TEEKAY OFFSHORE PARTNERS LP

Moderator: Peter Evensen
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2:00 p.m. CT

Operator: Now, for opening remarks and introductions, I would like to turn the call over to Mr. Peter Evensen, Chief Executive Officer of Teekay Offshore GP. Please go ahead, sir.

Kent Alekson: Before Mr. Evensen begins, I would like to direct all participants to our Web site at www.teekayoffshore.com where you will find a copy of the presentation that Mr. Evensen will review during today's conference call.

Please allow me to remind you that our discussion today contains forward-looking statements. Actual results may differ materially from results projected by those forward-looking statements. Additional information concerning factors that could cause actual results to materially differ from those in the forward-looking statements is contained in the restatements and the update presentation available on our Web site.

I will now turn the call over to Mr. Evensen to begin.

Peter Evensen: Thank you, Kent. Good afternoon everyone, and thank you for joining us on today's call. With me today from Teekay Corporation are Vince Lok, Chief Financial Officer and (Brian Fortier), Corporate Controller.

On our call today, I will walk you through the restatement process we've been focusing our efforts on for the past three months, discuss our restated results and why it has taken longer than previously anticipated, as well as highlight the procedural changes we have made as a result of this review. After the restatement, I will review Teekay Offshore's financial condition and the reasons why we believe Teekay Offshore is strong and stable.

The foundations of our business model, substantial fixed rate revenue and cash flow with strong counterparties, a strong liquidity position, and a favorable debt profile given our use of long duration amortizing liabilities puts us in a strong competitive position in today's tough economic and financial climate.

Turning now to slide three, I can update you that our accounting restatement process is now complete, following what has been three long months of hard work by our accounting team. I'm pleased to report to you that, as expected and communicated when we announced our preliminary second quarter earnings back in August, all of our reported changes are non-cash in nature and have not impacted our cash flow, liquidity, distributions or financial condition.

This is probably best evidenced by the 12.5% increase to our distribution declared in early November, while this restatement process was ongoing. Also our distributable cash flow, which we present every quarter net of non-cash unrealized items, has not changed for any of the periods covered by the restatement. The underlying rationale for our use of hedging derivatives is still sound and is consistent with our risk management policies.

It is important to point out that the restatements do not relate to any accounting irregularities and do not call into question the integrity of our core financial information. Rather, they are strictly related to the accounting treatment or presentation of various complex, non-routine areas of accounting. Lastly, as a result of this review, we've made a number of changes to our financial statement preparation process to avoid having this happen again in the future.

Due to the extent of the work required by our accounting team and our auditors to complete the restatements, our third quarter earnings release will be delayed until mid-December. I will therefore not be in a position to discuss our expected third quarter results on today's call.

Turning now to slide four, I'll briefly review the very thorough restatement process we've just completed before describing the restatements in more detail. This restatement process took longer than we anticipated, in part, because of the thoroughness of the review process, the sheer volume of detailed audit work that was undertaken and the expanded scope of the restatement.

The audit process involves subject matter experts from Ernst & Young's Vancouver office as well as from their Canadian and U.S. National offices. In addition, we engaged the services of another accounting firm to assist us throughout the process. Together, we conducted a thorough review of all of our derivative transactions during the past five years to reassess whether our hedged documentation met with the requirements of FAS 133.

A standard audit usually involves testing a sample of transactions. However, during this restatement process, Ernst & Young essentially performed a 100% audit of all of our derivative transactions over the past five years.

In addition to FAS 133, we also reviewed other areas of complex or evolving accounting standards to ensure that they had been appropriately applied. From this review, a few other related areas were unexpectedly brought into scope. As expected and previously announced, we made changes to the way the partnership accounts for derivative transactions, most of which are used to economically hedge our interest rate and foreign currency risk.

In addition, we've made changes to our accounting for certain vessels we have acquired from Teekay Corporation subsequent to our IPO in 2006. I'll discuss each of these restatement items in more detail.

Further, the results of a subsidiary we disposed of prior to our IPO have now been reflected as discontinued operations for our historical periods prior to July 1, 2006.

Turning now to slide five, I will briefly describe the changes in our hedge accounting treatment. As was previously communicated, certain derivative instruments we used to hedge interest rate, charter rate, and foreign exchange risks do not meet the strict technical requirements for hedge accounting under FAS 133.

I'll provide a couple of examples of our hedge documentation that do not meet the technical requirements of FAS 133 to help provide some perspective on this issue.

One example is when interest rate swaps were transferred to us from Teekay Corporation. The original hedge documentation did not anticipate the swaps would one day be dropped down into a subsidiary and thus was not appropriate for that new situation.

Another example of where our hedged documentation did not meet the FAS 133 requirements is on the matching of our foreign currency forward contracts against the foreign currency expenditures being hedged.

For instance, we may enter into two separate FX forward contracts in equal amounts to hedge a basket of Norwegian kroner expenditures in a particular month. Although, the hedge is economically effective, our hedge documentation did not specify which portion of the basket of expenditures it was supposed to hedge – that is, to say, the first half of the month or the second half of the month.

As can be seen from these examples, the underlying risks are still economically hedged and the relevant cash flows are fixed. However, certain of our hedge documentation did not meet the strict requirements of FAS 133.

Just to summarize the difference in accounting treatment between applying the hedge accounting and not applying hedge accounting – in both cases, all derivative instruments are mark-to-market quarterly. However, under hedge accounting, the unrealized portion of the change in fair value of the derivatives would be recorded directly to partner's equity on the balance sheet, whereas such unrealized gains and losses are recorded on the income statement when not applying hedge accounting. This change in accounting treatment will lead to greater volatility of our reported GAAP income. However, this has no impact on the partnership's distributable cash flow.

An important point I'd like to make at this time is to explain why the mark-to-market adjustment of derivatives is unrealized and non-cash. Some companies finance themselves with fixed rate bonds, while others including our partnership, find it cheaper to create fixed-rate liabilities by borrowing from banks at floating rate LIBOR and then using an interest rate swap, a derivative, to create a fixed rate. We use derivatives to hedge or lock-in our costs, which is prudent to do, especially, when you have fixed rate revenue and want to lock-in your operating margin.

When we enter into a derivative transaction, we intend to hold the position until maturity, as with a bond, to lock-in our costs. However, while the fair value of both the bond and the derivative may change each quarter as the underlying market interest rates change, accounting convention specifies that only the derivative must be mark-to-market.

If we hold the derivative instrument from inception to maturity, all the cumulative unrealized gains and losses would net to zero at maturity. Therefore, the change in fair value would only be realized if we were to unwind the derivative position before maturity. As a result, the change in accounting treatment for derivatives does not impact the economic effectiveness of the hedging transactions nor our actual cash flows.

Turning now to slide six, subsequent to the release of the preliminary second quarter results, we reviewed the implications of an impending change to the accounting rules for business combinations. During that review, we determined that although there are currently two alternative accounting treatments available, the SEC's preference is to treat vessels acquired on dropdowns from Teekay Corporation as the acquisition of businesses not as the acquisition of assets.

As a result of this change in accounting, after the dropdown of the vessels to us from Teekay, we will now recast our historical results to include the results of the acquired vessels as if they had been owned by us from the date the vessels were originally operating and under the control of Teekay.

This change in accounting has no impact on the financial results of the partnership subsequent to the date the vessels were acquired by the partnership. This accounting treatment is also consistent with what the new accounting standard will require when it comes into effect in 2009.

Turning now to slide seven, we've reproduced the summary of restated second quarter operating 2008 results from our news release to show that the adjusted distributable cash flow hasn't changed as a result of these restatements because the adjustments are non-cash in nature. The same is true for all of the periods covered by the restatement. Distributable cash flow and cash distributions have not changed.

Turning to slide eight, we summarize the changes that have been made in our accounting processes as a result of this restatement. We've implemented a more rigorous process to determine the accounting treatment for complex accounting issues and non-routine financial structures and arrangements, which includes the engagement of appropriately qualified external expertise.

In addition, we've decided to no longer apply hedge accounting treatment for all of our derivative instruments except for certain foreign currency forward contracts. This will lead to greater volatility of reported GAAP earnings, particularly to interest expense. However, we will provide sufficient information in future earning releases to enable readers to identify the amount of the unrealized gains and losses from such derivative instruments.

In addition to the changes made by the partnership, our independent auditors, Ernst & Young, have also strengthened their team to include relevant subject matter experts going forward.

In summary, the partnership has always prided itself on the quality and integrity of its financial reporting. So, we are obviously disappointed to have had gone through this accounting restatement process. The amount of time this has taken, however, is testament to the robustness of the process. And to underscore the point I made at the outset, the restatements did not relate to any accounting irregularities nor call into question the integrity of our core financial information.

Turning now to the second part of today's presentation, we've received a number of questions recently regarding our financial condition, not the least, due to our headline amount of debt and debt profile. The restatement process has kept us on the sidelines with respect to reporting to you on these and other matters, but I now welcome the opportunity to review with you the highlights of Teekay Offshore's financial condition.

Turning now to slide ten, we believe that Teekay Offshore is well positioned in the current difficult economic and financial environment for a number of reasons. First, we have a strong liquidity position. Second, we have a favorable debt profile with no near-term refinancing requirements. Third, our substantial long-term fixed-rate revenue and cash flow with counterparties we consider to be creditworthy comfortably supports our debt. I'll address each of these topics in the following slides.

Turning now to slide 11, I want to briefly touch on some of Teekay Offshore's financial statistics. We recently increased our distribution by 12.5% to $1.80 per unit annualized, which at yesterday's price represents a yield of 23%. We had a total liquidity of $258 million at June 30, 2008 and have no requirements to tap the equity markets because we completed a $217 million follow-on offering in June of this year to help fund the acquisitions we made earlier this year.

In addition, we have no CapEx commitments. Standard leverage metrics used across the MLP space are not representative of Teekay Offshore's actual credit metrics due to its historical low book equity. Teekay Offshore's book equity represents the historical book value of the ships to Teekay, not the fair market value of the TOO/OPCO fleet. As of June 30, 2008, using an estimated fair market value of the fleet, Teekay Offshore has a net debt to fair market value of 52% compared to 89.5% using historical book equity.

Turning now to slide 12, Teekay Offshore has no significant near-term refinancing requirements over and above the normal amortization of its debt facilities. We have only $50 million in balloon payments due between now and the end of 2013, and our liquidity position is more than sufficient to repay all of our near-term refinancing requirements.

On slide 13, we want to show you that our debt is very light on covenants, which provides significant flexibility. The primary financial covenant is to maintain a minimum liquidity level to find its cash and undrawn revolving credit facilities and with ample cash and undrawn revolvers, we aren't facing any covenant concerns.

In light of credit concerns affecting other shipping segments, today, it's important to know we have only one facility representing $87 million, which has a minimum hull value covenant.

Currently, the value of the ships, as it relates to the total borrowings available under this facility, is 185% compared with the minimum requirement under the covenant of a 105%. And as you can see from the sensitivity table we've included, the vessel values pertaining to this facility would have to drop precipitously before we would even have to partly pay down the relevant debt to remain in compliance. For example, if values were to drop 50% from where they are today, we would only lose about $10 million of capacity.

Turning now to slide 14, we have a diverse portfolio of long-term contracts with high-quality customers that provide stability of cash flow. Our current contract portfolio is very strong with over half of the shuttle tanker fleet working under life-of-field contract of affreightment contracts. The estimated average field life for the field serviced by our CoA contracts is approximately 15 years and the remaining shuttle tankers operate under time charter contracts and bareboat charters and have an average remaining life of approximately five years.

Our five floating storage units operate under fixed-rate contracts with an average remaining term of approximately four years. And our nine conventional tankers and two lightering vessels operate under fixed-rate time charters and bareboat charters with an average remaining term of approximately six years. Our customers include the major oil companies, such as ExxonMobil, StatoilHydro, ConocoPhillips, BP, Shell, Chevron, Marathon and Petrobras.

Turning now to slide 15, before we open the call for questions, I wanted to again summarize why we believe Teekay Offshore is well positioned in the current environment. We have the strong liquidity position of nearly $260 million in cash and undrawn revolvers. We have a favorable debt profile with no covenant concerns and no requirements to raise public capital. And lastly, we have a very significant fixed-rate contract portfolio with very strong counterparties.

Thank you for listening. And operator, I would like to open the call up now for questions.

Operator: Thank you. Ladies and gentlemen if you would like to ask a question, please press star one on your touch tone phone. To withdraw your question, press the pound sign. If you use a speaker phone, lift your handset before entering your request. Please standby for your first question. Your first question comes from Ron Londe of Wachovia. Please go ahead.

Ron Londe: Thank you. A significant part of your business is done in the North Sea. Can you give us some perspective on what's happening there from a production standpoint for the offshore platforms? I know that there was some significant maintenance and work-over this summer and maybe you can give us some history behind production in the North Sea?

Peter Evensen: Sure. Well, what – from a historical context, Britain developed its oilfields first and Norway came afterwards. So, Britain has already peaked, whereas Norway, depending on how you look at it, is in the process of peaking its oil production as it moves a little bit more towards trying to develop its gas reserves. We've anticipated this and so we have a flexible profile. We have chartered in various tonnage. So, as we expect a certain drop-off in the North Sea oil production on our fields, we have the ability to redeliver in charter tonnage.

However, if it lasts longer, as what has happened now, because the oil price has been higher, so people want to keep production going much longer. We have to remember that oil production is a function, not just of the physical life, but also of how much money it costs to develop those fields.

So, obviously, an oilfield will last longer at $50 than it will at $18 or $24. And so, we have the ability to be flexible with our tonnage because we have some tonnage that we chartered in. On the other hand, we can declare those options to extend that in charter tonnage and we can move it to other areas such as Brazil and other more benign areas which don't need – which don't have the harsh environment of the North Sea.

And that's our plan, which is to take surplus tonnage when it eventually happens in the North Sea. But every year, we find that the production stays a little longer than what the engineers had said. And so, right now, we are very tight on tonnage in the North Sea. We don't have any slack capacity. But we have two ways we can use that tonnage. We can either trade it in the conventional markets, or we can find another area such as Brazil that is developing its shuttle tanker trade.

And over time, we've built up the amount of shuttle tankers that we have down in Brazil and we would expect that there probably will be an increased requirement for shuttle tankers in the North Sea. And that's one reason why – as well as Brazil – and that's one reason why our sponsor has four new building shuttle tankers on order for delivery from 2010, because they anticipate new fields coming on in the North Sea, as well as in Brazil.

Ron Londe: The North Sea has never really been a swing producer from the standpoint of world demand for crude oil, has it?

Peter Evensen: That's right. It's all non-OPEC oil and Norway followed the traditional method of awarding licenses to major oil companies. So, sometimes – there have been instances in the past, for example, 1986, when we had about $10 oil, where Norway has decided that it would go along and make certain cuts, but what they did in reality was they just scheduled greater maintenance.

But on the whole, Norway continues to produce, whether the oil price is $50 or $140, and that's one of the benefits of the shuttle tankers is there is always a constant requirement for them. But each oil company makes that assumption, but as I started to say earlier, most of these fields were developed when the oil price was $18 or $24 as the break-even price. So, they can go on producing economically for a long time.

Ron Londe: Thank you.

Peter Evensen: Thank you.

Operator: Ladies and gentlemen, if there are any additional questions, please press star 1 at this time. Your next question comes from Darren Horowitz from Raymond James. Please go ahead.

Darren Horowitz: Hi, guys. Peter, one macro question for you. When you're looking out longer term, and this kind of dovetails with the previous question – and you're looking at the four Aframax shuttle tanker new builds that are on order, I recognize that they were scheduled to be delivered towards the tail end of 2010 through 2011.

But when you look at the potential for those vessels to be offered to you from parent, a lot of that hinged on you know any sort of long-term fixed rate contracts that could be awarded prior to delivery or you know any sort of OPCO affreightment contracts in the North Sea. Has anything changed there with the dramatic retrenchment in crude oil and essentially a flattening of the forward curve?

Peter Evensen: No. It hasn't changed. In fact, I think those – first of all, those new buildings, the contract price from those compares favorably, today, with what it would cost you if you were going to order them today, even with lower steel prices or if you were going to convert the existing tonnage. So, they are the right ships and they're going to arrive at the right time. And I think that's particularly true as it looks – if you look at the whole shuttle demand including what's happening in Brazil. There’s going to be an increased ramp up in production in Brazil and there aren't enough shuttle tankers, right now, to handle that amount of increased production when you look at the total demand for shuttle tankers. So, we think we're well positioned with those ships.

On the other hand the reason we ordered those as Aframaxes, as opposed to Suezmaxes, which is what we had moved to is because we saw that the new fields that will be developed in the North Sea will be smaller fields. And so they won't have – you aren't finding the really big, so called elephant field in the North Sea anymore. So, there is going to be a requirement for smaller ships and smaller lots of oil. And so, we think those are the right kind of ships and that's especially true if we start to see reduced production on certain existing fields. We can take a Suezmax, reemploy it, say, in Brazil and put an Aframax in its place.

Darren Horowitz: OK. That's helpful. I appreciate that color. And then one final question for you as it relates to distributable cash flow. You know in terms of liquidity, obviously, you're in a good position when you look at a lot of the annuity type cash flow that's coming into the model over the next couple of years. You know it would suggest that you would also be in a pretty good position to continue to grow the DCF line. But, in light of current market conditions and seemingly a more prudent approach to balancing retained cash, how do you look at the distribution curve over the next two years?

Peter Evensen: Well, I would like to point out, first of all, that we don't have any exposure to oil prices. You know lots of MLPs these days are talking about how they actually had exposure to oil prices or nat gas prices and we don't have any of that. We get paid the same amount whether the oil price is $50 or $140. So, unless we bring in new units, we really cannot increase the distribution beyond what we have today.

Where we're starting to get some benefit is from the fact that the dollar has strengthened vis-à-vis the Norwegian kroner. And we also think that as a result of this economic slowdown, the price of steel is dropping, so the cost of some of our dry-dockings and other things that have been rising a lot in the last few years is going to drop.

So, on the operating side, we think we're going to benefit, but on the whole, that isn't going to make a material change in the operating margins. It will improve it on the margin, as will some of the rollover of the contracts that we have, but pretty much we're a steady state entity. So, we're going to be looking for new ways to grow and that, of course, is trying to move some of the FPSOs into the partnership. But, obviously, at today's unit price, in order to make those deals accretive, they're going to have to be even more profitable than they were before.

Darren Horowitz: Sure. I appreciate it. Thanks, Peter.

Peter Evensen: Thank you.

Operator: Thank you. There are no further questions at this time. I'd like to turn the conference back to Mr. Evensen.

Peter Evensen: OK. Thank you very much. This was the last of all four Teekay entities to have its restatement call. So, I thank everyone, who listened today and I look forward to speaking with you next month and reporting on our third quarter earnings. Thank you very much. Good bye.

Operator: Ladies and gentlemen, this does conclude the conference call for today. You may now disconnect your line and have a great day.

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