TEEKAY OFFSHORE PARTNERS LP

Moderator: Peter Evensen
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12:00 pm CT

Operator: Welcome to Teekay Offshore Partners fourth quarter and fiscal 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, participates will be asked to press star one to register for a question. For assistance during the call, please press star zero on your touchtone 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, Mr. Evensen.

David Rajanayagam: Before Mr. Evensen begins, I would like to direct all participants to our website at www.teekayoffshore.com where you will find a copy of the fourth quarter and fiscal 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 fourth quarter and fiscal 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 and thank you for joining us on our fourth quarter and fiscal 2011 investor conference call. I'm joined today by Teekay Corporation's CFO Vince Lok and MLP controller David Wong.

On slide number 3 of the presentation, I will review some recent highlights for Teekay Offshore. We generated distributable cash flow in the fourth quarter of $41.6 million, up approximately 55 percent from $26.9 million generated in the same quarter one year ago. This large increase is primarily due to the acquisitions we made last year.

In addition, we were able to reduce our operating expenses, most notably in our shuttle tanker segment despite adding new vessels to our fleet. For the fourth quarter, we declared a quarterly distribution of $0.50 per unit, which was paid to unit holders on February 14. We also recently completed a number of transactions late in 2011 and early 2012 that I would like to highlight. We completed the acquisition of the Piranema Spirit on November 30, 2011 for $165 million. The acquisition was initially funded with proceeds from $170 million equity private placement, and I'm happy to report that we recently completed $130 million commercial debt facility secured by the Piranema Spirit with a consortium of banks, which increases TOO's liquidity.

We also completed the acquisition of the Scott Spirit shuttle tanker new building for $116 million, which has a potential price adjustment based on incremental Shuttle Tanker revenues secured over the next two years. This acquisition was financed with cash on hand and a $93.3 million debt facility assumed from Teekay. Due to our current strong coverage ratio and the distributable cash flow growth from the Piranema Spirit FPSO and the Scott Spirit, we intend to recommend to the Teekay Offshore Board of Directors a distribution increase commencing with the first quarter of 2012 distribution, which is payable in May 2012.

In January of this year we successfully completed an unsecured Norwegian bond, which, when swapped over to US dollar fixed, bears an interest rate of 7.49 percent. The five-year non-amortizing $100 million equivalent bond marks Teekay Offshore's second issuance in this strategically important financing market. This issuance, together with our recently completed $130 million Piranema financing, increases Teekay Offshore's liquidity to approximately $430 million, which positions us well to take advantage of further growth opportunities in the future.

Turning to slide number 4, let's look back at some of our notable accomplishments in 2011. We acquired 49 percent of OPCO for $390 million in March of last year. This acquisition not only provided significant incremental cash flow to Teekay Offshore, but also simplified our partnership structure. On the back of this acquisition we increased our quarterly distribution by 5.3 percent to $0.50 per unit in the first quarter of 2011. Last June, we were awarded a contract by a subsidiary of BG Group to supply four 1 million-barrel shuttle tankers onto 10 year charters in Brazil. These contracts will commence soon after the ships are delivered from the shipyard, which is scheduled for mid- to late 2013.

In August, we acquired the Peary Spirit shuttle tanker, the third of the four explorer class shuttle tanker new buildings, which we've purchased from Teekay Corporation over the past 15 months. And finally and most notably, we were able to execute on these growth initiatives in 2011 while still delivering strong results from our existing operations. Teekay Offshore achieves a coverage ratio of 1.19 times, which is above our targeted range and reflects the strong results primarily from our shuttle tanker franchise, which achieved higher revenue and lower costs in 2011.

Turning to slide number 5, I'm pleased to announce that over the past few months Teekay has made significant progress with the integration of the Sevan transaction that we announced in

October. We acquired the Piranema FPSO directly from Sevan for $165 million on November 30, and the unit is continuing its operations in Brazil producing oil for Petrobras. I had the pleasure of going on board the unit a few weeks ago, and it's definitely impressive and its innovative design has many potential applications apart from just being constructed as an FPSO. The Piranema is currently generating cash flow from vessel operations, or CFVO, of approximately $23 million, but we hope to increase this to approximately $27 million once we complete certain upgrades to the gas compression unit in the coming months.

Importantly, as I mentioned earlier, with the recent completion of the dedicated debt facility, the FPSO has now been fully financed. Our sponsor, Teekay Corporation, acquired two related units, the Hummingbird FPSO from Sevan, and it's currently operating in the North Sea on a relatively short-term contract generating annual CFVO of $22 million. Teekay is already discussing subsequent employments with clients for this unit.

The second unit, which is the upgrade of the Voyager FPSO, which Teekay Corporation is financing, is progressing well, and we expect that Teekay will purchase the FPSO once it begins producing oil, which is currently expected for early in the fourth quarter of 2012. Teekay expects this FPSO unit to generate approximately $75 million of CFVO annually upon the commencement of its fixed rate time charter contract in the North Sea. And importantly, both the Hummingbird and the Voyager FPSOs will be eligible for Teekay Offshore to acquire once they are on charters for three years or longer.

And lastly, Teekay Corporation invested $25 million in a recapitalized Sevan Marine, which trades on the Oslo Stock Exchange. We are confident that Sevan will be successful in securing new FPSO projects, which, thanks to an omnibus agreement between Sevan and Teekay Offshore will provide us with an additional avenue for growth. There are a number of strategic benefits for the Sevan transaction that will benefit both Teekay and Teekay Offshore Partners. We are now able to offer both shipshape and cylindrical FPSOs, broadening the oil production solutions to be provided to our customers.

The harsh weather FPSO market demands operational excellence with superior quality assets, and as a result, we see only a handful of competitors who are able to compete for new business in these markets.

Now, due to the cooperation agreement in place between Teekay and Sevan, we expect the number of competitors bidding on future projects in these harsh weather regions to be reduced even further. More importantly, we anticipate that Sevan will serve as another source of accretive FPSO growth for Teekay Offshore, driving future distribution growth. And finally, Sevan Marine will continue to generate revenues through engineering and paid FEED studies and potential licensing agreements for its existing and new hulls.

Turning to slide number 6, we have provided illustrations for the many applications we believe are possible using Sevan's cylindrical design, thanks in part to its high base load and storage capacity and stability in harsh weather. Sevan has had proven success with the FPSO and drilling units, and it's evident there remains several other unique applications on this slide that could find similar success. These applications will continue to be explored by Sevan, and we're excited by the potential for them to develop new, innovative projects, which Teekay Offshore can own in the future.

Turning to slide number 7, the North Sea is seeing a resurgence in activity, which has the potential to benefit each of our offshore franchises in the coming years. Exploration activity in the North Sea is at a record high level as shown in the chart at the top left of the slide, which shows the number of exploration wells drilled off Norway over the past 30 years. High oil prices, as well as an industry-supportive tax regime, are encouraging the development of new areas as well as the redevelopment of areas that were previously considered mature. It was in a mature and previously well explored area that Statoil and Lundin made the world's largest oil discovery of 2011, the 1.7 billion to 3.3 billion-barrel Johan Sverdrup field.

If this discovery proves to be at the higher end of the estimate, it would be the third largest oil field ever discovered in Norwegian waters. Looking further north in the Barents Sea, the Skrugard and Havis discoveries are estimated to contain between 400 million to 600 million barrels of oil and will require high-spec, harsh weather production units and shuttle tankers to develop them. These new discoveries bode well for the new long-term future of the North Sea oil industry and should create demand for harsh weather FPSOs, floating storage units, and shuttle tankers, which is all of our areas of expertise.

Looking at the more immediate future, the chart at the bottom left of the slide shows demand for FPSOs and FSOs over the next five years. The total of 15 North Sea projects are currently looking at FPSOs as a potential development solution, along with four projects which may require a floating storage unit. Given the relatively few numbers of operators who are in a position to service these projects, we feel that Teekay is well placed to take advantage of growth in the North Sea FPSO and FSO space in the coming years.

Slide number 8 summarizes the significant visible growth opportunities that are available to Teekay Offshore over the short to medium term. In addition to our four BG shuttle tankers, which we ordered directly and which are delivering 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 the distribution growth, which all of our unit holders are looking forward to.

On slide number 9 I will review our consolidated operating results for the quarter, comparing an adjusted Q4 2011 income statement against an adjusted Q3 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 decreased by $1.9 million primarily as a result of a decrease in the conventional tanker fleet due to the sale of the Scotia Spirit in Q3 and the termination of two time charters with Teekay Corporation in Q4. The Piranema Spirit FPSO contributed one month to partially offset these decreases. Vessel operating expenses decreased by $1.1 million mainly from lower repairs and maintenance expenses from the shuttle tanker fleet and the Rio das Ostras FPSO and the lay-up of the Basker Spirit.

This was partially offset by an increase in repairs and maintenance for the Varg FPSO, whose maintenance work was postponed from Q3, and a full quarter's cost for the Scott Spirit, and a month's cost for the Piranema Spirit FPSO. Time charter hire expenses decreased $1.2 million, mainly due to an increase in off-hire days in the in chartered fleet in Q4, and the redelivery of the Akarita Spirit, partially offset by an increase in spot end chartering.

Depreciation expense increased by $1.7 million, mainly due to the Scott Spirit being depreciated for a full quarter and the Piranema Spirit FPSO for one month. General and administrative expense decreased by $500,000, primarily from a net decrease in management fees from Teekay Corporation. While not included in the adjusted income statement column, we recorded non-cash impairment charges of approximately $58 million in Q4 related mainly to two of our conventional oil tankers, two of our older shuttle tankers, and one of our floating storage units. The impairment reflects the intention to sell two of our older conventional tankers, the decline in asset values for older shuttle tankers and the short remaining tenures of the fixed rate contracts on some of these vessels.

It's important to note that this non-cash charge does not affect our operations, cash flow, liquidity, or any of our loan covenants, but does reflect the fact that tanker asset values have fallen. In addition, upon the sale of the two conventional tankers which are currently on time charter to Teekay Corporation, Teekay Offshore will receive an early termination fee from Teekay

Corporation. From Teekay Offshore's perspective, sale of these vessels will allow to us to avoid expensive upcoming dry dockings while also monetizing the future value of the time charters.

Continuing down the income statement, net interest expense, including realized losses on interest rate swaps, increased by $2 million, mainly due to financing costs related to the purchase of the Scott Spirit. Income tax expense increased approximately $5 million, mainly due to recording the annual tax provision from the Norwegian FPSO entities. Looking at the bottom line, adjusted net income decreased to $22.3 million in Q4 from $31.6 million in Q3.

I won't walk through all of slide number 10, which was included in our recent earnings release, however, I would like to highlight the information in the box at the bottom of the slide. We generated approximately $41.6 million in distributable cash flow which, when compared to our total distribution payout, resulted in a coverage ratio of 1.10 for the fourth quarter. I would like to point out that the coverage ratio of 1.10 for the fourth quarter was impacted by the equity private placement which we completed in November. Had we not completed the equity offering when we did, our coverage ratio would have been 1.21 times. The recent acquisition of the Piranema Spirit FPSO is expected to provide further distributable cash flow growth, which will help offset the reduction in our conventional tanker fleet cash flows.

On slide number 11, we have presented our financial position at the end of December 2011. We finished the quarter with strong liquidity of over $200 million, and we have no near-term refinancing requirements. On a combined basis, the completion of the Piranema debt facility and the $100 million Norwegian bond will provide an incremental $230 million of liquidity, which will provide additional financial flexibility to the partnership going forward.

We have no refinancing requirements in 2012, and we look to secure a new debt facility to finance the remaining installment payments related to our four BG shuttle tanker new buildings, which are under construction at Samsung later this year. In addition, we are actively working to address our refinancing requirements in 2013 and 2014.

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

Operator: Thank you. Ladies and gentlemen, if you would like to ask a question, please press star then one on your touchtone phones. To withdraw your question, please press the pound sign. If you're using a speaker phone, please lift your handset before entering your request. And now let us stand by while we assemble the queue.

And our first question comes from Eddie Rowe of Raymond James. Please go ahead.

Eddie Rowe: I read in the press release that you are selling two conventional vessels. Can you shed some light on how you're looking into this sale, and if you have a particular target date that you're looking at?

Peter Evensen: Yes. We listed them as vessels held for sale in the balance sheet, and we're actually already marketing those vessels. So, hopefully we'll be able to sell them in the coming quarter.

Eddie Rowe: Okay, very good. And second – with the shuttle tankers, the four new vessels, are these vessels with the $470 million, will this attract a similar multiple to, say, the Piranema? Is that your expectations going forward, once the new builds are completed?

Peter Evensen: No. I think the cash flow multiple will be higher on it. We haven't given full guidance on that, but generally our shuttle tanker new buildings, given that the longer charter period, have higher EB to EBITDA multiples.

Eddie Rowe: All right. Thank you. That's all I have.

Operator: And our next question comes from John Tysseland of Citigroup. Please go ahead.

John Tysseland: Quick question, on the – when you look at any significant rollovers in 2012, do you have any one? I think the only thing that we show was one conventional tanker. Is that it, or are we missing something? And is that one of the vessels that you expect to sell this year?

Peter Evensen: Yes. So, you're talking about the in-charter fleet that we have on the – or sorry, on the charter out-fleet that we have on the conventional vessels. So, those are some that we are looking forward to selling and avoiding the dry-docking.

John Tysseland: And are there any other vessels –

Peter Evensen: One of those is. Sorry.

John Tysseland: No problem. And then, are there any other vessels in the fleet that have contract rollovers in 2012 that we should expect?

Peter Evensen: Not on the shuttle side. In fact, on the shuttle side, we're looking to get even more days booked – for example, on the Scott Spirit. But what we're looking at on the conventional side, while we have listed two for sale, we have two, the Leyte and Luzon, that came off of charter and we're looking to convert them to floating storage units once we get a contract. But we're not going to convert them unless we get a contract.

John Tysseland: Okay. And then another question on financing – when we look at the balloon payments, how should we think about the cost of debt capital there? The Norwegian bond was unsecured in the 7 percent range. On those balloon payments, I would assume that any kind of debt on those, if they were secured, it would be lower than that. Is that fair to say?

Peter Evensen: Yes. I think the existing revolvers that we have, they're priced at less than LIBOR plus 1 percent; whereas in the new markets, you're talking about LIBOR plus 2.5 percent to 3 percent. But the good news is that LIBOR is much less than it was. So, all in, you, on a floating rate basis, you end up at around about 4 percent to 5 percent.

John Tysseland: What should we expect in terms of –

Peter Evensen: On a secured basis, sorry.

John Tysseland: Okay. And then what should we expect in terms of the financing of those new vessels coming in? How do you think about the equity versus debt component?

Peter Evensen: We could finance up to 80 percent, but that's probably not what we're going to do. We might, as we did with the Piranema, where we totally equity financed it, and then we just took the extra debt facility as a – add to our liquidity and left it undrawn. I would expect you probably would see that we would use about 40 percent equity, about 60 percent debt on a drawn basis, even if we could borrow more against it. In general, we're trying to use a little bit more equity, and that's just a function of how we're managing the debt to EBITDA, which we want to hold at around four times.

John Tysseland: That's great. Thank you very much.

Operator: Thank you. And our next question comes from Ron Londe of Wells Fargo. Please go ahead.

Ron Londe: Yes. Getting back to the conventional tanker area, if you sell these two tankers and you convert two other tankers to store offshore storage, what will the fleet look like after that?

Peter Evensen: Then – well, it's actually sort of a moving target. We're looking at these vessels that are older, especially the ones that we took the write-down on. We're either going to sell them or find other uses for them. So, one of the big things that we're looking at, the Basker Spirit is laid up; the Leyte and Luzon are trading as conventional ships, so they're not making as much money as they once made on the charter contracts. But we think that there's a big opportunity to convert them to floating storage units, but not as big an opportunity that we would convert them before we had a contract.

But we're bidding on three to five FSO contracts. So, we look to change over the conventional fleet into longer life assets. What you saw us do, for example, on the Falcon Spirit FSO, which is in Qatar, which will take the unit out to approximately 31, 32 years of vessel age.

Ron Londe: What do you think the timing would be on being able to switch out, if you did switch over these tankers to floating storage?

Peter Evensen: I think you would – well, there are contracts we're bidding on right now. If you put that through, I would say you'd – and then put in six, nine months of conversion, you're talking about cash flow coming in 2013.

Ron Londe: Okay. Thank you.

Operator: Thank you. As a reminder, ladies and gentlemen, if you would like to ask a question, please press star then one on your touch tone phones.

And our next question comes from Marc Minikes of Kayne Anderson. Please go ahead.

Marc Minikes: Hey, it's good to see you have the intent to recommend the distribution increase for the next quarter. Any sense to help us gauge what the potential magnitude is? How should we be thinking about what type of distribution increase you're potentially contemplating?

Peter Evensen: We're not willing to give any guidance on exactly how big that distribution increase will be; but I would say, in general, we're comfortable that we have sufficient growth to be able to increase the distribution in TOO on an annual basis in the mid- to-higher single digits on an annual basis.

Marc Minikes: Okay. And then, what's the hold back here versus TGP, where you really you put out the 7 percent number, and you're still committed to that? Any reason why we can't see something along those lines with TOO as well?

Peter Evensen: It's just that there's a little bit more volatility in our cash flows; and as you put in place, for example, the Piranema, which I said we're going to get $22 million, $23 million in cash flow, we're hoping to be able to increase that. You just have to bed down the amount of volatility in cash flows. We've also have had more volatility in our shuttle tanker fleet over the past, so we're trying to make sure that we are sure about the different volatility of the cash flows.

On the shuttle side, I'm very pleased that we were able to reduce the operating costs, which we've had extraordinary cost inflation there. So, I think Management and the Board just want to make sure that we have bent the cost curve on the shuttle tanker fleet.

Marc Minikes: Okay. Fair enough. So really then – so, going toward, though, an aspiration is mid- to-high single digits for distribution growth target?

Peter Evensen: That's right, Marc.

Ron Londe: Okay, great. This is just a longer-term question. Given all of the recent offshore activity in West Africa and a similar geology to Brazil, any potential there for you longer-term to extend your franchise to that market?

Peter Evensen: Well, of course, we're following what's going on in Angola, and it's very exciting to see the drilling results from Maersk and Cobalt, but it's way too early for FPSOs. Of course, we have some LNGs in our sister partnership that is operating out of Angola. So, we have connections down there, but it's way too early.

I think we're more excited about the possibility of FPSOs in Norway, where I think they have the infrastructure built up, and they have much more sense of the seismic that you'll see concrete FPSO opportunities. They've just started the drilling there. So they're not – so I would say, they're at least five years away and probably even a little more.

Marc Minikes: Okay, great. Thank you very much.

Operator: Thank you. And our next question Martin Roher of MSR Capital Management. Please go ahead.

Martin Roher: Peter, I have a question – what is the economic advantage these days of converting some of your old tankers into floating storage vessels? I have some numbers from years ago before you had the inflation we've seen in construction. But how does it look today? What are the advantages that it gives Teekay Offshore?

Peter Evensen: The advantage is that if we – basically, some of our ships that we've written down now, they're basically selling just about at scrap. So, if we can find a way to extend them, we get much more life. As I said, the Falcon Spirit, we would have scrapped, but that one we were able to get an eight-year floating storage contract for.

So, what we're trying to do is move these ships that were in the North Sea or in other harsh weather places to more benign environments, where they can be there, as I affectionately call them, as floating bathtubs. And, when you look at the opportunities in places like Thailand and Cambodia and Vietnam, those are prime centers that we can put in floating storage units.

Martin Roher: What's the approximate cost to convert those older ships versus what a new one would cost if you went out and ordered it?

Peter Evensen: Well, the answer is, that you have a real advantage because the storage part of the floating storage unit is already there at a written down value; whereas if you tried to construct it with new steel, it would cost you two times, three times more, measured up against the steel. So, the amount of top side equipment would be the same. It's just that you start with a better or a cheaper raw material, being the steel price.

And so, the engine isn't a requirement, but one thing that you do get is that with the older ships, if you purpose-built a new floating storage unit, you would probably tow it – and the towage costs right now are very high – rather than put in a new engine room. Whereas what we do is – you basically use the engine that you had as a tanker, which it allows you to place it as a floating storage unit, and then you basically mothball the engine.

Martin Roher: Interesting. Look, congratulations again on the job and that terrific acquisition of Sevan Marine that you accomplished. Impressive.

Peter Evensen: Thank you very much, Martin.

Operator: Thank you. Ladies and gentlemen, once again if you would like to ask a question, please press star then one on your touchtone phones.

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

Peter Evensen: All right. Thank you very much for listening. We look toward to reporting back to you next quarter.

Operator: Thank you. Ladies and gentlemen, this does conclude your conference call for today. We thank you for your participation. You may now disconnect your lines, and have a great day.

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