TEEKAY OFFSHORE PARTNERS LP

Moderator: Peter Evensen
May 18, 2012
10:00 am CT

Operator: Welcome to the Teekay Offshore Partners' First Quarter 2012 Earnings Results conference call.

During the call, all participants will be in a listen-only mode. Afterward, you will be invited to participate in a question-and-answer session. At that time, if you have a question, participants will be asked to press star one to register for a question.

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

As a reminder this call is being recorded.

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

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 first quarter 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 first quarter of 2012 earnings release, and earnings presentation available on our website.

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

Peter Evensen: Thank you, Dave. Good morning everyone and thank you for joining us on our first quarter 2012 investor call.

I'm joined today by Teekay Corporation's CFO, Vince Lok; its Chief Strategy Officer Kenneth Hvid; and MLP Controller, David Wong.

We will try to keep this call short, as we reported our fourth quarter 2011 results less than 12 weeks ago, and we will be giving you a comprehensive presentation in mid-June at our bi-annual investor event, which I will detail on the last slide of today's presentation.

Turning to slide number three of the presentation, I will briefly review some recent highlights from Teekay Offshore. We generated distributable cash flow in the first quarter of $42.4 million, up approximately 45 percent from the $29.2 million generated in the same quarter one year ago. This large increase is primarily due to the acquisition from our sponsor of the remaining 49 percent of Teekay Offshore Operating LP, or OPCO, in March of last year, and our direct acquisition of the Piranema Spirit FPSO from Sevan on November 30, 2011.

In addition, through active management of our shuttle tanker fleet, we were able to reduce our vessel operating and time-charter higher expenses. With our increased distributable cash flow resulting from the acquisition of the Piranema Sprit FPSO, we increased the first quarter distribution by 2.5 percent to 0.5125 cents per unit, which was paid to unit holders on May 14.

As I highlighted last quarter, Teekay Offshore is a relatively strong financial position, with over $435 million of liquidity in the form of cash and undrawn revolving credit facility. In January of this year, we successfully completed another unsecured Norwegian bond. This five-year, non-amortizing $100 million bond bears a fixed interest rate of 7.5 percent.

We also completed a $130 million, five-year commercial bank financing of the Piranema Spirit FPSO during the first quarter. We believe this strong level of liquidity positions us well to take advantage of further growth opportunities in the near future.

On slide number four, I will review the current outlook for the FPSO market.

Looking at the charts at the top of the slide, the latest projections from the International Maritime Association, or IMA, shows that the number of FPSO projects in the planning stage has doubled in the last five years, from a projection of 68 units in the planning stage in 2006, to over 141 today. And this outlook is consistent with what we have seen to date in 2012, looking at the chart in the upper right. Over the past four months, we've already seen 10 FPSOs ordered, compared to the longer-term average of 15 per year.

As a result, the IMA has updated its annual FPSO outlook from a low of 20 orders per year, to a high case of almost 30 expected orders per year over the next five years. We're very encouraged by this trend, and have already been experiencing a high level of tender inquiry in our two key areas of North Sea and Brazil. The three FPSOs owned directly by Teekay Offshore Partners, which consists of two units operating in Brazil, and one operating in the North Sea, have performed as expected over the past quarter, with an average production up-time of over 97.5 percent throughout the quarter.

Our sponsor, Teekay Corporation's FPSO business, has remained active, with Teekay's three large FPSO upgrade and new building projects proceeding toward first oil. The Tiro & Sidon FPSO and Voyageur FPSO are both on track to commence production on their respective fields in Brazil and the North Sea in the fourth quarter.

The Knarr FPSO project, which is scheduled to begin operating under its contract with BG in the North Sea in early 2014, is also proceeding on time and on budget. Teekay has been actively pursuing new business, and is currently involved in several front end engineering and design studies. This type of work builds on our project capabilities, and places Teekay in a strong position to win future work when these projects go out for tender for construction.

As a reminder, pursuant to the omnibus agreement in place between Teekay Corporation and Teekay Offshore Partners, Teekay is obligated to offer us its interest in certain shuttle tankers, FSOs, and FPSO units that Teekay owns or may acquire in the future, provided the vessels are servicing contracts with remaining durations of greater than three years. Turning to slide number five, in addition to our FPSO related business, we are also experiencing strong activity in our shuttle and floating storage and off-take, or FSO segments.

This work is mostly related to highly specialized units in the North Sea, and the more harsh weather Barents Sea area. With our experience as a top tier operator in the Norwegian and North Seas, we're perfectly situated to help our customers, as they look to produce in the harsh weather Barents Sea on fields such as Statoil's, Skrugard, and NE's Goliat field. Getting new business is really a matter of meeting our return parameters, as we've seen strong competition from customers willing to accept lower rates.

And while we're encouraged by the promising developments in our North Sea shuttle business, our other core shuttle tanker market in Brazil is also expected to heat up later this year.

Looking at the graph in the upper right, with the offshore production fleet in Brazil expected to increase from less than 60 unit this year to over 125 by 2018, the demand for shuttle tankers required to service these offshore production units is expected to increase, as well. I'm happy to report that we've began steel cutting on the first two of the four shuttle tanker new buildings at Samsung shipyard that will go on contract with BG in Brazil.

These vessels are on schedule to deliver during calendar year 2013. We also continue to experience a steady stream of contract extensions in our existing shuttle business. Over the past few months, we successfully extended two contracts, one in Brazil, and one in the North Sea, for 12 and 24 months, respectively.

Finally, with the strong pace of developments in the Barents Sea, we've also seen the pace of project tendering activity for that region pick up, and we expect this will ultimately lead to additional shuttle business in an area where we already have the strongest shuttle tanker operation.

On slide number six, I will review our consolidated operating results for the quarter, comparing an adjusted Q1 2012 income statement with an adjusted Q4 2011 income statement, which excludes the items listed in Appendix A of our first quarter and earnings release, and re-allocates realized gains and losses from derivatives to their respective income statement line items. Net revenues increased by $3 million, primarily as the result of a full quarter's contribution from the Piranema Spirit FPSO, partially offset by a decrease in product revenues from the shuttle fleet, and a decrease resulting from the expiry of two conventional time-charter contracts in the fourth quarter.

Vessel operating expenses increased by $1.8 million, mainly from a full quarter's costs for the Piranema Spirit FPSO, partially offset by lower crewing costs relating to our other two FPSOs, and timing of maintenance work in the shuttle fleet. Time-charter hire expenses decreased by

$3.8 million, mainly due to the re-delivery of the Akarita vessel in Q4, and less spot-in chartering from utilizing the capacity of our own fleet.

Depreciation expense increased $1.4 million, mainly due to the change in the estimate of the useful lives of six of our older shuttle tankers, and a full quarter's depreciation expense on the Piranema Spirit FPSO, partially offset by decreases resulting from the vessel write-downs taken last quarter.

General and administrative expense increased by $3.2 million, primarily from a full quarter expense for the Piranema Spirit FPSO, and an increase in management fees from higher business development costs related to or FSO tenders.

Continuing down the income statement, net interest expense, including realized losses on interest-rate swaps, increased by $1.5 million, mainly due to the bond we issued in January, and the new term loan on the Piranema Spirit. Income tax expense decreased by approximately $3 million, mainly due to timing differences.

Looking at the bottom line, adjusted net income increased to $26.1 million in the first quarter of 2012 from $22.3 million in the previous quarter. I won't walk through all of slide number seven, 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 $42.4 million in distributable cash flow, which, when compared to our total destitution payout, resulted in a solid coverage ratio of 1.09 times for the first quarter.

On slide number eight, we've present our financial position at the end of March 2012. As previously mentioned, we finished the quarter with liquidity of over $435 million, and we have no refinancing requirements in 2012, and we are in the process of securing a new debt facility to finance the remaining installment payments relating to our four BG shuttle tanker new buildings, which are delivering in 2013. In addition, work has begun on refinancing plans for the upcoming 2013 and 2014 debt maturities.

As I mentioned at the beginning of the call, slide number nine include details of our upcoming investor event to be held in New York City on Monday, June 18 of the Waldorf Astoria. If you are unable to make it to join us in person, the presentation will be web cast from www.teekayoffshore.com.

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

Peter Evensen: Operator? Operator?

Operator: I'm sorry about that. Thank you. Ladies and gentlemen, if you'd like to ask a question, press star one on your touch-tone phone. To withdraw your question, press the pound sign. If you use a speakerphone, lift your handset before entering your request. We will pause for a moment to assemble the queue.

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

Edward Rowe: Good morning.

Peter Evensen: Good morning.

Edward Rowe: In regards to the two recently renewed shuttle tankers, could you share with us the rates? Were they higher or lower than expected for these vessels?

Peter Evensen: They were slightly higher than what we already had.

Edward Rowe: Okay. All right. And in terms of shuttle tankers that are up for renewal in the North Sea and Brazil markets in the second half, do you know how many vessels are up for renewal?

Peter Evensen: In Brazil?

Edward Rowe: Yes. For the second half of 2012?

Peter Evensen: Vince, do you have that?

Vince Lok: It's really limited, actually. We just extended Torinita, but the Marita is on until 2013. So really, there isn't any other ones that are coming up for renewal.

Edward Rowe: Okay. All right. And last question. In terms of some of the financial obligations and contractual commitments you kind of talked about, so we have the $114 million balloon payment, and around $323 million from the BG new builds, and some incremental from the revolvers. In terms of the future drop-downs that may occur in 2013 or late 2012, how are you guys looking to refinance this really large obligation that's going to hit in '13?

Peter Evensen: Well, first we don't have a large obligation in 2013. As the slide says, it is only $100 million.

Edward Rowe: Okay.

Peter Evensen: So we could easily issue another bond, for example, for that. But what we're waiting for is that some of those charters that those loans cure on, we'll be able to refinance those out. So as the options that customers have on some of those units are extended, then we extend the financing. And so we're relatively comfortable as it relates to that.

As it relates to BG, the shuttle tankers, we're well on our way to putting in place financing on those, and since they have minimum 10-year contracts with BG in Brazil, we were really waiting to figure out which ones were going to go on Brazilian flag, and which ones were going to be on foreign flag, as that influences which banks we would have finance it. And so we've recently known which ones will be on Brazilian flag, so now, we can go ahead and complete the financing. But the real payment isn't due to the yard until 2013 at delivery.

Edward Rowe: At delivery, okay. All right. Thank you.

Peter Evensen: Thank you.

Operator: Thank you. The next question comes from Chris Tombe from JPMorgan.

Chris Tombe: Yes. Hello. I just have a very general question about the FPSO market. In light of volatility with global oil prices, at which level or threshold do you become concerned about the economics that would support much of the order book in the FPSO space?

Peter Evensen: I would become concerned if we see oil prices – and I look at Brent, because that is what our guys are – or how our customers are concerned with. If that was dipping into the $70s, then I think you might find some impact on the development plans going forward. But at present, it isn't there, as you know, on a Brent basis. People look at WTI in the U.S., but we very much concentrate on Brent because of the North Sea and Brazil. So the volatility that we've seen right now hasn't changed the development plans that we've seen from our customers.

Chris Tombe: Okay, that's clear. And with respect to the drop-down candidates, you provided some color and update today. Can you give us a bit more detail in terms of potential contributions to the distributable cash, and what the overall drop-down price might look like? Or a range at least?

Peter Evensen: I think we'll give more of that at our investor day presentation. We'll give more of that on what the effect would be of the drop-downs. But we are very much geared toward the partnership being in a position to acquire the new building units that are coming, Tiro Sidon, where Teekay owns 50 percent, as well as the Voyageur.

Chris Tombe: Okay. And the last question, is the Piranema a good benchmark in terms of debt versus equity, likely equity contribution for those future drop-downs?

Peter Evensen: First of all, we did a private placement. So we actually took down the Piranema Spirit with a full equity private placement, and then we subsequently put in place the $130 million term loan for it. So I think going forward, as we do acquisitions, we are aiming closer to doing a 50 percent drawn debt, and 50 percent equity.

Chris Tombe: Okay. Thank you.

Peter Evensen: Thank you.

Operator: Thank you. Ladies and gentlemen, as a reminder, if you would like to ask a question, please press star one on your touch-tone phone.

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

Peter Evensen: All right. Thank you very much, and we look forward to seeing you at investor day, if possible. Otherwise, we will report back on the second quarter. Thanks very much.

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

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