Atlantic Pilotage Authority

Administration de Pilotage de l'Atlantique

Atlantic Pilotage Authority

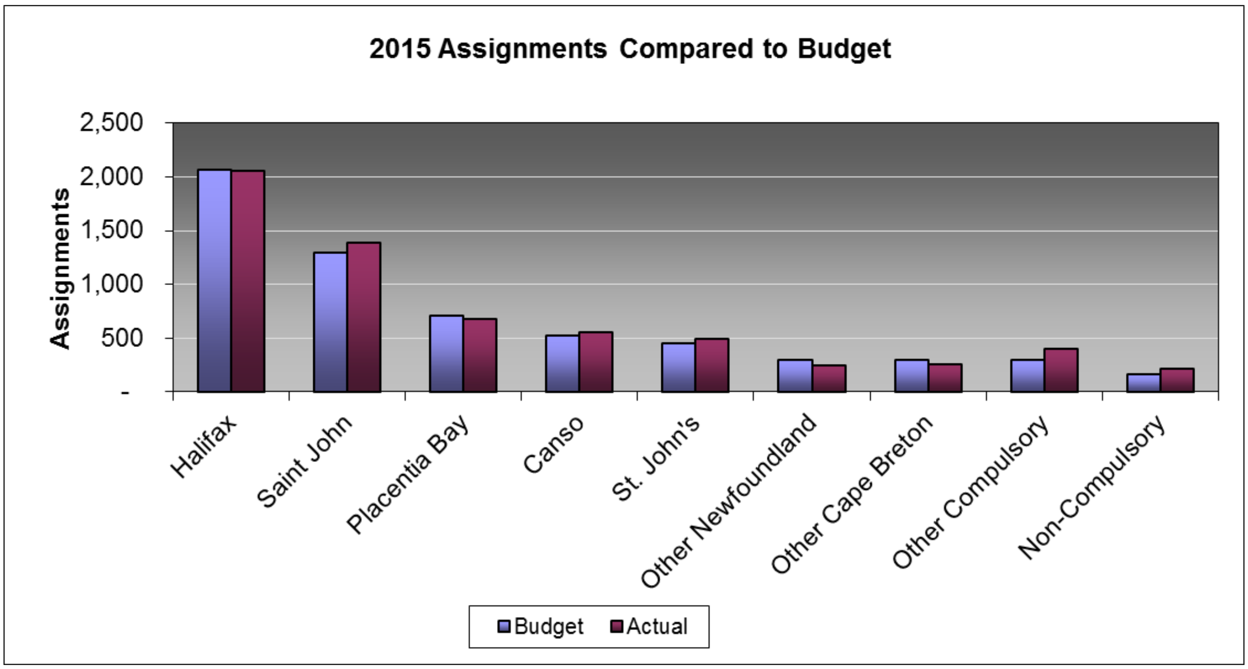
Third Quarter 2015

Management's Discussion and Analysis

November 30, 2015

TRAFFIC REVIEW

Pilotage Area	Actual Traffic through 3rd Qtr 2014	Budget Traffic through 3rd Qtr 2015	Actual Traffic through 3rd Qtr 2015	Variance from 2014	Percentage Variance from 2014	Variance from Budget 2015	Percentage Variance from Budget 2015
Halifax	2,079	2,064	2,057	-22	-1%	-7	0%
Saint John	1,270	1,292	1,390	120	9%	98	8%
Placentia Bay	701	707	683	-18	-3%	-24	-3%
Canso	511	526	555	44	9%	29	6%
St. John's	571	452	492	-79	-14%	40	9%
Other Newfoundland	320	300	251	-69	-22%	-49	-16%
Other Cape Breton	256	301	260	4	2%	-41	-14%
Other Compulsory	236	293	397	161	68%	104	35%
Non-Compulsory	172	163	212	40	23%	49	30%
Total	6,116	6,098	6,297	181	3%	199	3%



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 for the Authority are 3% above budget and 2014 at the end of the third quarter. The Authority has four major compulsory areas that contribute approximately 75% of its pilotage assignments each year (Halifax and Strait of Canso in NS; Saint John, NB; and Placentia Bay, NL). Of the four major areas, Halifax and Placentia Bay have slightly fewer assignments than in 2014, while the activity in Saint John and Canso is well above last year. When compared to budget, a similar trend is evident.

While the Authority is 3% over budget in pilotage assignments, revenue is 3% below budget at the end of the third quarter. This discrepancy between assignments and revenue is a result of two major factors: revenue from the fuel charge has declined with the decrease in fuel prices, and in some ports the average size of ships is smaller resulting in lower revenue per assignment than budgeted.

For Halifax, NS, tanker traffic has declined by 74 assignments (or 19.3%) from 2014, but this decline has been offset by increases in RORO (Roll On, Roll Off) and Vehicle Carrier assignments. There have been modest increases in container ships and cruise ships from 2014. It is expected that there will be continued growth in container traffic as two weekly callers were added late in the third quarter. When compared to budget, the total activity and revenue in Halifax are within 1% of budget for the nine months ended September 30, 2015.

In Saint John, NB, the Authority has had a 9.4% increase in pilotage assignments through the third quarter of 2015 compared to 2014. Pilotage assignments on tankers have increased by 7% (or 62 assignments). Tankers account for 66.3% of assignments in Saint John in 2015 (70.7% in 2014). Other vessels have had an increase of 58 assignments, led by an increase in cruise ships (12 assignments) and tug and barge traffic (34 assignments). Total revenue in the port is 3% over budget while assignments are 7.6% over budget. This disparity is caused by a trend toward smaller tankers as noted previously.

The traffic in Placentia Bay, NL is generated primarily from two major oil industry customers; 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 activity at Whiffen Head dramatically and has led to a significant financial shortfall in the area for the Authority. This maintenance is continuing 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 8% from 2014 and are 13% (or $595 thousand) below the 2015 budget.

In the Strait of Canso, NS, tanker traffic has increased 27% 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 19% from 2014 as the port loses activity on these larger vessels. This has left the area 6% over budget in activity, but 8% under budget on revenues through September 2015.

FINANCIAL AND STATISTICAL REVIEW

COMPARATIVE REVIEW FINANCIAL AND STATISTICAL DATA		
As at September 30		
	2015	**2014**
FINANCIAL (000'S)		
Total Revenue	$ 17,008	$ 16,489
Operating Expenses		
Salaries, Fees and Benefits	10,926	10,079
Pilot Boats	4,484	4,762
Other	1,865	2,051
Total Operating Expenses	17,275	16,892
Loss/Gain	$ (267)	$ (403)
STATISTICAL		
Pilotage Assignments	6,297	6,116
Shipping Incidents	3	4
% of incident free assignments	99.95%	99.93%
Customer Complaints Filed	15	63
% of complaint free assignments	99.76%	98.97%

The overall revenue for the Authority has increased as a tariff increase came into effect late in February. Overall, traffic has increased by 3% from 2014 levels through September 2015, with revenues also increasing by 3%.

Salaries, fees, and benefits through the third quarter of 2015 have increased from the same period of 2014. The Authority has added 11 trainee pilots since the middle of 2013, while having 5 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. Amounts paid to contract pilots have also increased significantly as traffic and related revenues in the ports serviced by contractors has grown. 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. 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 the fourth quarter. The Authority schedules training at times other than the busiest part of the cruise ship season.

While the Authority has been increasing its workforce, the revenue base has been negatively impacted by a move to smaller vessels in several ports. This trend is apparent in Placentia Bay, Saint John, and the Strait of Canso. The Authority has also had a large increase in traffic in St. John's, NL, but vessels and revenues in that port are smaller, on average, than in other areas. The traffic in St. John's is impacted by the number of supply ship masters who obtain pilotage certificates allowing them to pilot their own vessels.

The Authority had a loss though September 2015 of $267 thousand. A profit of $64 thousand was budgeted for this point of the year. While total operating expenses (excluding depreciation) is on budget, revenue is $375 thousand below budget, largely due to the decline in Placentia Bay mentioned previously. The delay in having tariffs implemented resulted in a loss of revenue of $108 thousand. The Authority is anticipating finishing 2015 in a loss position.

CUSTOMER COMPLAINTS AND LEVEL OF SERVICE

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 15 complaints out of a total of 6,297 assignments during the first three quarters of 2015. The remaining 99.76% of assignments were performed without a complaint from the customer. For the same period of 2014, there were 63 complaints received out of 6,116 assignments, with the remaining 98.97% 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 September 2015 the Authority has had three minor 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. The average ship size in the area remains smaller than the historical trend this year.

Maintenance at facilities related to offshore oil extraction or oil refining may also have a significant impact 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 marine traffic at the oil refinery in Saint John has decreased recently due to a maintenance project that will extend into the fourth quarter. The full financial effect of these projects 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 since the middle of 2013. 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.

Third Quarter 2015

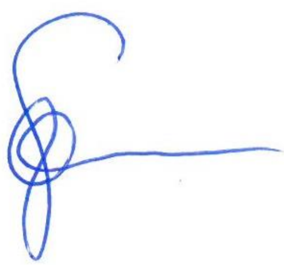
Interim Unaudited

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
November 30, 2015

ATLANTIC PILOTAGE AUTHORITY

Statement of Financial Position

Unaudited

(in thousands of Canadian dollars)		**September 30, 2015**	December 31, 2014
Assets			
Current			
	Cash	**$ 260**	$ 1,149
	Trade receivables	**3,931**	3,280
	Prepaid expenses	**83**	132
		4,274	4,561
Non-current			
	Intangible assets	**214**	248
	Pilot boats and equipment	**10,045**	10,394
		10,259	10,642
		$ 14,533	$ 15,203
Liabilities			
Current			
	Trade and other payables	**$ 1,861**	$ 1,889
	Bank loans	**433**	422
	Employee severance benefits	**108**	112
		2,402	2,423
Non-current			
	Bank loans	**3,886**	4,212
	Employee severance benefits	**1,370**	1,426
		5,256	5,638
		7,658	8,061
Equity			
Retained earnings		**6,875**	7,142
		6,875	7,142
		$ 14,533	$ 15,203

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 2015	Three Months Ended September 30 2014	Nine Months Ended September 30 2015	Nine Months Ended September 30 2014
Revenues					
	Pilotage charges	**$ 6,330**	$ 6,037	**$ 16,973**	$ 16,427
	Other income	**8**	10	**35**	62
		6,338	6,047	**17,008**	16,489
Expenses					
	Pilots' fees, salaries and benefits	**2,936**	2,750	**8,287**	7,626
	Pilot boats, operating costs	**1,204**	1,360	**3,527**	3,800
	Pilot boat crews' salaries and benefits	**445**	412	**1,328**	1,279
	Staff salaries and benefits	**493**	387	**1,311**	1,165
	Amortization and depreciation	**321**	313	**972**	971
	Transportation and travel	**194**	219	**608**	609
	Professional and special services	**109**	127	**369**	431
	Training	**15**	102	**113**	266
	Utilities, materials and supplies	**106**	95	**338**	311
	Rentals	**71**	68	**216**	214
	Finance costs	**34**	38	**104**	109
	Communications	**33**	32	**102**	104
		5,961	5,903	**17,275**	16,885
Profit (loss) for the period		**377**	144	**(267)**	(396)
Other comprehensive loss		**-**	-	**-**	-
	Actuarial loss on employee severance benefits				
Other comprehensive loss		**-**	-	**-**	-
Comprehensive income (loss)		**$ 377**	$ 144	**$ (267)**	$ (396)

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

ATLANTIC PILOTAGE AUTHORITY

Statement of Changes in Equity

Unaudited

	Three Months Ended September 30		Nine Months Ended September 30	
(in thousands of Canadian dollars)	**2015**	2014	**2015**	2014
Retained earnings, beginning of the period	**$ 6,498**	$ 7,308	**$ 7,142**	$ 7,848
Profit (loss) for the period	**377**	144	**(267)**	(396)
Other comprehensive loss	**-**	-	**-**	-
Total comprehensive income (loss)	**377**	144	**(267)**	(396)
Retained earnings, end of period	**$ 6,875**	$ 7,452	**$ 6,875**	$ 7,452

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	
	2015	2014	**2015**	2014
Operating Activities				
Receipts from customers	**$ 5,562**	$ 6,159	**$ 15,977**	$ 15,961
Payments to and on behalf of employees	**(3,658)**	(3,699)	**(11,105)**	(9,806)
Payments to suppliers	**(1,228)**	(2,344)	**(4,679)**	(6,847)
Finance costs paid	**(34)**	(38)	**(104)**	(109)
Other income received	**8**	10	**35**	375
Net cash provided by (used in) operating activities	**650**	88	**124**	(426)
Investing Activities				
Purchases of intangible assets	**(2)**	-	**(8)**	(36)
Purchases of pilot boats and equipment	**(190)**	(162)	**(689)**	(528)
Net cash used in investing activities	**(192)**	(162)	**(697)**	(564)
Financing Activities				
Repayment of bank loan	**(106)**	(102)	**(316)**	(296)
Net cash used in financing activities	**(106)**	(102)	**(316)**	(296)
Increase (descrease) in cash	**352**	(176)	**(889)**	(1,286)
(Debt) cash, beginning of the period	**(92)**	774	**1,149**	1,884
Cash, end of the period	**$ 260**	$ 598	**$ 260**	$ 598

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.