TEEKAY LNG

TEEKAY LNG PARTNERS LP

Moderator: Emily Yee
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Operator: Welcome to Teekay LNG 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 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 *0 on your touch-tone phones.

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 LNG Partner's Chief Executive Officer. Please go ahead Mr. Evensen.

Ryan: Before Mr. Evensen begins, I'd like to direct all participants to our Web site at www.teekaylng.com, where you will 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 Web site. I now turn the call over to Mr. Evensen to begin.

Peter Evensen: Good morning 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, 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 Web site.

Turning to Slide number 3 of the presentation, I'll review some recent highlights. For the second quarter of 2014, the partnership generated distributable cash flow of $61.5 million, up 11% from the same quarter of the prior year. The year over year increase is mainly due to the acquisition and fixed rate charter back of two LNG carriers from a Wilco LNG in late 2013 and higher earnings for the partnership's EXMAR LPG joint venture. Partially offset by the sale of two 2000 build conventional tankers in December 2013 and February 2014 respectively.

For the second part of 2014, the partnership declared and paid a cash distribution of 69.18 cents per unit, consistent with the product border. In June and July, the partnership finalized two significant transactions that will contribute to the partnership's future distributable cash flow program. In early July, Teekay LNG -- through our new 50/50 joint venture with China LNG Shipping -- finalized agreements to provide six icebreaker LNG carriers for the Yamal LNG project.

Through our new joint venture, Teekay LNG will invest just over $1 billion to construct these new building LNG carriers. Prior to this, in late June, the partnership acquired from BG Group ownership interest in four 174,000 cubic-meter LNG carrier newbuildings, which will each operate under long-term chargers with BG. Through this acquisition, Teekay LNG will invest approximately $250 million to construct these new building LNG carriers.

Marking a milestone in the partnership's LPG fleet renewal and growth strategy, in April and June, EXMAR LPG joint venture took delivery of the first 2 of 12 mid-size LPG carrier newbuildings, delivering into the fleet over the next four years. The joint venture also sold two of its older LPG carriers and recorded a $9.8 million gain on the sale based on Teekay LNG'g 50% interest, which is not included in our distributable cash flow.

Turning to Slide number 4, I'll take a moment to provide some details on the recent finalized agreement to provide six LNG carriers for the Yamal LNG project located in Northern Russia. The ownership of these new building vessels will be through our new 50/50 joint venture between Teekay LNG Partners and China LNG Shipping. The Yamal LNG project is an international joint venture, consisting of Novatek, Total and China National Petroleum Corporation.

The project -- which is scheduled to start up in early 2018 -- will consist of three LNG trains capable of generating a combined 16.5 million metric tons of LNG ((inaudible)). LNG from the new liquefaction facilities will be transported primarily to Europe and Asia and nearly all of the expected LNG production has already been agreed to be purchased by affiliates of the Yamal LNG project sponsors and other third parties.

The project is expected to have a low break-even gas price, making it more competitive relative to other global liquefaction projects. Our joint venture will provide six 172,000 cubic-meter ARC-6 ice class LNG carrier newbuildings, which will be constructed by Daewoo Shipbuilding in South Korea for totally fully built up cost of approximately $2.1 billion. Teekay LNG's 50% portion of this investment would be just over $1 billion.

The vessels are scheduled to deliver between the first quarter of 2018 and the first quarter of 2020 and each will operate under charter contracts until December 31st, 2045, not including extension options following their respective deliveries.

The shipbuilding contracts include a tail-heavy payment profile with a majority of the funds due upon delivery. The partnership has already funded its equity portion of the first installment payments of $95 million with proceeds from the recent $141 million equity offering, which we completed in July 2014. And the next shipyard installment payments won't occur until 2016 on the first new building and later for the next newbuildings.

The Yamal LNG project will also require a number of a conventional LNG carriers, which we will also have the opportunity to bid on later this year in a new tender.

Turning to Slide number 5, I'll provide further details of our recent acquisition of ownership interest in the four LNG carrier newbuildings from BG Group. Almost two years ago, our sponsor at Teekay Corporation secured a contract with BG to provide construction supervision and technical management services for these four LNG carrier newbuildings. Subsequently, in late June 2014, the partnership agreed to acquire BG Group's ownership interest in these four newbuildings.

Through this transaction, Teekay LNG acquired 30% interest in the first two LNG carrier newbuildings and then a 20% interest in the second two LNG carrier newbuildings. The vessels will be constructed by Hudong Shipbuilding in China for an aggregate fully-built up cost of approximately $1 billion, for which Teekay LNG's investment bridge net 25% ownership interest is expected to total approximately $250 million.

The vessels are scheduled to deliver between September 2017 and January 2019 and each will operate under 20-year contracts, not including extension options with BG. With this acquisition and the Yamal LNG project, we have further broadened our diversified LNG customer base with two new and important customers in the LNG space. We're particularly pleased to leverage the Teekay Group's existing relationship with BG in the offshore business to now add BG as a strategic customer in our LNG business.

Finally, through both transactions, Teekay LNG has developed new strategic relationships with China base partners, which has been a strategic focus for a number of years.

On Slide number 6, we've updated our forward fixed-rate revenue projections to include our recent growth projects. This slide has been a hallmark of Teekay LNG since the partnership first went public in 2005 and I'm pleased to report it keeps getting stronger. Regardless of the type of the vessel, all of our charter revenues are fee-based in nature and we have no commodity price or volume exposure.

As the table indicated, our LNG franchise is by far the greatest contributor to Teekay LNG's forward revenue portfolio with approximately $10.1 billion of forward revenues with an average remaining contract term of 14 years. This figure is expected to increase when we secure fixed rate charters for our three currently uncommitted ((inaudible)) LNG newbuildings. Our LPG carrier segment has also been growing, primarily through our investment in our 50% LPG joint venture with EXMAR.

Lastly, our conventional tanker segment is expected to contribute an additional $300 million of fixed rate revenues of the next several years, providing complimentary fixed rate cash flows in addition to our core gas fleet. With approximately $11 billion of forward fixed rate revenues, the partnership's existing portfolio long-term fixed rate contracts will provide our unit holders with a strong foundation of stable cash flows for many years to come.

Turning to Slide number 7, I'll focus for a moment on our LPG business and how the partnerships EXMAR LPG joint venture is looking to capitalize on the positive fundamentals in the LPG shipping market. LPG shipping demands typically increased in the summer months when importers restock inventories in advance of the colder fall and winter months. However, LPG shipping rates are particularly strong right now relative to previous periods for all vessel segments of the market.

In addition to seasonal demand, the main factors for stronger rates in the second quarter were steady Middle East to Asia trade and the increasing US exports, driven by the arbitrage between US and Asian LPG prices. Driven by higher activity levels in the Atlantic basin and supported by steady shipments to India, rates for medium-size gas carriers, or MGCs, increased to an average of 890,000 per month, or $29,300 per day in the second quarter, which are the highest average quarterly MGC rates since the first quarter of 2008.

Even with the recent increase, you can see from the graph at the top of the slide that MGC rates that we've experienced far less volatility compared to the very large gas carriers, or VLGCs. This plays well for Teekay LNG as it means our large fleet of jointly owned MGCs should continue to deliver stable cash flows. The LGC spot rates were also at record high levels in the second quarter of 2014 and have increased further in July, partly as a result of the increasing LPG exports from the United States.

To capitalize on the future growth opportunity in the LPG trade, our joint venture with EXMAR continue to grow and renew its fleet with modern times. During the second quarter, the EXMAR LPG joint venture took delivery of two MGCs newbuildings and also sold two older LPG carriers, realizing a capital gain of 19.5 million, of which Teekay LNG's portion was 9.8 million.

Over the next four years, the EXMAR LPG joint venture will add ten more MGC newbuildings to its fleet. Some of these vessels will replace older ((inaudible)), with her is consistent with the joint venture strategy of continuing to provide its customer base with a modern and competitive fleet.

Turning to Slide number 8 now, I will discuss the LNG shipping demand, which is expected to benefit from the development of LNG export projects in the United States. As shown in the table at the top left, there are several US-based projects which have already or are expected to achieve FID in the future. The projects shown in the table here have a combined export capacity of 78 million metric tons per annum. Which, based on Clarkson's estimate of vessel requirements will require over 80 LNG carriers based on the expected total export volume and distances.

Two projects have made a positive final investment decision, including the first four ((inaudible)) being passed, which are already under construction and the Cameron LNG project, which took FID earlier this week. All remaining projects are anticipating an FID decision later in 2014 or 2015. In addition, the Freeport project has recently received its final approval from ((inaudible)).

This demonstrates the ongoing progression of US LNG export projects, which we believe will create significant demand for our current and future fleet of LNG carriers. In particular, our (Meggy) LNG newbuildings are especially attractive to US LNG export projects, given their industry leading fuel efficiency, large capacity, and ability to transit the expanded Panama Canal.

We expect to take delivery of two of our (Meggy) newbuildings in 2016 and three more in 2017. Given our confidence in the (Meggy) design, we anticipate opportunities to add further (Meggy) vessels to support our fleet group. As a reminder, we continue to hold in the money options with DSME to order up to an additional three (Meggy) LNG vessels.

In addition to the US projects shown here, we also see future demand for our vessels outside of the US from export projects in Russia, Australia, Canada, and ultimately, East Africa.

On Slide number 9, I'll review our consolidated results for the quarter compared to the adjusted income statements for the second quarter to the adjusted income statement for the first quarter, which excludes the items listed in Appendix A of our earnings release.

Starting at the top of the income statement, net voids revenues were comparable to the first quarter as a result of higher dry docking last quarter and one vessel being off hire in the first quarter for repairs. Partially offset by the sale of the Al Jazeera's Spirit Suezmax tanker in February and lower revenues earned on the Hamilton and Bermuda spirit as a result of lower second quarter Suezmax ((inaudible)) tanker rates.

Looking ahead to the third quarter, we're expecting a total of 43 off hire days for the scheduled dry docking of one Suezmax tanker and one LNG carrier. Vessel operating expenses were consistent with the prior quarter. Depreciation expense decreased by $600,000 primarily due to the sale of the Suezmax tanker in February 2014. In Q3, the Huelva Spirit Suezmax tanker is expected to be sold during August.

General and administrative expenses were consistent with the prior quarter. Equity income increased by 1.7 million, primarily due to higher BLGC rates earned by the EXMAR LPG joint venture in the second quarter. Partially offset by scheduled dry dockings in the Malt LNG joint venture, also in the second quarter.

Net interest expense increased by $900,000, which was primarily related to a new debt facility related to the acquisition of the second Awilco LNG carrier. Other income and income tax expense was consistent with the prior quarter.

I won't walk through all of Slide number 10, which was included in our recent earnings release. However, I will note a coverage ratio of 1.0 times for the second quarter. This decrease from the first quarter coverage, 1.02 times is primarily due to an increase in our aggregate quarterly distributions as a result of the issuance of approximately 3.1 million common units from the July 2014 public offering. Excluding the impact of the new units, the coverage ratio would have increased to 1.04 times.

On Slide number 10, we've provided an updated snapshot of the partnership's growth pipeline of over $2.5 billion, which now includes the interest in the six icebreaker LNG newbuildings for Yamal and the four LNG carrier newbuildings under long-term charters to BG. These projects further complement our existing pipeline of growth projects which are scheduled to deliver between 2014 and 2018.

In addition to future potential projects which may result from exercising the remaining three options on our (Meggies) and bids for new LNG and FSRU contracts. Based on the strong long-term fundamentals in LNG and LPG shipping, we believe that our new building order book shown on this slide will provide an attractive pipeline of distributable cash flow growth over the next several years.

Before I open up the call to questions, I'd like to turn your attention to Slide number 11, where we've provided some details on Teekay Group's 2014 investor date, which is scheduled for the morning of Tuesday, September 30th. The event will take place at the St. Regis Hotel in New York, where we will provide a detailed presentation for Teekay LNG covering our strategy, financial position and market outlook.

The event will be webcast live for all interested investors. We encourage everyone to mark this date in their calendars and we look forward to presenting and meeting with all current and prospective investors at that tie. Operator, I'm now available to take questions.

Operator: Thank you. Ladies and gentlemen, if you'd like to ask a question, please signal by pressing star 1 on your telephone keypad. If you're using a speakerphone, please make sure that your mute function is turned off to allow your signal to reach our equipment. Again, if you wish to ask a question, please press star 1 on your telephone keypad. We'll pause for a moment to allow everyone an opportunity to signal for a question. Please stand by.

And our first question comes from (Samira Tanjiwane) of Raymond James. Please go ahead. Please go ahead.

(Samira Tanjiwane): Hello?

Peter Evenson: Hello?

(Samira Tanjiwane): Hi, good morning.

Peter Evensen: (Samira)?

(Samira Tanjiwane): Yes. So I think you mentioned this a little earlier in your presentation about the arbitrage opportunity for LPG between the US Gulf Coast, Northwest Europe and even Southeast Asia, so I'm kind of wondering what's your capacity to add additional LPG vessels and specifically ethane carriers given the potential export capacity coming online in the US Gulf Coast?

Peter Evensen: Right, so we have two - so we're talking about two different exports. We're talking about exports of propane and we're talking about exports of ethane. The conventional LPG carriers, including ours, cannot take ethane. That would be taken in smaller ships which are typically ethylene carriers. But they aren't the right size for these longer haul distances so there's going to have to be a new class of ships built for ethane projects and some, for example, Reliance ordered six for their own account just a few weeks ago from Samsung.

We're competing on several tenders, but we haven't been successful and we're competing through our EXMAR LPG joint venture. And we expect the low prices of exports relative to what you have in Europe and Asia to continue to increase those exports and that is a great feed stop for petrochemical plants. And so it will probably steal market share from NAPTA.

(Samira Tanjiwane): Okay, great. So could you provide any guidance on maybe how long it would take to build these vessels for ethane specifically?

Pete Evensen: It will take about two years.

(Samira Tanjiwane): Okay and then I'm kind of turning to the EXMAR JV. You mentioned that it sold a few vessels during the quarter and kind of given your comments on the strategy to maintain and updated fleet, are there any more vessels that the EXMAR JV can sell at the same time while receiving, you know, the vessels that are already in the pipeline for it?

Peter Evensen: Yes, we have a plan to sell our older ships and we're realizing good values on those with the increase in rates, given the fact that we ordered about two years ago at at that time lower rates. So all of our newbuildings are in the money and we're doing very well by selling our older ships, even though they're making good money right now. You have to sell into the strength, as we like to say. So that’s why we’re recording gains and we anticipate selling a few more ships over the next couple of years.

(Samira Tanjiwane): Okay, great. And then turning to the LNG side, do you think there's any variation between the timing and magnitude of liquefaction capacity coming online and the timing of LNG vessel additions based on recent FSRU announcements by competitors?

Peter Evensen: Well in general I would say the answer is yes. But for Teekay LNG, we're sold out on all of our ships until 2017 on our newbuildings. So we have already fixed our 2016. So I think that’s more of a situation for competitors. For example, of the 117 vessels that are on order, about 30 of them don't have contracts. And so that’s something that people are having a problem with in ’14 and ’15 and ’16.

What we anticipate is that when the export projects come on, it will soak up that capacity, but until that time we anticipate low charter rates. The same thing is true on the FSRU side. A lot of people have ordered FSRUs without contracts and so that puts them in a difficult position. The way we're looking at FSRUs is we're working it on a build to suit basis. In other words, we will only order an FSRU with the additional equipment if we have a contract.

(Samira Tanjiwane): Okay, great. Appreciate the color, thank you.

Peter Evensen: Thank you.

Operator: Thank you. We'll move to our next question from Michael Webber of Wells Fargo. Please go ahead.

Michael Webber: Hey, good morning guys, how are you?

Peter Evensen: Fine, how are you Mike?

Michael Webber: Good, good. Peter, wanted to touch briefly on Yamal and I'm sure this is something - or a question you guys have prepped for, but can you help us think about your involvement within this project and the kind of evolving geopolitical risk associated with Russia right now and maybe you can kind of lay out the capital outlays for ((inaudible)) talk that they're not going into service for several years. But just how we should think about that capital outlay and then, you know, how you think about the geopolitical risk associated with that project.

Peter Evensen: Yes. Well first of all, there is a - there is a risk with it. Obviously we have the situation in which the sanctions that have been put against Russia are only on the oil side. Gas was specifically excluded. And in addition, the equipment for the project has already been ordered and so what we have observed is that the sanctions are on equipment and projects going forward, rather than projects that are already, if you will, in the hopper or taking place.

I think the biggest risk is the financing of the project - of both the project and for us, our ability to finance the vessels. For us, as I said in my comments, we've already raised the money for the initial installment. We don't have any more money that is due until 2016, 2017 and I think we'll get a better idea of the timeline of the project at that time. So the biggest question for us is can the project come up with the financing?

And what we have seen and I was around and we've been around talking to the banks is between Russia, Chinese and Korean financing institutions, they have already secured the - I would say probably the bulk of the financing that’s available. So the Western banks, which I would say are hesitant to lend anything that extends to Russia, there isn't much reliance on them. But that’s something that we'll see over the next few months.

The other thing that we like about our six ships is they’re coming later in the project rather than later in the project and so we aren't - if the vessel - if the project is delayed by a year, it doesn’t have a huge effect on our six newbuildings.

Michael Webber: Sure. And I guess when you think about that entire project, you guys and ((inaudible)) are participating in the riskier end of that project with those icebreaking assets an there's a ((inaudible)).

Peter Evensen: Well the project is going ahead. First of all the sponsors have already spent $5 billion. So the project is going ahead and we really like the project because when it comes on stream it will be low priced gas and they need the vessels. Sot the vessels are absolutely critical to the whole project and so - and what they liked about Teekay was our ability to train up crews and operate in the ice conditions that you have several months of the year there.

So we're confident that this is the beginning of Yamal and it isn't just the first three LNG trains. And it's also critical that we've seen, for example, government to government agreements between Russia and China as it relates to this project. So it's part of a bigger geopolitical question but you have to look at it not just from a US point of view, you have to look at it from a European point of view and you also have to look at it from an Asian point of view.

And from an Asian point of view in particular, they want this gas. And so that's what I saw having worked on this project for over two years that there's a real keen sense in Asia that - and especially in China that they want to diversify their source of gas. And that's why you're finding Korean, Japanese, Chinese interest teaming together with Russian interest and now with Teekay in order to make this project happen.

Operator: Thank you. And we'll move to our next question from Fotis Giannakoulis of Morgan Stanley. Please go ahead.

(Fotis Giannakoulis): Yes, good morning. Peter, you mentioned I think earlier that you have contracted all your capacity, your LNG capacity for 2016? I thought that you had a couple of ((inaudible)) vessels that they were coming off in 2015 and '16. I'm talking about the (methane) Spirit and the Magellan Spirit. Have you found the new contracts for these vessels?

Peter Evensen: Sorry, I added the word newbuildings.

Fotis Giannakoulis: Oh...

Peter Evensen: So our newbuildings that are coming in 2016 have been contracted. You are right, we are sold out right now but we have one contract - one LNG contract of which we have 50% that's rolling in 2015 and we have another contract in 2016 of which we have 50% rolling. So you can say we have one open vessel between 2015 and 2016.

Fotis Giannakoulis: Can you give us an update of how the discussions are going, if there is any interest right now for chartering these vessels and how is the situation in the LNG chartering market and when do you expect this situation to change towards the better?

Peter Evensen: Well we are out having discussions with charterers about short-term charters. We're also trying to team those charterers together with some of our (Meggy) projects and putting them together. But I have to be honest with you that short-term rates have been declining for two years and they're at or near $60,000 a day. And with the level of uncommitted ships coming in, we think the best case is that you'll get about $60,000 a day for it. And that's really because there isn't a lot of new gas coming on, certainly not this year and you've had a few setbacks like Angola.

And until we start to see much more gas coming up that soaks up the capacity, I don't think you'll see a turnaround in the charter rates. But that's all right because given the price that we bought our Maersk - the vessels from Maersk, we're comfortable having - being able to charter them at around $60,000 a day

Fotis Giannakoulis: I see that you have three more undeclared options for your (Meggy) newbuildings. Can you tell us when these options expire and if you are considering exercising these options as we move closer to the delivery of the first couple of vessels?

Peter Evensen: Yes, so we have steadily extended those options. I was just out in Korea a month ago and so we're working to extend those options so we can continue the discussions we have with charterers on taking delivery of them with contracts. We know that they are at a preferential rate, but our partnership generally likes not to have too many uncommitted vessels. So hopefully we'll find employment for them in the next few months and then we can declare those options.

But right now we have three open ones and we don't want to have too many open ships. Although the delivery window at which we would get them -- 2017, 2018 -- is very favorable. But that's something that we're - so we're extending the date by which we have to declare those options.

Fotis Giannakoulis: Okay, thank you. Can you give us some guidance about the expenses of the Yamal vessels? I understand that the repairs will be very similar to all these long-term builds, but in order to model it, given the fact that these are special vessels, at what levels will the expenses going to be?

Peter Evensen: We'll be giving more detail on the Yamal economics at our investment day, but the returns are better than what you see in the conventional market.

Fotis Giannakoulis: Okay, that's very helpful. Thank you. And one last question about the LPG market, the market we see is booming at this point, especially for the larger vessels. Shall we expect any considerable difference in the LPG revenue, both on absolute basis but also on a daily basis from the LPG fleet?

Peter Evensen: Well we've been recording much better certainly than our acquisition model. And as I said in my prepared remarks, we're very happy with that. But we're also cognizant of the fact that a lot of VLGCs have been ordered so we're looking to sell some of our older tonnage even though - into that strength given how many VLGCs have been ordered. People are really bullish on it and of course, when the rates are as high as they are at present but when you're not getting your ship until 2016, 2017, it could be a different market.

So really what we see is the LPG market is the mirror opposite of LNG's. In LPG's we see very strong short-term markets but ultimately we think those markets come down given that the order book is 50% in a lot of classes, whereas on the LNG side, we see short-term weakness but long-term strength, as we see a lot more demand coming on in the LNG side in 2017 and beyond.

Fotis Giannakoulis: So - and about the near term, the next couple of quarters, shall we expect any significant change in the income from the partnerships from the equity accounted vessels given this strength of the LPG market?

Peter Evensen: Yes, well I think we'll continue to get strength. We're working on fixing some of our newbuildings that are coming and I'm hopeful that we'll announce more term contracts there and you'll probably see us sell a couple of older ships as well. So net net we're - net net we ordered our newbuildings at a really favorable time so they're very profitable and we're selling our older, depreciated ships and racking up nice gains.

Fotis Giannakoulis: Thank you very much Peter.

Peter Evensen: Thank you, (Fotis).

Operator: Thank you. There are no further questions at this time, please continue.

Peter Evensen: All right. Thank you all very much and we look forward to tuning in for investor day.

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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