Atlantic Pilotage Authority

Administration de Pilotage de l'Atlantique

Atlantic Pilotage Authority

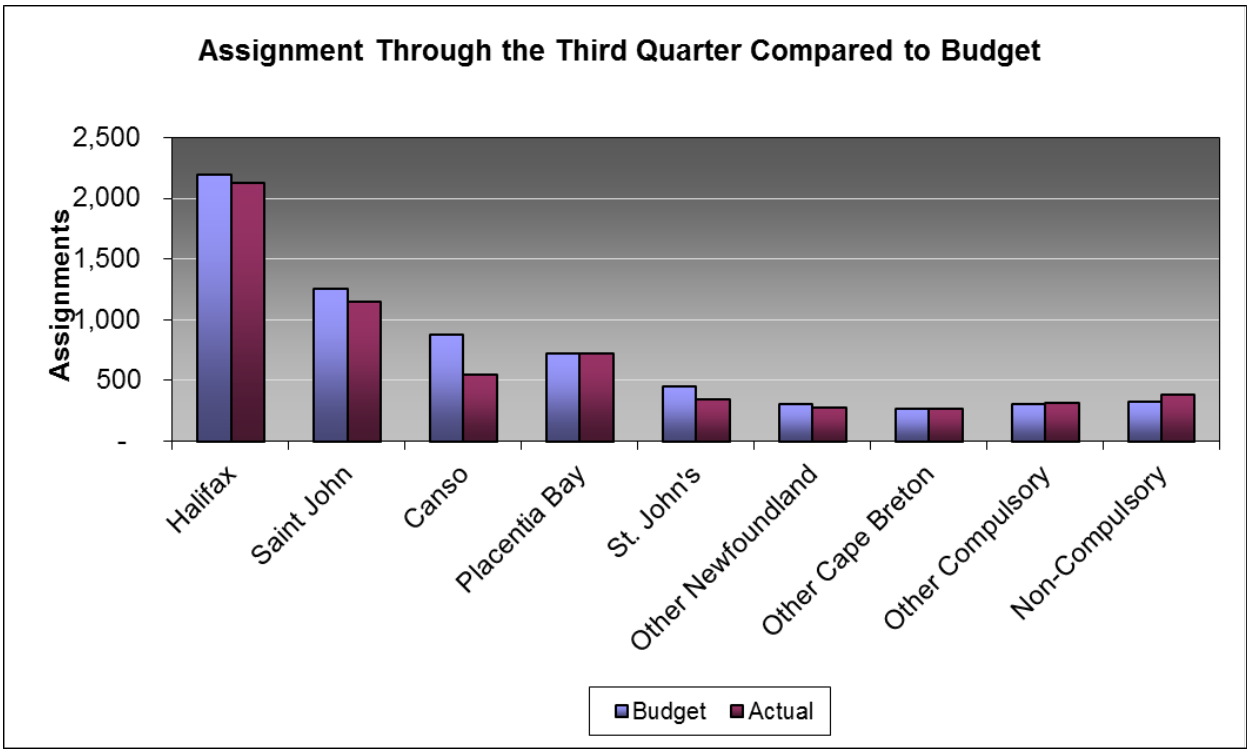
Third Quarter 2012

Management's Discussion and Analysis

November 30, 2012

TRAFFIC REVIEW

Pilotage Area	Actual Traffic through 3rd Qtr 2011	Budget Traffic through 3rd Qtr 2012	Actual Traffic through 3rd Qtr 2012	Variance from 2011	Percentage Variance 2011	Variance from Budget 2012	Percentage Variance from Budget 2012
Halifax	2,311	2,201	2,124	-187	-8%	-77	-3%
Saint John	1,277	1,258	1,149	-128	-10%	-109	-9%
Canso	872	874	548	-324	-37%	-326	-37%
Placentia Bay	635	719	725	90	14%	6	1%
St. John's	439	452	343	-96	-22%	-109	-24%
Other Newfoundland	324	310	274	-50	-15%	-36	-12%
Other Cape Breton	292	268	267	-25	-9%	-1	0%
Other Compulsory	275	310	312	37	13%	2	1%
Non-Compulsory	349	324	383	34	10%	59	18%
Total	6,774	6,716	6,125	-649	-10%	-591	-9%



Traffic levels have continued to be disappointing in the third quarter. The Authority has four major ports (Halifax, NS; Strait of Canso, NS; Saint John, NB; and Placentia Bay, NL) that contribute approximately 80% of its revenue. None of the four major ports has achieved its budgeted revenue expectations through the end of the third quarter. The sharpest decline has occurred in the Strait of Canso, NS, which is 37% under budget on assignments and 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 are approximately half of that achieved in the first three quarters of 2011.

The port of Halifax, NS, has been recovering from a very slow start to 2012 that was caused by a significant downturn in container shipping and reduced demand for oil products in the first quarter. Overall, assignments in the third quarter improved to within 3.2% of the same quarter of 2011, while revenues were within 1% of the same quarter last year. Overall, the port has 8% fewer assignments and 8% less revenue than through three quarters of 2011. When compared to budget, the assignments are 3% and revenue is 6% under budget at the end of the third quarter of 2012.

Saint John, NB, continues to struggle through a weaker than expected year. When compared to the year-to-date results for 2011, assignments and revenue are both down by 10%. The primary reason for the decline is reduced oil tanker activity, with this sector having declined by 12% in assignments and 10% in revenues from last year. When compared to budget, the port has a shortfall of 9% on assignments and 11% on revenue through September 2012. The LNG terminal continues to operate well below capacity, with only 21 assignments in the first three quarters of 2012 compared to 41 in 2011. The initial prognosis for traffic at this facility had been for peak activity of over 300 assignments in a calendar year, but this has not been realized due to the production of shale natural gas within the past few years.

Assignments in St. John's have been below budget and below the level reached in the first three quarters of 2011. This reduction has been caused by masters on regular callers in the port acquiring pilotage certificates during the past year. This certificate allows them to pilot their own vessels. As an example, the Authority had 138 assignments through September 2011 on cargo vessels operating in the port. This year, there have been only 13 assignments while certificated masters have piloted their own vessels on more than 100 occasions. However, the second quarter did show improvement over the first quarter, and traffic has remained steady through the third quarter. The expectation is for an increase in traffic during the remainder of 2012 and looking forward to 2013.

FINANCIAL AND STATISTICAL REVIEW

COMPARATIVE REVIEW FINANCIAL AND STATISTICAL DATA		
For the nine months ended September 30, 2012		
	2012	**2011**
FINANCIAL (000'S)		
Total Revenue	$ 15,029	$ 16,412
Operating Expenses		
Salaries, Fees and Benefits	9,115	9,245
Pilot Boats	4,109	4,158
Other	1,783	1,605
Total Operating Expenses	15,007	15,008
Profit	$ 22	$ 1,404
STATISTICAL		
Pilotage Assignments	6,125	6,774
Shipping Incidents	2	3
% of incident free assignments	99.97%	99.96%
Customer Complaints Filed	19	21
% of complaint free assignments	99.69%	99.69%

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

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

- The tanker traffic lost in Canso is not expected to return in the short or medium term.
- In Halifax, the container traffic is still below last year by 18% at the end of the third quarter, but the activity in the third quarter shows some improvement, being just 6% below the activity of the same quarter last year. There are concerns regarding the future of the oil refinery in the port. The facility is up for sale, and the owner has indicated that they will close it early in 2013. The facility may be converted to a different use, such as a marine terminal, but it is unknown what the impact on vessel traffic will be.
- The activity in St. John's has begun to improve and is expected to remain strong through the remainder of 2012. Additional business is expected in the port through 2013.
- The Authority is expecting the traffic in Saint John to remain above last year's traffic for the last quarter, and to improve in 2013.
- Placentia Bay traffic has slowed in the third quarter as repairs are done to two FPSO (Floating Production, Storage, and Offloading) vessels working on the Grand Banks. The oil refinery in the area was also shut down for maintenance in the quarter, returning to full production in the fourth quarter.

After having shown some improvement in the second quarter, revenues in the third quarter of 2012 were a disappointing 11% decrease from the third quarter of 2011. The Authority had a modest profit in the third quarter, but this is usually the strongest period of the year. The current projection is that the Authority will break even or have a small profit for 2012. This will be well below the budgeted profit for the year.

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

The Authority received a total of 37 complaints out of a total of 6,125 assignments during the first three quarters of 2012. The remaining 99.4% of assignments were performed without receiving a complaint from the customer. For the same period of 2011, there were 28 complaints received out of 6,774 assignments, with the remaining 99.6% 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 third quarter of 2012 the Authority had two minor shipping incidents. There were four incidents at this point in 2011.

RISK ANALYSIS

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

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

Third 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
November 30, 2012

ATLANTIC PILOTAGE AUTHORITY

Statement of Financial Position

Unaudited

(in thousands of Canadian dollars)		September 30, 2012	December 31, 2011
Assets			
Current			
	Cash	$ 984	$ 3,356
	Trade receivables	2,961	3,008
	Prepaid expenses	127	60
	Other assets	-	-
		4,072	6,424
Non-current			
	Intangible assets	222	216
	Property, pilot boats and equipment	10,057	8,447
		10,279	8,663
		$ 14,351	$ 15,087
Liabilities			
Current			
	Trade and other payables	$ 1,709	$ 1,995
	Bank loans	283	251
	Employee severance benefits	125	297
		2,117	2,543
Non-current			
	Bank loans	3,119	3,338
	Employee severance benefits	1,232	1,345
		4,351	4,683
		6,468	7,226
Equity			
Retained earnings		7,883	7,861
		7,883	7,861
		$ 14,351	$ 15,087

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

ATLANTIC PILOTAGE AUTHORITY

Statement of Comprehensive Income

Unaudited

(in thousands of Canadian dollars)		Three Months Ended September 30 2012	Three Months Ended September 30 2011	Nine Months Ended September 30 2012	Nine Months Ended September 30 2011
Revenues					
	Pilotage charges	$ 5,215	$ 5,890	$ 14,971	$ 16,366
	Other income	28	12	58	46
		5,243	5,902	15,029	16,412
Expenses					
	Pilots' fees, salaries and benefits	2,459	2,583	7,055	7,185
	Pilot boats, operating costs	1,139	1,214	3,459	3,444
	Staff salaries and benefits	333	347	1,001	1,141
	Pilot boat crews' salaries and benefits	361	317	1,059	919
	Amortization and depreciation	253	220	622	659
	Transportation and travel	191	194	508	506
	Professional and special services	152	114	459	335
	Utilities, materials and supplies	70	59	255	256
	Rentals	72	70	217	207
	Finance costs	44	46	133	142
	Communications	26	28	89	87
	Training	46	33	150	127
		5,146	5,225	15,007	15,008
Profit (loss) for the period		97	677	22	1,404
Other comprehensive loss		-	-	-	-
	Actuarial loss on employee severance benefits				
Other comprehensive loss		-	-	-	-
Comprehensive income (loss)		$ 97	$ 677	$ 22	$ 1,404

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 September 30 2012	Three Months Ended September 30 2011	Nine Months Ended September 30 2012	Nine Months Ended September 30 2011
Retained earnings, beginning of the period	**$ 7,786**	$ 7,080	**$ 7,861**	$ 6,353
Profit (loss) for the period	**97**	677	**22**	1,404
Other comprehensive loss	-	-	-	-
Total comprehensive income (loss)	**97**	677	**22**	1,404
Retained earnings, end of period	**$ 7,883**	$ 7,757	**$ 7,883**	$ 7,757

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

ATLANTIC PILOTAGE AUTHORITY

Statement of Cash Flows

Unaudited

	Three months ended September 30		Nine months ended September 30	
	2012	2011	**2012**	2011
Operating Activities				
Receipts from customers	**$ 5,117**	$ 4,935	**$ 15,020**	$ 15,235
Payments to and on behalf of employees	**(3,477)**	(3,260)	**(9,543)**	(9,223)
Payments to suppliers	**(1,331)**	(1,460)	**(5,424)**	(5,224)
Other income received	**34**	13	**64**	46
Net cash provided by operating activities	**343**	228	**117**	834
Investing Activities				
Purchases of intangible assets	**(29)**	-	**(44)**	-
Purchases of property, pilot boats and equipment	**(771)**	(666)	**(2,257)**	(1,492)
Net cash used in investing activities	**(800)**	(666)	**(2,301)**	(1,492)
Financing Activities				
Repayment of bank loan	**(63)**	(61)	**(188)**	(178)
Net cash used in financing activities	**(63)**	(61)	**(188)**	(178)
(Decrease) increase in cash	**(520)**	(499)	**(2,372)**	(836)
Cash, beginning of the period	**1,504**	3,341	**3,356**	3,678
Cash, end of the period	**$ 984**	$ 2,842	**$ 984**	$ 2,842
Supplementary Disclosure				
Finance costs paid	**$ 44**	$ 46	**$ 133**	$ 142

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