TEEKAY OFFSHORE PARTNERS LP

Moderator: Alana Duffy
February 25, 2011
12:00 pm CT

Operator: Welcome to the Teekay Offshore Partner's fourth quarter and fiscal 2010 earnings results conference call.

During the call, all participants will be in a listen-only mode. And afterwards, you will be invited to participate in the 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 pres star 0 on your touch-tone phone. And 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 Partner's Chief Executive Officer. Please go ahead.

(Ken): Before Mr. Evensen begins, I would like to direct all participants to our Web site at www.teekayoffshore.com where you will find the copy of the fourth quarter and fiscal 2010 earnings presentation.

Mr. Evensen will review this call – 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 materially differ from those in the forward-looking statements is contained in the fourth quarter and fiscal 2010 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 (Ken). Good afternoon everyone and thank you very much for joining us on our fourth quarter and fiscal 2010 investor conference call. I'm joined today by Teekay Corporation CFO, Vince Lok; and MLP controller, David Wong.

On slide number 1 of the presentation, you will see a picture of the FPSO Varg, which is operating in the North Sea and is chartered out to tell us man energy on the Varg field. Turning now to slide number 3 of the presentation, you can – which you can find on our Web site at teekayoffshore.com; we generated distributable cash flow in the fourth quarter of $26.9 million up approximately 30% from the 20.8 million generated last quarter. We declared and pay the 47-1/2 cent distribution for the fourth quarter.

We finished the year with a strong liquidity position in excess of $550 million, which was helped by the $175 million follow-on offering completed in December of last year. Our liquidity was also bolstered by the proceeds received from our first ever bond offering. We raised the equivalent of approximately $98.5 million in the Norwegian bond market at attractive terms, and it matures in November of 2013.

We hope to be able to continue to access this bond market going forward, which will provide the partnership with another source of capital to fund our growth. In February of this year, we received an offer from Teekay Corporation to acquire the remaining 49% of Teekay Offshore LP or OPCO that we don't already own. This transaction is currently being reviewed by our conflicts committee, which is made up of our three independent directors.

And their job is to – is to determine if the price is fair and reasonable. The board will then meet to discuss the transaction. And if approved, I anticipate we will make in an announcement in early March.

Turning now to slide number 4, 2010 was a positive year for the partnership. In April 2010, we increased the distribution by 5.3% to 47-1/2 cents per quarter or a $1.90 per annum. We acquired the floating storage unit Falcon Spirit, which is on a long-term charter with Occidental Petroleum in Qatar.

In August, we signed a number of shuttle tanker contract. The most important of which is the amended shuttle tanker contract with Statoil, which converted a number of our volume-dependent contracts of affreightment to time charters on initially seven shuttle tankers. In October of 2010, we acquired our second FPSO, which is on a 7-year charter Petrojarl Varg in Brazil.

And we acquired or agreed to acquire three new building shuttle tankers. Each of which will serve on long-term charter to Statoil. The first two were acquired in the fourth quarter of 2010 and the third, the Peary Spirit will be acquired in July 2011.

I believe looking at the coverage ratio is a good method of summing up the financial impact of all of these transactions. We finished the year with a healthy coverage ratio of 1.09 times for 2010 including the new units issued in connection with the $175 million follow-on offering completed in last December. We raised approximately $400 million from the three follow-on offerings. And our units are up 46% over the last 12 months. And we paid a $1.90 per unit in distributions. So, all in all, 2010 was a good year for our partnership.

Looking ahead to our priorities for 2011 on slide number 5, if recommended by the conflicts committee and approved by the board, our first priority will be to close on the acquisition of the remaining 49% of OPCO. Secondly, we will deliver the Cidade de Rio das Ostras FPSO from the shipyard in Brazil where it's currently undergoing scheduled upgrades and will go on the Aruana field in the Santos basin in offshore Brazil. Importantly, when the unit is delivered to the new field, we will receive a slight increase in revenues on the FPSO unit according to the terms of the charter contract.

And as previously mentioned we plan on taking delivery of the Peary Spirit new building shuttle tanker concurrent with the commencement of its time charter contract in July of this year. We have a few shuttle tankers operating on shorter term or contract of affreightment contract types that are up for renewal in 2011. And due to a tight supply/demand for shuttle tankers and a robust offshore oil environment, we expect these contracts to be renewed at rates closely approximating their current time charter rates.

The FPOS Petrojarl Varg is operating on a very high uptime, which we need to maintain. And I anticipate this year; we will work with customers to maximize the production of the Varg fields including possibly tying in some other nearby fields. We plan to pursue value-added projects similar in size and scope to the Falcon Spirit floating storage project that I spoke about earlier has a potential longer term use of some of our older tonnage.

With high oil prices and strong fundamentals in the offshore oil production space, we see increasing opportunity to extend the life of our settles and/or conventional ships by turning them into floating storage units. And we will pursue new shuttle tanker projects in our core markets of the North Sea and Brazil to either extend existing contracts, sign new contract of affreightment contracts for our existing fleet or possibly for the new ships including the new buildings, Scotia Spirit, which is currently under construction and owned by our sponsor, Teekay Corporation.

Turning to slide number 6, in addition to the 49% of OPCO, Teekay corporation has several other offshore assets that will be offered to us, which includes three existing FPSOs and operation, the Cidade de Rio de Itajai, which is scheduled to deliver in the second quarter of 2012 from the conversion yard and the Scotia Spirit new building shuttle tanker wants its chartered on a minimum 3-year contract.

Teekay Corporation is also currently bidding on a number of other FPOS projects that would be suitable for Teekay Offshore to acquire. We believe this multiyear built-in growth sets Teekay Offshore apart from other company. Slide number 7 gives a brief snapshot of the FPSO market as we see it looking at the competitive landscape of the FPSO market.

At present, there are 158 FPSO projects under construction including approximately 70 in Teekay's core regions of the North Sea and Brazil. In Brazil's state-owned oil company, Petrobras along with international oil companies continue to make giant discoveries in the subsalt regions off the coast. And that's going to generate significant demand for both FPSOs and shuttle tankers for many years to come.

Not all of the FPSO opportunities fit our sweet spot of engineering and operating skills, but many do. In the North Sea, high oil prices have stimulated a new round of offshore oil exploration with fields that were previously deemed too marginal or uneconomic to develop. These are now being opened up with higher oil prices estimates.

These two will create significant demand for offshore production unit and shuttle tankers, particularly for the harsh weather units where Teekay has a strong competitive operating advantage. In addition to an increase in project activity, the offshore market has also undergone some consolidation in the last couple of years, which has helped our competitive position. Many of the small startup companies, which had speculatively ordered FPSOs in anticipation of winning future contracts have gone.

Leaving a relatively small number of experienced FPSO operators who are able to successfully compete on project tenders. As a result, customers are much more focused on awarding tenders to operators with a proven track record of operational and financial excellence. And in this regard, Teekay is extremely well positioned.

The finite number of qualified bidders compared to the number of project tenders is also resulting in higher returns on FPSO projects compared to the recent past. And these are in the reigns of 11 to 14% unlevered return on invested capital. Turning to slide number 8, I will review our consolidated operating results for the quarter.

In order to present the results on a comparative basis we've shown in adjusted fourth quarter income statement against an adjusted third 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 increase $31 million given the full quarter of the new Statoil master agreement, which includes the operation of the new Amundsen Spirit for the full quarter and the new Nansen Spirit for 20 days.

There was an increase from conventional tankers as a result of fewer vessels being in dry dock in the fourth quarter. In the FPSO segment, earnings improved from the Varg due to vessel undergoing extensive repairs in the third quarter and returning to normal operations in the fourth quarter, as well as the acquisition of the Cidade de Rio das Ostras FPSO in October. Vessel operating expenses increased 15.5 million in the fourth quarter relative to the third quarter.

Excluding the operating cost associated with the new vessels, the Amundsen Spirit, the Nansen Spirit and the Cidade de Rio das Ostras FPSO; vessel operating cost increased by $6 million.

This increase relates mainly to unexpected repair cost relating to certain shuttle tankers, the delayed completion of seasonal repair and maintenance activities on certain of our shuttle tankers and the expenses for the subsea inspection of one of our floating storage units. These are all set by reduced vessel operating cost on the Varg FPSO given its heavy maintenance in the third quarter.

Depreciation expense increased by $6.6 million mainly due to the three-vessel acquisitions during the fourth quarter. And general and administrative expense increased by 1.2 million, primarily related to the Cidade de Rio das Ostras acquisition. Net interest expense increased by $4 million – excuse me – primarily due to the Norwegian bond and interest from associated debt related to the three acquired vessels.

Teekay Offshore had a tax recovery of $2.3 million in their fourth quarter, a decrease of 2 million from the third quarter, mainly due to increased tax expense on the Varg given the higher earnings on this vessel compared to the prior quarter. On slide number 9, we have presented our financial position at the end of the year. We finished the year as I said before with strong liquidity of over $550 million.

However, we expect this to decline by 175 million to just under 400 million if the board approves the acquisition of 49% of Teekay Offshore operating LP. 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 to 2013.

We're close to assigning a term sheet for the $14 million balloon payment due this year. And the balloon payment due in 2013 is the new unsecured bond, which will look to extend closer to the day. Finally, turning to slide number 10, our business objective that has been in place since our IPO in 2006 is still intact and drives management sections. We will continue to execute on the series of strategies.

All of which are focused on increasing distributions per unit. We will look to expand our operations in high-growth regions like Brazil and the new Niche oil fields that are being developed for production in the North Sea. We will pursue FPSO opportunities that are arising whether from our sponsor or from external parties.

And we will look to acquire additional assets only if they're on long-term fixed-rate contracts. That is to say we will not be ordering ship speculatively. And lastly, we will continue to provide superior customer service by maintaining a high level of operational expertise with the focus on safety.

Operator, I am now available to take questions.

Operator: Perfect; ladies and gentlemen, if you would like to ask a question, please press star 1 on your touch-tone phone. To withdraw your question, press the pound sign. And if you are using a speakerphone, please lift your handset before answering your request. Please standby for the first question.

Our first question comes from Darren Horowitz with – oh, my apologies, with Raymond James. Please go ahead.

Darren Horowitz: Peter, within the Brazilian shuttle tanker market, how much vessel demand do you expect from either Petrobras or the international company say over the next 6 to 12 months in order to accommodate that expected production ramp looking for to year two.

Peter Evensen: If you're talking about how much shuttle tanker demand we see, we see that there are opportunities for three to five shuttle tankers that are going to be needed down in Brazil. If you look at FPSOs, that's a longer timeframe. In other words, you will be tendering and looking at specific projects and those – and those FPSOs would come in, in 2 to 4 years from now.

Darren Horowitz: Okay. For the shuttles in particular, where do you see shuttle demand can grow beyond 2012? Specifically, do you think it's possible that Petrobras demand for shuttles could double where it is currently?

Peter Evensen: Yes, I certainly do especially as they are doubling. They have plans to double production.

Daren Horowitz: Okay.

Peter Evensen: They're investigating building some in Brazil. But we think they will put more priority on building more offshore units like drilling rigs. And therefore, they will continue to rely upon shuttle tankers built outside Brazil rather than inside Brazil.

Daren Horowitz: Final question for me, within the fragmented FPSO market of small players as you detailed on slide 7, how many of those vessels across those 15 or so small companies haven't secured contracts and i.e. vessels that you view as in the forefront for acquisition opportunity?

Peter Evensen: Several of those that you see in the green on the bottom left, which are in the order book don't have contracts. And so, those are opportunities. But we aren't going to buy units where we cannot contract them.

For example, our sponsor who has the Terastodon award, which must be offered to us when it's completed. That was originally ordered by a smaller player who then defaulted and we went to the yard, got a cont – got an option to pick it up. But then we went and got a contract on it. So, we're not going to buy units in the anticipation of contract. And then, we go get an option or get an understanding. And then, we go get a contract for it.

And only then do we hit the button.

Daren Horowitz: Clear enough. Thank you.

Peter Evensen: Thank you.

Operator: Thank you. Our next question comes from Ron Londe with Wells Fargo. Please go ahead.

Ron Londe: Thank you. You are talking earlier about re-contracting of certain shuttle tankers that come off contract in 2011, can you give us more information there how many tankers, what kind of percentage increase might see from those re-contracting of shuttle tankers?

Peter Evensen: Hi, Ron. We're actually in the middle of contracting some of those – re-contracting some of those. And so, for competitive reasons, I don't really want to get into what percentage we would see. But we are confident that we will do the same or an improvement on about three to five contracts – three to five contracts.

Ron Londe: Okay. And then …

Peter Evensen: It depends a little bit on whether they stay on their existing contract or move to other opportunities such as Darren was asking about in Brazil.

Ron Londe: Okay. All right, thank you.

Operator: Thank you. Ladies and gentlemen, as a reminder if you would like to ask a question, please press star 1 on your touch-tone phone. Our next question comes from Martin Roher with MSR Capital Management. Please go ahead.

Martin Roher: Thank you. Regarding the 49% of OPCO that you should about to acquire, is it premature to disclose whether it will be accrued or diluted on a per share basis?

Peter Evensen: Hi, Marty.

Martin Roher: Hi, Peter.

Peter Evensen: All of our transactions when we buy them are creative. We don't do deals that we don't expect our creative to what we're doing. We think the 49% of OPCO, you will recall when we floated the company, we floated it with 26% of OPCO because it was such a big fleet. And so, this will complete what we had started over 5 years ago with buying OPCO. And I think that will help inventors by seeing that. You know it will simplify the financials as they see it.

And then, they can see that we have and own the whole shuttle tanker franchise, which is the biggest shuttle tanker franchise that we have. So, expect it to be in a creative transaction.

Martin Roher: Terrific. Thank you and good luck.

Peter Evensen: Thank you.

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

Peter Evensen: Okay. Thank you all very much. We planned to have quarterly calls this year because we've received feedback from investors that they want to hear more from us. So, we look forward to speaking with you next quarter. Thank you very much.

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

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