TEEKAY OFFSHORE PARTNERS LP

Moderator: Peter Evensen
May 13, 2011
12:00 pm CT

Operator: Welcome to Teekay Offshore Partners First Quarter 2011 Earnings Results conference call. During the call, all participants will be in the listen-only mode. Afterwards, you will be invited to participate in a question and answer session. At that time, if you have a question, participants will be asked to press star 1 to register for a question.

For assistance during the call, please press star 0 on your touch-tone phone. As a reminder, this call is being recorded. Now for opening remarks and introduction, I would like to turn the call over to Mr. Peter Evensen, Teekay Offshore Partner's Chief Executive Officer. 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 first quarter 2011 earnings presentation. Mr. Evensen will review this presentation 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 first quarter 2011 earnings release and earnings 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 very much for joining us on our first quarter investor conference call. I'm joined today by Teekay Corporation CFO Vince Lok and MLP Controller David Wong. On slide number 3 of the presentation, I will review some recent highlights from Teekay Offshore. We generated distributable cash flow in the first quarter of $29.2 million, up approximately 6% from $27.6 million generated a year ago. We completed the acquisition of the remaining 49% of Teekay Offshore operating LP or OPCO.

We financed the acquisition with $175 million in cash and the issuance of 7.6 million common units to our sponsor and seller Teekay Corporation. This was an important acquisition for our partnership because it simplified our ownership structure, and as I'll detail later, it provides significant incremental distributable cash flow. And importantly, based primarily on the cash flow we expect to be generated from this acquisition, we declared and have now paid the first quarter distribution of 50 cents per unit, an increase of 5.3% 2-1/2 cents per unit from last quarter's distribution of 47-1/2 cents per unit.

We finished the quarter with strong liquidity in excess of $380 million. Some of you may have tuned in to Teekay Corporation's earnings conference call yesterday, and heard of two developments in its FPSO business. First Teekay recently entered into a joint venture agreement with Brazil-based Odebrecht to jointly pursue FPSO opportunities in the Brazilian market. And this week, Teekay signed a conditional contract with Samsung Shipyard to construct a new building FPSO subject to finalizing a contract with a major oil and gas company for a new North Sea FPSO project.

Including this potential FPSO unit, Teekay Corporation is currently involved in multiple FPSO feasibility studies known as FEED, or front end engineering and design studies. And they are seeing increased demand in Brazil from international oil companies, other than Petrobras, looking at shuttle tankers as a solution to their offshore oil production needs. Investors will recall any

FPSO or shuttle projects that our sponsor creates or becomes involved in that has a contract term of 3 years or longer must be offered to Teekay Offshore Partners. Turning to slide number 4, in light of our recent acquisition of 49% of OPCO, I wanted to briefly review our updated and much simpler partnership structure.

Those of you who are familiar with us will notice that the OPCO box has now disappeared, and for all intents and purposes, all our vessels are now owned by Teekay Offshore, which in turn is owned 37% by our sponsor, Teekay Corporation, which includes the 2% general partner interest and 63% by public unit holders. Turning to slide number 5, we take a look at developments in the FPSO business. The search for new sources of oil to satisfy growing global demand, coupled with high oil prices of over $100 a barrel has led to an increase in offshore exploration and production activity in recent months.

As a result, we've seen an increase in the number of FPSO projects around the world with 100 projects currently in the planning stage for FPSOs compared to 78 projects in 2009. Half of these FPSO projects are located in Teekay's core regions of the North Sea and Brazil. In Brazil state-owned oil company, Petrobras, and other international oil companies, continue to make large, new finds, which will lead to continued demand for floating production systems in the coming years. In the North Sea, the high oil price environment and steady depletion of existing fields is also encouraging new exploration, including the push into harsher weather environments, which is Teekay's area of expertise.

The majority of the FPSO projects, which are projected to come online over the next 5 years, have yet to be ordered, as shown by the green bars in the chart. We estimate that around 80% of future FPSO requirements will be met by new buildings and conversions, with the remainder being met by the redeployment of existing FPSO units. Slide number 6 provides an overview of the current outlook in recent activities in our shuttle tanker business. Shuttle tanker demand is set to grow significantly in future years as new offshore production comes online, particularly in deeper waters.

In the North Sea, we envision future demand will come increasingly from harsher weather environments, such as Barents Sea, where, for example, Statoil recently announced a find of 500 million barrels of oil equivalent, the biggest North Sea oil find in a decade. In Brazil, we also see a large growing future requirement for shuttle tankers, particularly as the giant deep water pre-salt oil fields start to come online in the next few years. Petrobras is leading the charge with an estimated future requirement of more than 30 shuttle tankers to serve these offshore oil fields.

However, future shuttle tanker demand in Brazil will not be limited to just Petrobras. International oil companies with equity stakes in these big pre-salt fields will also require shuttle tankers. And the requirement of these companies is expected to generate additional demand for upwards of ten shuttle tankers in the medium term. In recent months, we've seen an increase in tender activity for shuttle tankers, in both the North Sea and Brazil. Teekay Offshore's actively bidding on many of these tenders. And while competition on these tenders is stiff, we would prefer to stick to our return hurdles to ensure accretive projects, and if necessary to pull a capital in the higher return FPSO business in the interim.

I'd like to point out the competitive bidding we're seeing on new tenders is not having an impact on our existing fleet, where the few contracts we have rolling over every year continue to be rolled over at slightly higher rates. Turning to slide number 7, I will review our consolidated operating results for the quarter, comparing an adjusted first quarter 2011 income statement against an adjusted fourth quarter 2010 income statement, which excludes the items listed in Appendix A of our earnings release, and reallocates realized gains and losses from derivatives to their respective income statements' line items.

Net revenues increased by $4.8 million given a full quarter of operations for the Nansen Spirit shuttle tanker, which delivered in early December 2010. Higher revenues from our conventional fleet, primarily due to higher than normal net bunker revenues and higher revenues from the Rio das Ostras FPSO, which went on to a new, higher paying contract. These increases were offset by reduced project-specific revenues, the redelivery of the Basker Spirit and the sale of the Karratha Spirit floating storage unit.

Vessel operating expenses decreased by $1.8 million, mainly due to higher maintenance work on the higher shuttle fleet than in the previous quarter, and partially offset by increased repairs on the Rio das Ostras FPSO, given that the FPSO was in the yard during the first quarter for its upgrade work. Time charter hire expense decreased by $700,000 due to a redelivery of an in-chartered vessel in the fourth quarter. Depreciation expense decreased by $3.7 million, mainly due to no dry dock write-offs, which we expensed in the previous quarter, reduced depreciation on the Basker Spirit and Karratha Spirit, and an increase in the residual value assumption we used for depreciation calculations, given the increase in steel prices.

General and administrative expense increased by $1.8 million primarily due to higher business development activities and is in line with our budget for this period. Debt interest expense increased by $400,000 primarily from a full quarter of the Norwegian Kroner bond we issued. Teekay Offshore's income tax recovery increased by $1.5 million, mainly due to recoverable deferred taxes on the sale of the Karratha Spirit floating storage unit. I don't want to walk through all of slide number 8, because this has already been included in our earnings release.

However, I would like to highlight the information at the box on the bottom of the slide. Due to the timing of the closing of the acquisition of 49% of OPCO and the issuance of the 7.6 million shares to Teekay, on March 8th, our coverage ratio for the first quarter of 2011 was only 0.87. However, if we had concluded the acquisition on January 1st, our coverage ratio would have been much higher, at 1.14 times. Looking at slide number 9, in light of stories we are monitoring with respect to the possible taxation of MLPs, I wanted to highlight that right now, based on our understanding of how the tax rules could possibly change for MLPs, Teekay Offshore will likely not be impacted.

Teekay Offshore is structured as an MLP. However, because we don't carry on business in the U.S. and therefore don't attract corporate level tax, Teekay Offshore elected to be taxed as a U.S. Corporation since its inception. As a result, we don't expect the new taxes on energy, which have been quoted by some politicians in the United States, to have an impact on Teekay Offshore or its unit holders.

On slide number 10, we have presented our financial position at the end of March. We finished the quarter with strong liquidity of approximately $380 million, even after the OPCO acquisition. We have no unfunded CAPEX commitments, and no near-term need to raise equity. As the graph at the bottom of the slide shows, we have minimal balloon payments through 2013. Thank you for listening and operator, I'm now available to take questions.

Operator: Thank you, ladies and gentlemen. If you'd like to ask a question, press star 1 on your touch-tone phone. To withdraw your question, press the pound sign. If you use a speakerphone, lift your handset before entering your request. Please stand by for your first question.
Your first question comes from (Darren Horrowitz). Please go ahead.

(Darren Horrowitz): Hi, Peter, just a couple quick questions. First, I seem to remember that you had somewhere between three and five shuttle tanker contracts that were going to be rolling off this year. Have any rolled off? I assume maybe a few have here in the first quarter, but you know how many do you have left? And more importantly, can you quantify the magnitude of day rate increases that their rolling to?

Peter Evensen: We haven't had any rollover so far this year and so I can't quantify what the increase will be. But we're quite comfortable that we're going to be able to both employ the ones that are coming in, because they're already going on to Statoil, and then we're planning to reposition the tonnage that the new buildings will replace, back into Brazil where we usually get higher rates.

(Darren Horrowitz): Okay. So, when you think about the shuttle tanker fleet in whole, is it still three to five that are going to be rolling off contract this year?

Peter Evensen: Approximately three.

(Darren Horrowitz): Approximately three and how many next year?

Peter Evensen: I don't have that figure right now.

(Darren Horrowitz): Okay. Looking at the North Sea, just based on the development of that Statoil field that you discussed, and obviously other developments that you're monitoring, how many more shuttles do you think that area's going to need over the next 5 years?

Peter Evensen: I think that area will probably need, depending on the development – and I don't think that Statoil field will be developed in the next 5 years, by the way – I think that we're probably talking 8 to 10.

(Darren Horrowitz): Okay.

Peter Evensen: And included in that is some renewal of existing shuttles that as they get older, then they're – then they go out of the fleet.

(Darren Horrowitz): Okay, so that's a net of attrition number.

Peter Evensen: Yes.

(Darren Horrowitz): Okay. If you look at the total fleet in the North Sea, what is the attrition on a yearly basis?

Peter Evensen: I don't have those figures. I can get them for you on when the ships are reaching 20 years of age, which is when they come out of service.

(Darren Horrowitz): Okay. That's all I had, thank you.

Operator: Thank you. Your next question comes from Ron Londe. Please go ahead.

Ron Londe: Thanks. I was curious. Recently, there – I believe the Norwegian government has approved some added development and work over of the Ekofisk field. Do you service the Ekofisk field?

Peter Evensen: Hi, Ron. We do not service the Ekofisk field, which is run by ConocoPhillips, but we're aware of it and the Ekofisk field will probably last another 30 years. It's had a lot of investment in it. And they're reinvesting because it just shows you how long the oil fields can continue to run and they're starting to put more in enhanced oil recovery. And as the fields deplete in Norway, they're able, actually to invest in enhanced oil recovery. So that means our life-of-field contract that we have on other fields, not Ekofisk, last longer than we what had originally anticipated and that's also a function, of course, of oil prices. Meaning that it's economic in order keep these fields pumping.

Ron Londe: Right. Could one of the – one of the items that you listed as a driver and the quarter was higher bunker revenues. Can you talk about that a little bit more?

Peter Evensen: Yes. This is on our conventional fleet that we all have chartered out on fixed rates. With the high bunker costs we're actually – we actually make a little more money because of the formula that we have on the time charter. So, bunker costs would normally be a negative. It's a pass through for us, and we have it at a – at a – on a formula, so bunker rates are much higher, and that has given rise to a little bit of extra income. It's not…

Ron Londe: Is there a certain amount of lag to that?

Peter Evensen: There is a little bit of a lag, yes.

Ron Londe: Is it a quarter or less than a quarter or?

Peter Evensen: One quarter.

Ron Londe: Okay. All right. That's all I have, thanks.

Peter Evensen: Thanks, Ron.

Operator: Thank you. Ladies and gentlemen, if there are any additional questions, please press star 1 at this time. Your next question comes from Martin Rohr. Please go ahead.

Martin Rohr: Thank you. And thanks for having the four calls in 2 days. Not many companies do that. And it's very helpful.

The question I had, Peter, is back in October, at the analyst day, you disclosed that there were some upside exposure to oil prices, both oil prices and production volumes in the FPSO business. Approximately where does that kick in and how meaningful could that be?

Peter Evensen: Hi, (Marty). That – we have the one FPSO, but it's not at Teekay Offshore Partners. It's presently up at Teekay Corporation. And we have a – as part of that contract, we have a – we have a – part of the revenue that we get depends upon the volume and if the oil price is above a certain figure. So that's income that is recognized once a year, depending on what the average Brent oil price is. And so, if – Vince, you're on the call – but the first quarter number was closer to $9 million?

Vincent Lok: Yes or, that's on this one here, then, the unrecognized portion for the first…

Peter Evensen: Yes. So we didn't recognize it. We'll recognize it at the end of 2011. But, if it was to be annualized, that would be $36 million for Teekay Corporation. But, as you know oil prices trended higher through the quarter. I know they're short term down in the last week. But that's revenue that we – is unrecognized until the fourth quarter every year.

Martin Rohr: And that's only on the one unit?

Peter Evensen: Only on that one unit and it's up at Teekay Corporation, not at Teekay Offshore Partners.

Martin Rohr: I see. Okay. If I could just ask a second question, if you don't mind; you mention also at that analyst day the potential for consolidation in the industry. Has there been any activity since then? Or how do you see that developing?

Peter Evensen: We've looked at a few different opportunities. The – this is the consolidation of the FPSO space…

Martin Rohr: Right.

Peter Evensen: … where there's a lot of small players with one unit and they found out it was a little harder to operate than they thought, as well as convert. So, there are some opportunities, and we're – we continue to look at them, but it has to be a good accretive transaction, and it has to be a unit that we're comfortable with.

Martin Rohr: Thank you very much, and good luck.

Peter Evensen: Thank you.

Operator: Thank you. There are no further questions at this time.

Peter Evensen: Okay. Thank you very much. We look forward to reporting back to you next quarter.

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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