TEEKAY OFFSHORE PARTNERS LP

Moderator: (David Rajanayagam)
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Operator: Welcome to Teekay Offshore Partners Third Quarter 2011 Earnings Results conference call. During the call, all participants will be in a 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 one to register for a question.

For assistance during the call, please press star zero on your touch-tone phone.

As a reminder, this call is being recorded.

Now for opening remarks and introductions, I would like to turn the call over to Mr. Peter Evensen, Teekay Offshore Partners' Chief Executive Officer. Please go ahead.

(David): Before Mr. Evensen begins, I would like to direct all participants to our website. That's www.teekayoffshore.com, where you will find a copy of the Third Quarter of 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 Third Quarter of 2011 Earnings Release and Earnings Presentation, available on our website.

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

Peter Evensen: Thank you, (Dave). Good afternoon everyone on Veterans Day, and thank you for joining us on our Third Quarter of 2011 Investor Conference Call. I'm joined today by Teekay Corporation's CFO, Vince Lok, and (MLP) Controller (David Wong).

Turning to slide number three of the presentation, I will review some recent highlights for Teekay Offshore. We generated distributable cash flow in the third quarter of $52.1 million, up approximately 150 percent from the $20.8 million generated a year ago. This large increase is primarily due to the acquisition of the remaining 49 percent of Teekay Offshore Operating, L.P., or OPCO, from our sponsor, Teekay Corporation, in March of this year, the acquisition of the ((inaudible)) FPSO in October 2010, and the acquisition of the three shuttle tankers over the last three quarters.

In addition, our shuttle tanker segment had a very strong quarter, generating $55.1 million of cash flow from vessel operations or (CFBO), compared to $45.6 million a year ago. This nearly $10 million increase resulted from the acquisition of shuttle tankers, as I just mentioned, but also from the short term transportation and storage projects that we were able to get in the North Sea at higher rates during the third quarter.

We've declared a third quarter distribution of fifty cents per unit to be paid on Monday, November 14th. And we completed the acquisition of the Peary Spirit shuttle tanker in early August, and subsequently acquired the fourth and final Explorer class new building shuttle tanker, the Scott Spirit, on October 1st. Both of these vessels are now trading in the North Sea.

Teekay Offshore intends to acquire the Piranema FPSO directly from Sevan Marine later this month for a price of $165 million. We expect to initially finance the acquisition of the unit with the proceeds from $170 million equity private placement that we also announced yesterday ((inaudible)) on supplementing the purchase with a $130 million credit facility that we hope to have in position to draw upon later this year or early in 2012.

Reflecting the Piranema acquisition, we intend to recommend an increase to the partnership's quarterly distribution effective with the Q1 2012 distribution that will be paid in May 2012. Our sponsor, Teekay Corporation, has agreed to acquire two additional FPSOs from Sevan Marine which will be eligible for sale to Teekay Offshore when the units commence charter contracts in excess of three years.

Turning to slide number four, I would like to take a few minutes to describe the Sevan transaction in greater detail. Teekay Offshore will acquire the Piranema FPSO for $165 million. The unit is on charter to Petrobras in Brazil through March 2018 and includes cost escalation clauses and extension options for up to an additional 11 years.

The unit is expected to generate annual cash flow from vessel operations of approximately $22 million to $27 million per annum during the firm period of the charter.

Teekay Corporation has agreed to acquire two other units, the Hummingbird and Voyager FPSOs, and their associated charter contracts, and has agreed to fund the remaining costs to complete the upgrade of the Voyager which is expected to be completed in the third quarter of 2012.

Teekay Corporation will also invest an additional $25 million for a 40 percent ownership interest in a recapitalized Sevan and subsequently enter into a cooperation agreement for the joint marketing of Sevan's uniquely shaped cylindrical FPSOs.

This is important for our partnership as this cooperation includes an option for Teekay Offshore Partners to acquire new FPSO projects which are developed by Sevan which, in effect, gives Teekay Offshore another avenue for FPSO growth.

On slide number five, I'd like to walk you through the strategic rationale of the Sevan transactions for us. Together Teekay and Teekay Offshore become the fourth largest owner and operator of leased FPSOs in the world. This is important for customers when we're tendering our new FPSO projects because we can point to our operational experience in multiple regions, our scale possibilities, and our ability to work on oil fields with varying characteristics.

We also plan to bring together Sevan's FPSO engineering and design capabilities with our operational expertise and financial strength which, when they're packaged together, we believe will be a key differentiator with our customers in the future.

Each of the three FPSOs that the Teekay entities are buying from Sevan were built in the last four years and therefore have a long trading life ahead of them.

The cooperation agreement I spoke about earlier was a key component in this transaction and, as I said, represents significant value for Teekay Offshore, because of its potential to give us future FPSO growth.

Turning to slide number six, the Sevan transaction strengthens our position in our core markets of Brazil and the North Sea. As you can see from the table on the left, if we include the Cunard FPSO that's Teekay's currently constructing, and the Voyage FPSO acquired from Sevan, as well as the Teekay's and Teekay Offshore's existing FPSO units, together we are more than double the size of our closest competitor in the operationally intensive harsh weather North Sea. And while we're not the biggest in Brazil, as ((inaudible)) on the right side, nor do we aspire to be, we are increasing in size focusing primarily on smaller, more specialized FPSO units.

Turning to slide seven, I'd like to walk through some details of the unit supplier from Sevan. Firstly, in the red highlighted box, is the Piranema FPSO that we've agreed to acquire directly from Sevan for $165 million. This unit is operating under a long term time charter contract with Petrobras Offshore Brazil. The contract with Petrobras, which has a firm period ending in March 2018, includes 11 one-year extension options.

The Hummingbird FPSO, which will be acquired from Teekay Corporation, is currently operating under a shorter term time charter contract with (Ventrikay) in the North Sea until at least September 2012, but does have extension options for a total of five and a half years.

And finally, the Voyager FPSO is currently undergoing upgrades to prepare the unit for a new five year time charter with extension options with (Eon), also in the North Sea. Teekay has agreed to add technical resources to support the upgrades and finance completion of the Voyager's upgrades, and will then acquire the Voyager once it commences operation under its new contract, which is expected to occur in the third quarter of 2012.

Under the omnibus agreement, both the Hummingbird and Voyager would become eligible for sale to Teekay Offshore at fair market value once they're operating under a long-term contract with an initial term of greater than three years.

And this means that Teekay must offer the Voyager to Teekay Offshore within one year of commencing its long term contract in the third quarter of next year. And the Hummingbird will become eligible for sale to Teekay Offshore once Teekay secures a new long term contract for that unit.

Slide number eight, I think, is very interesting. It summarizes the visible growth opportunities that will be available to Teekay Offshore over the next few years. In addition to our four (VG) shuttle tankers which we've ordered and which will deliver in 2013, we expect to be offered a number of attractive assets serving under long term contracts with high quality customers over the next several years. And we believe that this growth pipeline will allow us to drive distribution growth to unit holders going forward.

On slide number nine, I want to review our consolidated operating results for the quarter, comparing an adjusted third quarter 2011 income statement against an adjusted second quarter 2011 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 statement line items.

Net revenues increased by $3.7 million, primarily as a result of an increase in shuttle tanker revenues from offshore projects in the North Sea, and the contribution from the new building shuttle tanker, the Peary Spirit, that was acquired on August 2nd. It was partially offset by reduced net revenue from the conventional fleet as the result of the sale of one unit in August.

Vessel operating expenses decreased by $3.8 million, mainly reflecting lower repairs and maintenance on our shuttle tankers and the Varg FPSO, partially offset by a full quarter's operating expenses for the Peary Spirit.

Time charter higher expenses were comparable with the prior quarter, and depreciation expense increased by $800,000 mainly due to the Peary Spirit being depreciated for a full quarter.

General and administrative expense decreased by $800,000, primarily related to lower audit ((inaudible)) expenses, partially offset by an increase in business development costs. While not included in the adjusted income statement column, we did record a non-cash impairment charge of approximately $24 million in Q3 related to two of our conventional oil tankers and one older shuttle tanker. The impairment largely reflects the decline in asset values in the conventional tanker segment and the short remaining tenures on the fixed rate contracts that some of these vessels have.

It's important to note that these non-cash charges do not affect our operations, cash flow, liquidity, or any of our loan covenants, but they do reflect the fact that tanker asset values have fallen. Continuing down the income statement, net interest expense increased by $1.4 million, mainly due to financing costs related to the purchase of the Peary Spirit. And looking at the bottom line, adjusted net income increased to $31.6 million in the third quarter from $26.2 million in the second quarter.

I won't walk through all of slide number 10, because this has already been included in the Earnings Release. However, I would like to highlight the information in the box at the bottom of the slide. Due to our acquisitions over the past year, and very strong results from our shuttle tanker segment, we generated approximately $52.1 million in distributable cash flow which, when compared to our total distribution payouts, resulted in a strong coverage ratio of 1.53 times for the third quarter.

Although we don't expect the fourth quarter results to be as strong, due to some of the positive seasonal factors I talked about earlier, the intended acquisition of the Piranema FPSO is expected to be accretive to Teekay Offshore's distributable cash flow.

On slide number 11, we presented our financial position at the end of September 2011. We finished the quarter with strong liquidity at $286 million, and we have no near term refinancing requirements. A portion of the $170 million equity private placement will be used to fund upcoming installments related to our four (BG) shuttle tanker new buildings under construction, and we intend to secure a new debt facility to finance the remaining installments sometime next year.

On a combined basis, the completion of the Piranema acquisition, together with the associated equity private placement and debt facility, is expected to provide an incremental $135 million of additional liquidity, which will provide financial flexibility to the partnership going forward.

Thank you for listening, and, Operator, I'm now available to take questions.

Operator: 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 are using a speakerphone, please lift your handset before entering your request. We will pause for a moment to assemble the queue

Your first question comes from Edward Rowe from Raymond James. Please go ahead.

Edward Rowe: Good morning, guys. My first question surrounds the Piranema and could you quantify how accretive the acquisition of the Piranema will be to (DCS)?

Peter Evensen: Hi. We aren't giving exact details about the accretion on the Piranema, but what we have done is we have raised equity that is equal to the Piranema acquisition costs. So rather than use a combination of debt and equity, we've chosen in order to be more conservative, in order to raise more of the -- raise more equity than we needed, which, as I said at the end of my remarks, will give us additional liquidity.

So I think depending on what we -- how we use that additional liquidity, it'll reflect how accretive it will be. But we do intend to recommend a distribution increase for the first quarter. We just haven't delineated that yet.

Edward Rowe: Okay. All right. Pretty good and leading to the acquisition from Teekay, from Sevan, could you give us a little better picture on future FPSO drop-down potentials from Sevan?

Peter Evensen: Yes. Well, first of all, Sevan has two unfinished hulls right now. So if they are -- and those are in China, so if Sevan is able to secure new contracts on those, and decides to build them for their own account, they would be offered to Teekay Offshore. I would estimate that if those hulls were used, we probably wouldn't be offered them before 2013.

On new projects, I would probably see -- probably look to a start date of somewhere around 2014.

Edward Rowe: 2014. Okay. And the last question is, on the upgrade to the Voyager? Can you-- what are the costs surrounding that for the upgrade?

Peter Evensen: First of all, these costs are being borne by Teekay Corporation.

Edward Rowe: Okay. Yeah.

Peter Evensen: But we would expect that the modules that are being put on, that relate to gas compression and dehydration, they would cost about $110 million to $130 million. But that's taking into account in the contract that it's going to go on to in the third quarter of 2012.

Edward Rowe: Okay. All right. Thank you.

Peter Evensen: Thank you.

Operator: Your next question comes from Mark Minikes from (Kane Anderson). Please go ahead.

Mark Minikes: Good morning, gentlemen.

Peter Evensen: Good morning.

Mark Minikes: Congrats on getting a nice set of assets from Sevan and locking up the equity financing. Just following up on the last question. Is there any way to sort of help us try to triangulate what the potential magnitude of any type of near term distribution increase would be? You had a 5 percent one this past year. Is that sort of the general ballpark we should be thinking about?

Peter Evensen: Hi, Mark. We're always trying to be -- try to have at least a mid-single digits type of distribution increase every year. It all depends on how much we have in terms of equity and debt. We've been over-equitizing our deals, but as you have seen from our presentation on slide eight, we have a lot of assets which are eligible to drop-down. So, the distribution increases will be more depending on the rate of drop-down. And we intend to be aggressive about that.

Mark Minikes: Mm-hmm. So when we're thinking about this, also longer term, just again, this mid-single digits is sort of, is a reasonable operating assumption for us to work with.

Peter Evensen: I think that's right.

Mark Minikes: Okay. And slide eight's very good and it's very helpful. And it would be also, I think, good for us to see sort of how much each of these assets potentially costs, so we could then also maybe try to triangulate that and sort of give us a clearer sense of not only just the pace of drop-downs, but also what the magnitude of the asset growth could be.

Peter Evensen: Well, I think that in the -- we haven't given that sort of distribution yet. But I think it's important to say that Teekay is adding value to the Voyager in terms of getting it to come on -- in terms of it being upgraded. As well as the Hummingbird, in terms of getting commercial employment. So that'll be reflected in the fair market value. But from Teekay Offshore's side, we intend to do the transaction that will be the most accretive.

Mark Minikes: Okay. And then just one last thing, just back in your Analyst Day, in October last year, you put out a 6 percent distribution growth aspiration, in a sense -- and again, it sort of follows up, sounds like it dovetails with what you're aiming for now, but any reason we haven't seen that again? Sort of, any type of published form?

Peter Evensen: Well, that's illustrative, but I think that's in line with our targets that we want to have. So, as we said during our Investor Day, we think Teekay Offshore has plenty of opportunities to grow, which is what we are showing on slide eight. I think the Sevan deal enhances that. So it's just a question of the equity markets being in the right place. I think we were gratified we were able to do this equity private placement.

You know, you -- the equity markets are strange these days. But I think that we feel even more confident that we can now show people what our growth pattern is, and people can therefore start to attribute a growth in distributions that will come from that.

Mark Minikes: Okay. You have a good pipeline going into the Sevan transaction. You just further extended it. So it's a real nice growth trajectory to have out there. It would be nice to sort of just lay it out for everyone to -- you know, see it for themselves.

Peter Evensen: Yeah. Well, we are planning to have an Investor Day -- I know that this sounds like a long time -- next fall. But I think you'll be pleased with the amount of activity we have at Teekay Offshore. Assuming that . . .

Mark Minikes: Okay. ((inaudible)) You did a good job.

Peter Evensen: Thank you very much.

Mark Minikes: Yeah. Bye.

Operator: Your next question comes from Martin Roher from MSR Capital Management. Please go ahead.

Martin Roher: Thank you. Good morning. I wanted to appreciate the added disclosure you gave on yesterday's parent company call, on the three vessels that you've acquired from Sevan. I have two questions related to that acquisition. One is -- I know you haven't finalized it yet but what do you think the approximate cost of the debt financing's going to be on those vessels? And the second question is, what do you think the long term benefits are of the 40 percent equity stake in the recapitalized Sevan?

Peter Evensen: (Marty), what was the second question?

Martin Roher: What, what -- you talk about Sevan's engineering skills and, you know, how it can benefit Teekay but can you add a little clarity to what that 40 percent equity stake in the recapitalized Sevan may mean for the ability to get new projects or to add value to existing projects down the road?

Peter Evensen: Sure. So the cost of financing has gone up that we're taking on, so I guess if I had to say where the markets are these days, I'd say for secured shipping and offshore deals that have long term contracts, I'd say it's about LIBOR plus 300 basis points.

Martin Roher: Okay.

Peter Evensen: But LIBOR is itself very low right now. So, if you have to model in a debt financing cost that would put five to six percent -- when -- all in, when you're looking at it. And the Sevan deal in which Teekay Corporation, our sponsor, is taking a 40 percent share -- we think that's very strategic because Sevan has some really great engineering skills.

And the cylinder technology can be used in a lot of different places, primarily up north where you have -- and when I say up north, I mean up in the Barents Sea, where they're looking for oil and where this vessel has good -- or this cylinder has good ice and mooring attributes, compared to a ship shape. And so we have been competing against Sevan, and doing Okay, meaning that we're winning.

But we like the fact that we can add them to our business development such that when we see an opportunity we can decide, are we going to bid on it with a ship shape, or are we going to bid on it with a cylinder. And that has to do with what the oil company wants, but also where we think we can do it cheaper. And so to have two different alternatives I think is really a plus for us.

And then of course, we have the scale -- then we have this omnibus agreement under which Sevan will sell us new projects at fair market value. So for Teekay Offshore Partners, it's looking, you know, from 2014 on, I think it brings an abundance of possibilities.

But I did note that Sevan is trading higher than where Teekay will subscribe to its shares. That's not a lot of money, but I think it reflects that the market is already anticipating a growth market for Sevan.

Martin Roher: Terrific. Looks like a great acquisition. Congratulations and good luck.

Peter Evensen: Thank you, (Marty).

Operator: Your next question comes from Derek Walker from Bank of America. Please go ahead.

Derek Walker: Hi, everyone. This is Derek Walker calling on behalf of (Gabe Marine). His first question is just on the Piranema acquisition. I think ((inaudible)) some color around the rationale of a direct transaction with Sevan versus the -- which I believe was the original plan of a drop-down from Teekay?

Peter Evensen: Yeah, well, the original plan was that Teekay or any subsidiary of Teekay would buy the three units. But we thought it was far more transparent to -- not to have Teekay stand in the middle -- just to have it purchased directly by Teekay Offshore. But in order to do that, we had to put together the equity for it. And therefore, the private placement route seemed to be the best one. We wanted to time it out property, and under the terms of the private placement, they won't fund it until the Piranema comes in. So because we could pull together the financing under short notice, Teekay Offshore can acquire it directly at the same price that Teekay would have bought it at.

Derek Walker: Okay, great. And then, just referencing the formal remarks in the press release, it looks like you said the fourth quarter results won't be as strong as the third quarter. Can you just provide some color there as far as what the drivers are?

Peter Evensen: That's really because we had an exceptional third quarter on the shuttle side. Usually what happens in the third quarter is that a lot of our oil production facilities in the North Sea go down for maintenance. But we were lucky this quarter that when they went down for maintenance, they also needed some of our ships to be floating storage units and take the place of some of the vessels that had down time. We also did some special projects.

So the down time maintenance actually helped us this -- in the third quarter this year, rather than hurt us. And we were able to get a lot of projects at higher rates than what we have on our longer term contracts. So that's why the coverage ratio was all the way up at 1.5 times. And so we don't expect that to be on a going forward on a run rate basis. But it told us that there's also a different market for our ships, which is why we're happy to have some slack because we can reemploy that at higher rates.

Derek Walker: Okay, that's helpful. And then just a last one from me, on the dry-dock schedule. It looks like, you know, there's a little bit more dry-dock and (off-hire) days in 2012, at least that's what I saw from the Teekay presentation. Is there any potential implications there?

Peter Evensen: No, I don't see any implications. That's just standard. Some years we have higher dry-docking years, and some years they're lower. That's just a timing question.

Derek Walker: Okay, fair enough. Thank you.

Peter Evensen: Thank you.

Operator: Your next question comes from Ron Londe from Wells Fargo. Please go ahead.

Ron Londe: Thanks. Just curious about your views toward what's going on in Brazil right now, regarding activity and contracting. Is it getting easier or more difficult to deal with the government and the oil companies down there?

Peter Evensen: Yeah. Hi, Ron. I've noticed there's a lot more articles on Brazil, whether it's in Barrons or the Economist. But as far as we're -- as far as what we're doing on the ground, it hasn't really changed with Petrobras. Petrobras is one of our best customers. They're a very consistent customer, and they are on a very ambitious growth path to invest a lot of money in order to double production from a little over two million barrels to over four million barrels.

So I think -- I think I'm continued to be amazed at how they can manage all of it. They have organized themselves to split themselves up into discrete units so that they don't -- so that those people can concentrate on that particular field, or that particular activity. And, you know, what concerns us about -- so there's a good news and a bad news story to Brazil.

The good news is that we see a wealth of opportunity for our shuttle tankers and FPSOs, and we have the (Terra Sedon) project that is up at Teekay but ultimately will be offered to Teekay Offshore, that's coming in the third quarter of next year. And we'll have three units down there operating shortly. So the good news is we see a lot of room for that. We're still bringing new units on the shuttle tanker side down to Brazil.

The bad news is you have to manage the cost inflation. And that's why we've done, on the FPSO side, we've done a joint venture with (Odabresh) because we needed to have access to a bigger type of training facility.

So getting the right people is, I guess, our biggest concern, which you always have when you have a big rush of people. And I see that all around the world, whether you're in Calgary, in Australia, in Norway, or even Brazil. There's only a certain pace at which you can do things. But so far, I have to say the Brazilians have handled it really well.

Ron Londe: Okay, thanks.

Operator: Ladies and gentlemen, as a reminder if you'd like to ask a question, please press star one.

There are no further questions at this time. Please continue.

Peter Evensen: Okay. Thank you all very much. We look forward to reporting back to you next year on our fourth quarter, as well as -- and we're going to concentrate on getting the Piranema FPSO purchased and integrated into our operations. Thank you all. Happy Veterans Day.

Operator: Ladies and gentlemen, this concludes the conference call for today. We thank you for your participation. You may now disconnect your line. And have a great day.

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