



TEEKAY

TEEKAY OFFSHORE PARTNERS LP
Moderator: Peter Evensen
08-08-14/11:00 am CT
Confirmation # 9278679
Page 1

TEEKAY OFFSHORE PARTNERS LP

Moderator: Peter Evensen
August 12, 2014
11:00 am CT

Operator: Welcome to Teekay Offshore Partners Second Quarter 2014 Earnings Results Conference

Call. During the call all participants will be in a listen-only mode. Afterwards you will be invited in a question and answer session. At that time if you have a question, participants will be asked to press star 1 to register for a question. For assistance during the call please press star 0 on your touch-tone phone. As a reminder, this call is being recorded.

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

Ryan: Before Mr. Evensen begins I'd like to direct all participants to our Website at

www.teekayoffshore.com, where you'll find a copy of the second quarter 2014 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 2014 earnings release and earnings presentation available on our Website.

I'll now turn the call over to Mr. Evensen to begin.

Peter Evensen: Thank you, Ryan. Good afternoon, everyone, and thank you for joining us on our second quarter 2014 investor conference call. I'm joined today by Teekay Corporation's CFO, Vince Lok; Chief Strategy Officer, Kenneth Hvid; and MLP Controller, David Wong.

During our call today, I'll be walking through the earnings presentation, which can be found on our Website.

Starting on slide number 3 of the presentation, I'll briefly review some of Teekay Offshore's recent highlights. The partnership generated distributable cash flow of \$40.1 million in the second quarter, down 7% from the same period of the prior year. The reduction in the partnership's cash flow during the quarter is due to a combination of temporary operational issues and cash flow timing differences related to certain of our offshore contracts.

While these matters have now been largely resolved, on a full-quarter basis, the effective fixed-rate contracts would have generated an additional \$8 million of distributable cash flow during the quarter. This would have resulted in distributable cash flow of \$48.1 million in the second quarter for an increase of 12% from the same period of prior year.

For the second quarter of 2014, the partnership declared and paid a cash distribution of \$0.5384 per unit. This past week, we completed the acquisition of Logitel Offshore, marking our entry into the growing global offshore floating accommodation market, providing further diversification through a complementary new channel for accretive growth.

Our initial investment will be approximately \$600 million, which includes three new floating accommodation units. However, we believe the transaction could lead to a \$1 billion plus business segment for Teekay Offshore.

In July, the conversion of the Salamander FSO was completed, and the unit left the shipyard for its field in Thailand. Following field installation and testing, the unit is expected to commence a 10-year charter contract with Salamander Energy in August.

In addition, our innovative Remora HiLoad export solution, the first offtake unit of its kind, is currently completing operational testing in Brazil, and is also expected to commence its full charter hire payment during the third quarter, but with retroactive effect to April 11.

Finally, our 50/50 joint venture with Brazil-based Odebrecht Oil & Gas was recently nominated by Petrobras as the leading commercial bidder for the Libra FPSO project in Brazil, subject to final contract negotiations.

The FPSO unit will service the Libra pre-salt oilfield in the Santos Basin, and is expected to commence operations into early 2017 following completion of the FPSO conversion project. This will be the second FPSO project for our joint venture with Odebrecht.

Turning to slide number 4. I'll provide an overview of our recent acquisition of Logitel Offshore. Just this past week, we completed the acquisition of Logitel, an offshore floating accommodation company affiliated with Sevan Marine, which included two newbuilding floating accommodation units currently under construction at the COSCO Shipyard in China.

In addition, we separately exercised one of Logitel's existing six options with COSCO to order an additional floating accommodation unit. Each of the Logitel units is based on Sevan's patented cylindrical hull design and will be equipped with dynamic positioning capabilities.

A three-year charter contract, not including extension options, has already been secured with Petrobras in Brazil for the first newbuilding, which is scheduled to deliver in the first quarter of 2015. We're currently bidding on charter contracts for the second newbuilding and expect to

secure contracts for both the second and third units prior to their scheduled deliveries in the fourth quarter of 2015 and the third quarter of 2016, respectively.

The Sevan cylindrical hull provides customers with an attractive and reliable low-cost solution that offers increased deck space, better stability and greater storage compared to other available floating accommodation alternatives. We believe that the floating accommodation market provides an attractive new channel of accretive growth and is a strong complement to Teekay Offshore's existing business segments.

Turning to slide number 5. I'll spend a moment to provide a brief overview of the strong fundamentals we see in the floating accommodation market. Demand for floating accommodation is already high and is expected to increase further in the coming years. This is particularly true in Brazil and the North Sea, where demand is expected to double between now and 2018.

In Brazil, the hookup of new offshore production unit and maintenance of aging offshore installations are the primary drivers for future floating accommodation demand. Accommodation units with dynamic positioning capabilities are particularly well-suited for the Brazil offshore market as the large number of ship-shaped FPSOs that require servicing will benefit from floating accommodation with DP capability.

The DP capability enables maximum uptime for the gangway between the FPSO and the floating accommodation unit as the FPSO turns or weathervanes around the turn. As the number of FPSOs installed to offshore Brazil increases in the coming years, particularly from the pre-salt regions, we expect that future demand for floating accommodation will grow.

In the North Sea, there's a growing shortage of high-end accommodation units which are capable of operating in harsh weather conditions. While jack-ups are well suited at low water depth, in deeper water, only DP semisubmersible and cylindrical units can operate year-round.

The majority of offshore installations in the North Sea were built in the 1970s and '80s, and are now approaching or have passed their original design life. However, due to enhanced oil recovery techniques, many of these installations are undergoing life extension maintenance and modifications, and this has created additional demand for floating accommodation units.

The North Sea is also expected to see new floating accommodation demand for hookup work on new developments, as well as for decommissioning of old platforms.

In addition to floating accommodation unit demand for new units, in the coming years, there will also be a requirement to replace an aging fleet of existing units. The average age of the semisubmersible accommodation fleet is 28 years, and many of the older units are approaching the end of their operational life and will need replacing.

As shown in the chart at the bottom of the slide, the supply-demand outlook for floating accommodation units appears to be finely balanced, and should result in the continuation of high fleet utilization and rates.

Turning to slide number 6. I want to provide an update of the Salamander FSO conversion project. In early July, we completed the conversion of an older shuttle tanker into an FSO unit for Salamander Energy, and the unit arrived on the Bualuang Field in the Gulf of Thailand in mid-July.

The charter with Salamander Energy will extend the operational life of the 1993 built shuttle tanker, the Navion Clipper, by at least 10 years and possibly longer if contract extension options are exercised. The unit is currently undergoing field installation and operational testing and is expected to commence its charter in August, after which time, the unit is expected to earn annual cash flow from vessel operations, or CFVO, of approximately \$7 million.

Turning to slide number 7 I'll provide an update on our Remora HiLoad DP unit. Operational testing of this innovative offshore loading technology has been successful to date, and the unit has already completed six floatings from an offshore unit to a conventional tanker.

We have provided a couple of photos of the HiLoad test loading operations at the bottom of the slide, and we currently expect the operational testing to be completed during the third quarter, at which time the unit is expected to commence its 10-year contract with Petrobras in Brazil retroactive to April 11.

Following commencements of its contract, the unit is expected to earn annual cash flow from vessel operations, or CFVO, of approximately \$13 million.

Turning to slide number 8, I will briefly update you on the Knarr FPSO project. Since Teekay Corporation took delivery in late June, the unit has been in transit to the North Sea. Following field installation and testing, the unit is expected to commence a 10-year charter with BG in the latter part of the fourth quarter, at which point the unit will be eligible to be acquired by Teekay Offshore.

Although the fourth quarter of 2014 continues to be the expected time frame for commencement of the charter contract, this timing is subject to the receipt of Norwegian regulatory approvals, along with favorable weather conditions on the journey from South Korea and during subsequent field installation and offshore testing.

Turning to slide number 9, I'll review our consolidated results for the quarter, comparing the adjusted income statement for the second quarter of 2014 to an adjusted income statement for the first quarter of 2014, both of which exclude the items listed in Appendix A of the earnings release.

Starting at the top of the income statement. Net revenues decreased by \$10.6 million, primarily due to lower utilization and higher repair days in the shuttle tanker fleet, lower production from the Voyager FPSO, the scheduled dry docking of the Dampier Spirit FSO associated with the 10-year extension of its time charter out contract and reduced rates on the extended Pattani Spirit FSO contract, partially offset by an increase in earnings on the Piranema Spirit FSO related to the produced water treatment plant startup during the second quarter.

Vessel operating expenses decreased by \$1 million, mainly due to lower repair and maintenance cost on the shuttle tankers and a decrease in crewing expenses on the FPSO and FSO units, partially offset by an increase related to the HiLoad unit commencing operations in mid-April.

As I noted a moment ago, we will commence recording revenue retroactive to mid-April once operational testing has been completed on the HiLoad unit, which is expected later in the third quarter.

Time charter hire expenses decreased by \$6.4 million, primarily as a result of the redelivery in the first quarter of onetime charter end shuttle tanker, a decrease in spot end chartering and the dry docking of two time chartering vessels during the second quarter.

Depreciation and amortization expense was consistent with the prior quarter. General and administrative expense increased by \$2.3 million, primarily due to higher business development costs related to FPSO tenders, including the Libra FPSO project, as well as costs associated with the acquisition of ALP.

Net interest expense increased by \$2.6 million, primarily due to interest expense on the \$300 million, 6% unsecured bonds we issued during the second quarter, and a full quarter of interest expense on the Norwegian kroner bonds we issued during the first quarter.

Equity income decreased by \$300,000, primarily due to annual incentive-related revenues recognized in the first quarter on the Itajai FPSO. And finally, income tax expense decreased by \$1.1 million, primarily due to lower taxes from our Norwegian and Brazilian entities.

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 \$40.1 million in distributable cash flow, which when compared to our total distribution payout, resulted in a relatively low coverage ratio of 0.79 times for the second quarter.

However, as shown at the bottom of the table, if we adjust for the temporary operational issues related to the Voyageur Spirit FPSO and the unscheduled off-hire of one of their Brazilian shuttle tankers, as well as the cash flow timing difference related to the HiLoad unit, the Dampier Spirit FSO and the Piranema water treatment plant, our coverage ratio would have been 0.95 times. And with the resolution of these issues, we expect the partnership's coverage ratio to return to a level closer to one times in the third quarter.

Turning to slide number 11, in addition to the robust pipeline of accretive Teekay Offshore organic growth projects, which we'll deliver over the next few years, the partnership also has a number of drop-down growth opportunities available from our sponsor.

This includes up to five FPSO units, which must be offered to the partnership once they're operating under eligible fixed-rate contracts. The largest and most near-term drop-down is, of course, the Knarr FPSO, and it remains on track for field installation and startup in the fourth quarter of 2014. We expect to receive an offer to acquire a portion of the Knarr FPSO later this year.

Before we turn the call over to questions, I would like to turn your attention to slide number 12, which provides some key information regarding Teekay group's 2014 Investor Day, which is scheduled for the morning of Tuesday, September 30.

The event will take place at the St. Regis hotel in New York, at which time we will provide a detailed presentation on Teekay Offshore's strategy, financial position and market outlook. The event will be webcast live for all interested investors, and we encourage everyone to mark this date in their calendars and look forward to presenting and meeting with all current and prospective investors.

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

Operator: Thank you. Ladies and gentlemen, if you'd like to ask a question please press star 1 on your touch-tone phone. If you are using a speakerphone please pick up the handset before pressing any keys. Once again if you would like to ask a question please press star 1. One moment please, for your first question. And your first question comes from the line of Darren Horowitz from Raymond James. Please go ahead.

Darren Horowitz: Good morning, Peter. Hope you're doing well.

Peter Evensen: I am, Darren. Thank you.

Darren Horowitz: Sure. I had a few questions for you, the first, if I could refer back to slide 5 regarding your outlook for the floating accommodation market. I'm just curious. How confident are you in the magnitude of adjusted supply that you think will get scrapped?

And are you concerned at all if there's any slippage in the amount of that capacity that possibly could get scrapped if that could have a pretty meaningful detrimental impact on either duration of contractor associated margin with regard to some of those new units getting put to work?

Peter Evensen: I'm not concerned because those units -- if you think about these floating accommodations, it's a lot like the hotel business. You have to regularly refurbish them, and people want newer units rather than older units.

And that's before you get to the aspect of the fact that our units have dynamic positioning, as well as they'll have better deck load capacity, as well as gear. So the question really becomes, do people want low-cost units? And because we have workers on board, the tendency is to want to have the newer units because they have greater efficiency. So there's a real efficiency change here that's taking place.

And what you have to remember is some of the earlier floating accommodation, they were moored up and they tended to be on the field for quite a while.

And now, particularly when you're talking about Petrobras, they -- when you're on an existing field with a lot of subsea work, they don't want to moor them. And therefore, even if they're cheaper, it exposes you to a different risk profile if one of the anchors should move or disturb the subsea. And as I talked about in the prepared remarks, particularly for FPSOs you want a gangway that will give you an uptime all the time.

So the stability of the newer units compared to the older units means that you don't have to pull the gangway as often. So that's another way of saying that the workers can continue to work and return to the floating accommodation unit. So that's why I'm confident.

Darren Horowitz: Do you have a sense, when you think about the economics around some of the newbuild accommodation units, do you have a sense on an unlevered IRR basis what some of the new units could command just on an absolute basis, and also the difference between how much more of a premium the new units could get relative to (some) of the older units?

Peter Evensen: Well, we'll be disclosing more of that at Investor Day, particularly the initial contract that we have with Petrobras. But I can tell you that we really like the market because even adjusting for utilization, we see mid-teens unlevered IRRs on this business. So it's a higher business, it's a higher return business than what we have but that's for a combination of reasons.

One, because of the Sevan unit, we think we have low-cost units relative to the competition. And then when you look at the market, you have to actually look at which units are designed in different locations.

For example, if you're in the North Sea, people want single rooms. If you're down in Brazil, they don't demand single rooms. You can go with double rooms. So there's a whole raft of capabilities that go into what is going on or what the rate structure is the -- not just what the total bed capacity is.

The other part that I would say is that the market that we're going after is more of a fixed rate term market of six months to up to five years. And what we also like about the floating accommodation market is because of the planning that goes in here, we can build a forward book.

And so for our partnership, we are not only interested in high returns. We're interested in being able to have stability in our revenues, so the ability to book employment one or two years out is what is attractive to our partnership and why we've decided to go into this market, which has the same customers, the same sort of manning that we have on our shuttle tankers or our FPSOs.

Darren Horowitz: Fair enough, I appreciate the color. Last question, just shifting over to the Knarr, has anything changed with regard to the expected unlevered rate of return there or is it still fair to assume that it should be about 12% to 14% on kind of an average basis?

Peter Evensen: Yeah, nothing has really changed. I would gear you down to the lower number, but I think it's more important just to think about the enterprise value, the EBITDA because we're getting to the point where we're looking at the cash. So the unit costs about \$1 billion, and it'll generate \$130 million to \$140 million of EBITDA. We get paid for utilization. So that's quite favorable.

And then when, of course, when you figure the unlevered IRR, you have to figure out how long it will last and various equipment that we have on. But we're very happy with that multiple that we get on that unit.

Darren Horowitz: Okay. And just from a...

(Crosstalk)

Peter Evensen: So that's about an enterprise value EBITDA of 7 times, and that's pretty favorable cash-on-cash.

Darren Horowitz: Yeah, that was going to be my final question. Just thinking about, you know, clearing your cost of capital, looking at cash-on-cash returns, is it fair to assume that somewhere around 11 or 11.5 times -- or excuse me, 11% or 11.5% would be about the lowest unlevered rate of return that you would accept for an FPO -- FPSO project, of course, based on similar type duration?

Peter Evensen: I'm not going to get caught out because competitors read the transcripts of these calls.

We always try to maximize the amount we get. Let me just say that.

Darren Horowitz: Okay. I think that's fair enough. Thanks, Peter, I appreciate it. Have a good weekend.

Peter Evensen: Thank you.

Operator: Once again ladies and gentlemen, if you would like to ask a question please press star 1 on your touch-tone phone. And your next question comes from the line of Michael Webber of Wells Fargo. Please go ahead.

Michael Webber: Hey good morning, guys. How are you?

Peter Evensen: Fine.

Michael Webber: We'll try this again. I apologize. I've got a bad connection. If I drop off, just assume I had a handful of very salient and profound questions for you. The -- I wanted to go back to the Brazilian potential FPSO with Odebrecht. And forgive me if you guys have given it somewhere that I haven't seen, but can we get a vague sense in terms of capital outlay and where that conversion would actually take place?

Peter Evensen: Sure. We're not going to give any specifics on it until we finalize it.

Michael Webber: Sure.

Peter Evensen: But it will be a conversion of an existing Teekay shuttle tanker. And we will convert it in Asia and also meet the Brazilian local content requirements that we have on that unit. And it'll be

an early well test unit and it'll have a 12-year charter. So it'll be able to move around. And that sets up, I think, well with our capabilities.

We already have some early well test units down there. And so when we finalize, we'll give greater financial data. But we're very happy with the expected returns, in line with the questions Darren had.

Michael Webber: Got you. No, the detail there is very helpful. And just along those lines, specifically with FPSO, do you think there are potentially some ancillary opportunity there in terms of shuttles or specifically FAUs or for that FPSO in general? Or is it -- are we getting a bit ahead of ourselves to think about that?

Peter Evensen: No. Well, first of all, yeah, they will bid a shuttle contract off of that. And I think that the interesting question will be -- but it isn't related to that. When we think about shuttle exports, we think about the doubling of Brazilian oil production. So whether it comes out of Petrobras or BG or some of the other partners that are down in Brazil, we see an abundance of shuttle opportunities, as well as opportunities for Remora.

And then in our other companies, we ultimately see good opportunities on the conventional side. So -- but on the floating accommodation, on an early well test unit, you don't need floating accommodation. It has enough accommodation by itself.

Michael Webber: Got you, okay. That's helpful. I wanted to shift briefly to the existing park line at Teekay, which is still pretty robust. You know, one, just wanted to get a sense of how things are shaping up maybe post-Knarr, who -- what might be the next drop-down in 2015, whether it's the Banff coming back online or maybe the Hummingbird, I would imagine?

And then specifically around the Hummingbird, if that asset needs to move to a different field and would need upgrade work, do you think that's something that would be handled directly at Teekay or is that going to be done at the TOO level?

Peter Evensen: I think that -- well, yesterday, on the Teekay Corporation call, I said that when the contract on the Banff, which is now back up and operating, which I'm happy to say, that will get much better by itself on January 2015. And because it's been off station for 30 months, we expect it to stay 30, at least 30 months longer. So then that will be eligible for drop-down in around January 2015.

And the Hummingbird, we actually think it'll probably stay on the existing field. We're having discussions with the existing partner. And -- or sorry, with the existing charter, Centrica. And if it does stay on the field, we would probably do the upgrade work on the field and -- which is consistent with life extension work.

And we already know what's required on that. And that way, we would continue to keep pumping. And that's the name of the game, if you will.

Michael Webber: Okay.

Peter Evensen: And so those are the ones we have. And ultimately, when we finish all this conversation on Petrojarl Foinaven with BP, the charterer, where we've addressed the operational issues, then we intend to drop that one down as well.

Michael Webber: Got you. Okay, that's really helpful.

Peter Evensen: So all in all, we have a plan to drop down the assets in the next two years.

Michael Webber: No, that's very helpful. And then just one more, and I'll turn it over. Specifically, around the FAUs and I know you talked a bit about them, but I don't remember this specifically, but can you talk a little bit about the cost advantage you guys have with this one triple design relative to some of the other competitors in the market and how that might help you guys, even in maybe a more competitive environment, that I think you need to build that business?

Peter Evensen: We think that because -- I won't get too specific for competitor reasons, but we have seen the contracts that some of our competitors have put in for their semisubmersibles. And we know we have a cheaper price. Obviously, we -- that those are the ones we're competing against.

And we like as well our ability to operate in places like Brazil as we have scale efficiencies going forward. So -- but it isn't just the capital investment. It's also the total service offering that you give. And so we realize we're the newcomer coming out and -- but because we have -- we're doing business with existing customers.

We think we can have that positive leverage effect of extending the Teekay franchise, which new people don't always have. So it's operating advantages as well as capital advantages. But the other thing is people like the Sevan design.

Michael Webber: Got you. Okay.

Peter Evensen: And I'm sure Kenneth will talk more about it at Investor Day, but it has various other efficiencies like good energy usage and things like that. So it's the operating costs including the fuel.

Michael Webber: Great. Well good I will follow up at the Investor Day. Thanks for the time, guys, I appreciate it.

Peter Evensen: Thank you.

Operator: Ladies and gentlemen, if you have any additional questions at this time please press star 1 on your touch-tone phone. And your next question comes from the line of Matthew Phillips of Clarkson. Please go ahead.

Matthew Phillips: Good afternoon, guys.

Peter Evensen: Hi.

Matthew Phillips: Just a follow-up on the floatels. I mean, is Brazil the primary market for the Sevan designs over the North Sea? And related to that, going forward, is there the potential for Brazilian ((inaudible)) laws to come into to play here potentially?

Because I know they've tried this with the drilling units before and, you know, those are obviously much higher technical spec. You know, could they potentially -- domestic shipyards compete more on the floatels. And is that something you see as a risk for the two newbuildings?

Peter Evensen: No, we don't see that as a risk because Petrobras has a critical need for these. So they are -- so they don't have the time to develop a local market for it. And so that isn't falling under the local content rules because they're not going to be there forever. When you have an FPSO, they are more interested in the local content because that's seen as part of the permanent infrastructure.

So that's why we haven't seen those rules necessarily for shuttle tankers, supply boats or for floating accommodation units because you're not there permanently.

Matthew Phillips: Okay, that makes sense. And do you think the North Sea will be a key market for these designs? I mean, I know that the DP spec is useful for the harsh weather environment, but clearly, Brazil seems to be the major growth area in general for this sort of assets.

Peter Evensen: Yes, I think that they -- yes, I think they will. And I didn't mention it, but we think Mexico is also -- well, we know Mexico is a great area as well. When you think about all that development that's going to come out with Mexico, or hopefully will come with Mexico, that'll be a big area as well. And so that's what we're seeing. Those are the, I would say, the three big regions that we see.

Matthew Phillips: Okay great. Thank you.

Operator: Gentlemen, there are no further questions at this time. I would like to hand the call back over to our speakers for closing remarks.

Peter Evensen: All right. Thank you all very much for listening today, and we look forward to giving you much greater detail at Investor Day. Thank you.

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.

END