TEEKAY OFFSHORE PARTNERS LP

Moderator: Kent Alekson
August 12, 2011
12:00 pm CT

Operator: Welcome to Teekay Offshore Partners second 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 1 to register for a question. For assistance during the call, please press star 0 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, sir.

Kent Alekson: 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 second 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 second 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, Kent. Good afternoon everyone and thank you for joining us on our second quarter investor conference call.

I'm joined today by Teekay Corporation's CFO Vince Lok, and MOP 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 second quarter of $42.6 million, up approximately 52% from $28.1 million generated a year ago. This large increase is primarily due to completion of the acquisition of the remaining 49% of Teekay Offshore Operating LP, or OPCO, from our sponsored Teekay Corporation in March of this year.

We declared and have today paid the second quarter distribution of $0.50 per unit, which was raised (5.3%), or $0.025 cents in the first quarter.

As previously announced, in June, we entered into a new shuttle tanker contract in Brazil with a subsidiary of BG, which will be serviced by four newbuilding shuttle tankers. These vessels, which will be constructed by Samsung Heavy Industries in Korea will cost approximately $480 million, and are scheduled to deliver in mid- to late-2013.

Upon their delivery, they will be time chartered out for an initial period of 10 years. BG will also have certain time charter extension and vessel purchase options. This is the first time the partnership has directly ordered newbuildings instead of relying upon Teekay Parent to warehouse the assets during the pre-delivery period.

Importantly, the financing costs associated with these newbuildings, whether with debt or equity, will not impact the partnership's distributable cash flow during the construction period since such costs will be considered part of the capital costs of the vessel.

In July, we raised $20 million via an equity private placement, which was used to partially fund some of the upfront shipyard installment payments on this project. And similar to last quarter, we've seen a pick-up in activity in the FPSO space, as evidenced by the recent award of a contract with BG to provide a new FPSO for the Knarr Field in the North Sea, as I'll talk about later. And we continue to see strong shuttle tanker demand, as new offshore projects come online in the North Sea and Brazil.

Turning to slide number four, we take a look at the developments in the FPSO business. The world's ongoing search for new sources of oil to satisfy growing global demand, coupled with Brent Crude Oil prices well above $80 per barrel, have led to a high level of FPSO tender activity during the first half of 2011. In total, 10 new FPSO contracts have been awarded since the start of the year, comprising a mix of new vessel orders, conversions, and the redeployment of existing units.

We anticipate that the high level of FPSO tendering activity is going to continue, and during the second half of 2011, with a further five new contract awards to eight new contract awards expected by the end of this year.

Looking further ahead, there are currently 123 visible offshore projects around the world, which potentially require an FPSO solution, around 50% of which are located in Teekay Offshore's core geographical regions of the North Sea and Brazil.

Of the 123 visible projects, we estimate that around 70% will proceed to development using an FPSO, with the remaining projects either failing to materialize or going ahead, but using a different development solution. This leaves around 85 FPSO projects which will have to be tendered over the next 5 years, or around 17 contract awards per year.

Given the relatively small number of companies who are able to bid on these projects, we believe that Teekay Offshore is well positioned to take advantage of the opportunities that are emerging in the FPSO sector over the next few years.

As I noted at the start of the call, Teekay Corporation's business development activities have begun to yield results, which we expect to benefit the partnership through future accretive acquisition opportunities. This includes the recent award of a new long-term FPSO contract, with a subsidiary of BG Group to service the Knarr oil and gas field in the Norwegian sector of the North Sea.

As was first announced at the end of June, this contract will include a firm period of either 6 years or 10 years, with options to extend for a total period of 20 years. The contract will be serviced by a FPSO with a capital cost of $1 billion, which will be constructed by Samsung Heavy Industries, and is expected to deliver in the first quarter of 2014. BG has until the end of 2012 to determine which firm period option it prefers.

Teekay is also engaged in FPSO business development activities in Brazil and is reviewing a number of new project opportunities with our new Brazilian joint venture partner, Odebrecht. We believe the joint venture has the potential to accelerate our growth in Brazil.

As part of the joint venture agreement, Odebrecht has taken a 50% interest in Teekay's Tiro Sidon FPSO project, which is scheduled to begin operating under a fixed rate contract, with Petrobras by mid-2012. Tendering activity in the FPSO space remains high and Teekay continues to bid selectively on additional new FPSO projects, as well as reviewing FPSO acquisition opportunities.

On slide number five, we provide an overview of the current outlook and recent activities in our shuttle tanker business. We see a lot of growth opportunities for shuttle tankers based on the high level of new offshore oil production, which is due to come online over the next few years. In the North Sea, we anticipate a steady requirement for shuttle tankers going forward, as production from new oil fields and the use of enhanced oil recovery techniques at existing fields offsets the decline for maturing oil fields.

New discoveries continue to be made in the North Sea, as shown by Statoil's recent announcement of the 200 million to 400 million barrel find off Stavanger in one of the most heavily explored areas of the North Sea. While recent discoveries further north in the Barents Sea bodes well for future developments which plays to Teekay Offshore's strengths in harsh weather environments. In Brazil, we know the requirement for new shuttle tankers will grow as new offshore oil production is brought online in the coming years, particularly from the giant pre-salt fields of the Santos Basin.

With Petrobras already having covered much of its upcoming shuttle tanker requirement through recent tenders, we anticipate that the majority of this demand will come from international oil companies and we anticipate that these companies will require up to 10 additional units over the next few years.

As the offshore industry develops, new opportunities are emerging that could result in the employment of older shuttle tankers in the offshore wind sector. Older shuttle tankers may also be candidates for conversions to floating storage units. And we've recently seen an uptick in our own shuttle tanker activity.

As I mentioned earlier, we were awarded the four newbuildings from BG and we recently took delivery of the Peary Spirit, which is the third of our Explorer class shuttle tanker newbuildings, which will serve under a contract with Statoil.

Teekay has been exploring business development opportunities in some of these emerging areas of the offshore industry, where they may be able to leverage our maritime expertise in dynamic positioning systems, as well as operations in harsh weather environments.

In June, Teekay Corporation announced it had entered into an agreement with A2SEA, a leading service provider to the offshore wind sector, to jointly develop an innovative design for a converted shuttle tanker vessel that can be employed in the installation and maintenance of offshore wind foundations. Although in the preliminary stages of design, such vessels could ultimately lead to new areas of business for our older shuttle tankers.

Turning to slide number six, I will review the Partnership's consolidated operating results for the quarter, comparing an adjusted second quarter income statement to an adjusted first quarter 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 $5.1 million, given lower contract of affreightment, or CoA, days. Lower contract of affreightment days are linked to reduced production from oil fields, which we see during seasonally slower maintenance periods.

Other items in the second quarter include the Basker Spirit being off-hire for most of the quarter subsequent to its redelivery from a contract at the end of the first quarter, the sale of the Karratha Spirit floating storage unit in the first quarter, and two vessels in drydock during the second quarter compared to only one vessel last quarter. Vessel operating expenses decreased by $1.5

million. The decrease was mainly due to the savings from the Basker Spirit and Karratha Spirit and lower operating costs on the Rio Das Ostras FPSO, given its heavier maintenance schedule in the first quarter when the vessel was in the yard undergoing upgrade work.

Partially offset by higher maintenance work coinciding with two shuttle drydockings we had this quarter and an increase in crew wages in the second quarter. Time charter hire expense decreased by $2.1 million due to reduced demand for contract of affreightment tonnage, consistent with the seasonally higher field maintenance period.

Depreciation and amortization, general and administrative expenses, and net interest expense remained relative constant with the previous period. Income tax recovery decreased by $3.3 million due to a tax recovery on the sale of the Karratha Spirit in the first quarter and increased taxes on the FPSOs.

Turning to slide seven, I won't walk through all of this because it was included in our earnings release. However, I would like to highlight the information in the box at the bottom of the slide.

As mentioned on our last earnings call, during the second quarter, we experienced a full quarter's worth of cash flow from our 49% acquisition in OPCO, and as a result, our coverage ratio has rebounded to a healthy 1.25 times.

On slide number eight, we presented our financial position at the end of June. We finished the quarter with strong liquidity at approximately $294 million. It's early in the process, but we've already received indicative financing proposals from banks interested in financing our four newbuilding shuttle tankers and we'll update you on subsequent earnings calls as this financing progresses.

And lastly, as the graph at the bottom of the slide shows, we have a good repayment profile with minimum payments due through 2013 and we're comfortable with being able to refinance the amount due in 2013.

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, press star 1 on your touchtone phone. To withdraw your question, press the pound sign. If you use a speakerphone, lift your handset before entering your request. We'll pause for a moment to assemble the queue.

Your first question comes from Darren Horowitz of Raymond James. Please go ahead.

Darren Horowitz: Peter, how do you think about shuttle tanker attrition relative to new capacity coming online over the next couple of years, just on a net basis as you think about the fleet?

Peter Evensen: Well, we have several vessels which are going – which will go into – become 20 years old. What I think is interesting is our ability to be able to move those to more benign waters, like Brazil. All indications that we have are that we will be able to move them down and therefore, they will have a longer life so we won't have to look at conversions to floating storage units or possibly windfarms.

Darren Horowitz: For the market as a whole, Peter, how do you think on a net basis as it grows over the next 3 years to 5 years?

Peter Evensen: I think we'll see net unit growth. We probably have about two vessels or three vessels reaching 20 years of age all the time, and so you are losing about 5% of the fleet every year and, but I would say that you'll have net growth because of the tremendous growth that's coming off the volumes in Brazil mostly.

Darren Horowitz: Based on the projects slate, how many more shuttles do you think is going to be necessary to meet North Sea demand?

Peter Evensen: I would say you're probably looking at a net need of two shuttles more per year.

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 Roher of MSR Capital Market. Please go ahead.

Martin Roher: Thank you. My question regards the $1 billion project that the Teekay Parent announced it is building for the Knarr field. I realize it's going to remain in the Parent Company during this construction phase, but if you're willing to discuss it, why is there different shorter periods available for the customer? And if they go the full 20 years you mentioned in the press release, are there any escalators in there for Teekay?

Peter Evensen: Yes. Hi, Marty.

Martin Roher: Hi.

Peter Evensen: So the first point is that BG has asked to be able to vary the charter period between 6 years and 10 years because they are still defining the production profile on the field. And so what oil companies try to do is, is they will pay us basically if they only take it for 6 years, they will pay us the same amount of money that we would have been paid over 10 years, so there's a present valuing going into it. But they want to gauge the amount because the field will produce more at the beginning rather than at the end, and they don't know the whole production profile. They wanted either an accelerated payment or a more relaxed payment over 10 years. And then there's options for them to be able to extend it, as we said, up to 20 years. And there are operating escalators built into it, because we're operating in the Norwegian sector of the North Sea, we've had to scale it because Norwegian Kroner costs will be more than U.S. Dollar costs.

Martin Roher: But from Teekay's perspective, if it was extended for the 20-year shorter period, does the profitability remain flat for the whole period, beyond the initial period?

Peter Evensen: That's something that has to be taken into – so obviously we either have to, if it goes off Charter at 10 years, we have to look for other employment in the Norwegian sector of the North Sea. So you have to compare it to an unknown, which is what would it get in 10 years? In general, we give an advantage to people if they are willing to take it for 20 years, but the net present value doesn't really change very much, to be honest with you.

Martin Roher: I see.

Peter Evensen: And so we hope that they take it for 20 years and we fully expect when they – with our look at the reservoir, that they would take it beyond 10 years.

Martin Roher: Are there any other, or …

Peter Evensen: That's a function of oil price as well as you know.

Martin Roher: Are there many opportunities for $1 billion project like this? In the old days, that was a lot of money for one vessel.

Peter Evensen: Yes, but actually there are. In the North Sea, we're seeing a lot of smaller fields, small compared to Brazil, but you're talking about anywhere from 100 million to the recent Statoil's 200 million to 400 million. And that's actually really good for a leased contractor, because then they only want the FPSO for 4 years or 6 years or 8 years. And so it actually sets it up very well for us.

One of the strengths we have is that we're the biggest operator in the Norwegian sector of the North Sea. And really, an FPSO has to be purpose-built for Norway. It's very hard to convert one that's, say, been in the UK sector or Brazil is near impossible, given the different specs that you have to operate on the Norwegian sector of the North Sea. So it's actually pretty good that we are the biggest operator on the North Sea. And because these fields are so small, they want a lease solution rather than to own it themselves.

Martin Roher: Thank you. And thanks again for doing the four conference calls in two days. I realize it's a lot of work but it's very informative. Appreciate it.

Peter Evensen: Well, thanks for tuning in.

Operator: Thank you. Once again, ladies and gentlemen, if you do have a question, please press star 1 at this time. There are no further questions at this time.

Peter Evensen: Okay. Thank you very much, and we made a lot of progress this quarter and we look forward to reporting to you next quarter. Thank you.

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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