (000'S)		
Total Revenue	$ 10,670	$ 10,442
Operating Expenses		
Salaries, Fees and Benefits	7,052	6,521
Pilot Boats	2,964	3,089
Other	1,298	1,372
Total Operating Expenses	11,314	10,982
Loss/Gain	$ (644)	$ (540)
STATISTICAL		
Pilotage Assignments	3,845	3,699
Shipping Incidents	0	3
% of incident free assignments	100.00%	99.92%
Customer Complaints Filed	12	26
% of complaint free assignments	99.69%	99.30%

The revenue for the Authority has increased as a tariff increase came into effect late in February. Overall, traffic has increased by 4% from 2014 levels through June 2015, with revenues increasing 2%.

Salaries, fees, and benefits through the second quarter of 2015 have increased from the same period of 2014. The Authority has added 11 trainee pilots within the last two years, while having 4 pilots leave over the same period. The hiring has been done to address service concerns in some areas, and to replace pilots who are retiring. 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 ($66 thousand less than 2014). The Authority schedules space in the required courses during times that will have minimal effect on 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 slowdowns at the offshore facilities have had a negative effect on revenues generated from Whiffen Head in 2015. The tanker traffic levels in Canso have increased, but the increase is in smaller, lower revenue vessels. The Authority also had a large increase in traffic in St. John's, NL, but vessels in that port are smaller, on average, than 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 though the first half of 2015 of $644 thousand. A loss of $567 thousand was budgeted for the midpoint of the year 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. Due primarily to the decline in Placentia Bay, the Authority is anticipating finishing 2015 in a loss position.

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 12 complaints out of a total of 3,845 assignments during the first half of 2015. The remaining 99.69% of assignments were performed without receiving a complaint from the customer. For the same period of 2014, there were 43 complaints received out of 3,699 assignments, with the remaining 98.84% 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 half of 2015 the Authority had no shipping incidents. There were four 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 does not control or influence the activity in each port. Variations in the ship size from the budget may result in a significant positive or negative result. 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 slightly 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 expected to be weak as compared to budget due to maintenance offshore. 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 cost of fuel, which has a significant 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 11 new pilots in the previous 24 months. The costs during their 2 - 3 year training period includes salaries, training courses, and transportation. This is a large investment by the Authority and will deflate the financial expectations of the entity over this period.

Second 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.

Sean Griffiths
Chief Executive Officer

P. MacArthur, CPA, CMA
Chief Financial Officer

Halifax, Canada
August 30, 2015

ATLANTIC PILOTAGE AUTHORITY

Statement of Financial Position

Unaudited

(in thousands of Canadian dollars)		June 30, 2015	December 31, 2014
Assets			
Current			
	Cash	$ -	$ 1,149
	Trade receivables	**3,163**	3,280
	Prepaid expenses	**189**	132
		3,352	4,561
Non-current			
	Intangible assets	**224**	248
	Pilot boats and equipment	**10,199**	10,394
		10,423	10,642
		$ 13,775	$ 15,203
Liabilities			
Current			
	Trade and other payables	**$ 1,338**	$ 1,889
	Bank loans	**428**	422
	Employee severance benefits	**178**	112
		1,944	2,423
Non-current			
	Bank loans	**3,996**	4,212
	Employee severance benefits	**1,337**	1,426
		5,333	5,638
		7,277	8,061
Equity			
Retained earnings		**6,498**	7,142
		6,498	7,142
		$ 13,775	$ 15,203

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)		**2015**	2014	**2015**	2014
Revenues					
	Pilotage charges	**$ 5,562**	$ 5,702	**$ 10,643**	$ 10,390
	Other income	**17**	41	**27**	52
		5,579	5,743	**10,670**	10,442
Expenses					
	Pilots' fees, salaries and benefits	**2,685**	2,506	**5,351**	4,876
	Pilot boats, operating costs	**1,227**	1,281	**2,323**	2,440
	Pilot boat crews' salaries and benefits	**436**	425	**883**	867
	Staff salaries and benefits	**403**	374	**818**	778
	Amortization and depreciation	**299**	330	**651**	658
	Transportation and travel	**214**	209	**414**	390
	Professional and special services	**141**	154	**260**	304
	Utilities, materials and supplies	**127**	105	**232**	216
	Rentals	**131**	78	**145**	146
	Training	**27**	58	**98**	164
	Communications	**34**	40	**69**	72
	Finance costs	**35**	37	**70**	71
		5,759	5,597	**11,314**	10,982
Profit (loss) for the period		**(180)**	146	**(644)**	(540)
Other comprehensive loss		-	-	-	-
	Actuarial loss on employee severance benefits				
Other comprehensive loss		-	-	-	-
Comprehensive income (loss)		**$ (180)**	$ 146	**$ (644)**	$ (540)

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 2015	Three Months Ended June 30 2014	Six Months Ended June 30 2015	Six Months Ended June 30 2014
Retained earnings, beginning of the period	**$ 6,678**	$ 7,162	**$ 7,142**	$ 7,848
Profit (loss) for the period	**(180)**	146	**(644)**	(540)
Other comprehensive loss	-	-	-	-
Total comprehensive income (loss)	**(180)**	146	**(644)**	(540)
Retained earnings, end of period	**$ 6,498**	$ 7,308	**$ 6,498**	$ 7,308

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	
	2015	2014	**2015**	2014
Operating Activities				
Receipts from customers	**$ 5,500**	$ 5,053	**$ 10,414**	$ 9,802
Payments to and on behalf of employees	**(4,047)**	(2,990)	**(7,446)**	(6,107)
Payments to suppliers	**(2,785)**	(2,220)	**(3,451)**	(4,503)
Finance costs paid	**(35)**	(37)	**(70)**	(71)
Other income received	**17**	355	**27**	365
Net cash (used in) provided by operating activities	**(1,350)**	161	**(526)**	(514)
Investing Activities				
Purchases of intangible assets	**(5)**	(20)	**(6)**	(36)
Purchases of pilot boats and equipment	**(403)**	(264)	**(499)**	(366)
Net cash used in investing activities	**(408)**	(284)	**(505)**	(402)
Financing Activities				
Repayment of bank loan	**(105)**	(102)	**(210)**	(194)
Net cash used in financing activities	**(105)**	(102)	**(210)**	(194)
Decrease in cash	**(1,863)**	(225)	**(1,241)**	(1,110)
Cash, beginning of the period	**1,771**	999	**1,149**	1,884
(Deficit) Cash, end of the period	**$ (92)**	$ 774	**$ (92)**	$ 774

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. USE OF ESTIMATES AND JUDGMENTS

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.