TEEKAY OFFSHORE PARTNERS LP

Moderator: Emily Yee
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11:00 am CT

Operator: Welcome to Teekay Offshore Partners 4th Quarter and Fiscal 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 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.

(Scott): Before Mr. Evensen begins, I would like to direct all participants to our Website at www.teekeyoffshore.com where you will find a copy of the 4th Quarter and Fiscal Year 2014 earnings presentation. Mr. Evensen will read 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 as contained in the 4th Quarter and Fiscal Year 2014 earnings release and earnings presentation available on our Website. I will now turn the call over to Mr. Evensen to begin.

Peter Evensen: Thank you (Scott). Good afternoon everyone and thank you for joining on our 4th Quarter 2014 investor conference call. I'm joined today by Teekay Corporation's CFO Vince Lok and MOP Controller David Wong. During our call today, I will be referring to the earnings presentation which can be found on our Website.

Starting on Slide 3 of the presentation, I will briefly review some of Teekay Offshore's recent highlights. The partnership generated distributable cash flow of $50 million in the 4th Quarter and declared a cash distribution consistent with the last quarter at 53.84 cents per unit.

During the quarter TOO continued to secure growth in both its offshore production and offshore logistics businesses. In December our board of directors approved the acquisition of the Knarr FPSO from Teekay Corporation subject to achieving first oil and commencement of the unit's fixed-rate contract which is expected in the 1st Quarter.

With the additional cash flow contribution from the Knarr FPSO, we expect to increase our distribution by 4 to 5% to be paid in the quarter following the purchase of the unit.

In December we also were awarded a new FPSO contract in Brazil and acquired the Petrojarl 1 FPSO from Teekay Corporation which will be upgraded prior to commencing the new contract with a consortium led by QGEP in Brazil during the first half of 2016. I'll talk more about this project in a moment.

In January through our 50/50 joint venture with Odebrecht, we finalized an agreement with Petrobras and its international partners to provide an FPSO conversion for the Libra field in Brazil.

Total capital expenditure for the project will be approximately a billion dollars on 100% basis or just under $500 million for Teekay Offshore's commitment. Upon completion of the conversion project, the unit is expected to commence a 12-year contract in the 1st Quarter of 2017.

Finally in November Teekay Offshore whole-owned subsidiary ALP Maritime agreed to acquire six on-the-water long-distance towing vessels from a consortium of German KG owners for approximately $220 million. I will also touch on this transaction in a moment.

Turning to Slide 4 I will provide an updated status on the Knarr FPSO. The FPSO arrived on its field in the North Sea in early December and during a cooperative weather window around Christmastime, all of the risers were pulled-in and the unit was fully hooked-up.

Also in December our board of directors approved the acquisition of the Knarr FPSO from Teekay Corporation for a fully built-up cost of approximately $1.2 billion subject to the unit achieving first oil and commencing its 10-year charter with BG.

Financing of the acquisition has been agreed and consists of the assumption of the existing $815 million debt facility with the remaining amount to be supplied by our sponsor in the form of a seller's credit and direct issuance of TOO units.

In 2015 to date we've been working hard to achieve first oil and we're confident it will be achieved in the next couple of weeks. After commencement of oil production further tests and achievement of operational milestones must be met before the unit is consider on hire and formally commences its 10-year charter with BG.

Once the Knarr FPSO has been acquired and is operating under its contract, it is expected to contribute approximately $80 million of annual distributable cash flow to Teekay Offshore. With this increase in cash flow we expect to be able to increase the partnership's distribution by 4 to 5% starting in the quarter following the acquisition.

Turning to Slide 5 I'll provide some additional details on a new FPSO project we announced in December. Teekay Offshore's been awarded an FPSO contract with a consortium led by QGEP for an early production system FPSO on the Atlanta field in the Santos basin.

It is estimated that the Atlanta field contains approximately 190 million recoverable barrels and has a production life in excess of 15 years. With the majority of the sub-sea work already completed, the cash breakeven oil price on this field is estimated to be relatively low.

In connection with the FPSO contract award, Teekay Offshore acquired the Petrojarl 1 FPSO unit from Teekay Corporation for $57 million and our partnership agreed to invest an additional $175 million to upgrade the unit.

Once the upgrade is complete, the unit will be deployed on the Atlanta field in the first half of 2016. The upgrades will also extend the useful life of this FPSO for an additional 10 years beyond the initial five-year contract.

Under its contract the FPSO is expected to generate approximately 55 to $60 million of annual cash flow from vessel operations and will be a strong contributor to distribution growth in 2016.

Turning to Slide 6 I'll provide an updated status of the high-low DP unit which has been undergoing testing with Petrobras in Brazil since early 2014. Unfortunately in late December Petrobras informed us they would not accept the unit for their operations because it did not meet certain technical criteria required to commence its time-charter contract.

However we continue to believe in the technology and will keep working with Petrobras to find a commercial solution while also considering other alternatives. For example we're currently working with another major oil company on a feed study for the potential of the high-low to directly export oil from Brazil.

Teekay Offshore has invested $60 million in the high-low DP to date and we're hopeful that we'll be able to secure a commercial opportunity for this innovative offshore technology which saves oil companies money in the export of their oil.

We continue to execute on numerous growth projects including acquisitions and organic growth and on Slide 7 we've highlighted a pair of successes in two of the new adjacent areas of business we entered in 2014 starting at the top of the slide with our acquisition of six on-the-water, long-haul, ocean-towage vessels that we agreed to acquire late last year.

I'm pleased to report that two of the vessels have already been contracted on a 55-day voyage and we're taking delivery of three vessels in the 1st Quarter and the remaining three vessels in the 2nd Quarter and just this week we also took delivery of our first floating accommodation unit, the Arendal Spirit from the Costco shipyard in China.

We expect the Arendal Spirit to be loaded onto a heavy-lift vessel in early March before it begins a dry-tow journey to Brazil where it will commence a three-year contract with Petrobras during the 2nd Quarter of this year.

Turning to Slide 8 given the recent headwinds in the global energy markets and repricing of energy-related stocks, I wanted to spend some time on today's call to reaffirm that Teekay Offshore's business remains both operationally and financially strong.

The cash flows that support our quarterly distributions are underpinned by a broad and well-diversified portfolio of fee-based contracts spread over a base of creditworthy customers which spans a broad spectrum of household names in the global energy industry.

Across our multiple lines of business our current fee-based forward revenue books that stands at approximately $7.8 billion. FPSOs make-up the majority of our forward revenue book at over 60% with an average remaining contract length excluding option periods of six years.

Shuttle tankers comprise our next-largest segment at approximately 30% with an average remaining contract length of approximately four years, again excluding option periods and our FSO's floating accommodation units and conventional tankers collectively make-up just over 10% of our forward revenue book with an average contract length of nearly four years.

Turning to Slide 9, over the past several years we've continued to grow Teekay Offshore's cash flows by adding new accretive projects and effectively managing costs in our operation. Despite the recent volatility in global oil prices, Teekay Offshore's cash flows are expected to remain stable and this is due to several reasons.

First virtually all of our partnership revenues are generated from fee-based contracts with quality counterparties and our contracts have no direct exposure to commodity oil prices. This provides for a very stable and predictable stream of cash flows with minimal variability from period to period.

Second, our assets are almost exclusively focused on the more stable production part of the oil value chain for which operating decisions are considerably less-sensitive to changes in oil price.

In contrast to the exploration part of the oil value chain for which expenditure decisions can be more easily postponed during periods like we have now of lower oil prices, existing production units and their peripheral transportation.

And storage assets including shuttle tankers and FSOs will continue to operate even in a declining or weak oil price environment because the cost of developing the field infrastructure is a sunk cost and the fields are able to produce at a relatively low marginal cost.

In contrast to a drilling rig, production assets such as FPSOs and FSOs are unique with systems and equipment specific to the conditions on the fields they operate on so for our customers production provides critical cash flow even in a low-price environment and they require our assets to continue production.

Finally let's look at our contract portfolio which is large and diversified and that itself gives significant cash flow stability. In any given year with only a small fraction of our contracts up for renewal, it limits our contract rollover risks and limits therefore cash flow variability.

To put this into context approximately 2% of Teekay Offshore's contracted cash flows will come up for renewal in 2015. Turning to Slide 10 and focusing specifically on our FPSO segment, due to the very specific nature of FPSO assets the current oil price environment is not expected to have a material impact on our existing FPSO business.

With a relatively low marginal cost of production on existing fields and given the critical nature of FPSOs within the oil production value chain, the switching costs for operating FPSOs are too high.

Our only near-term rollover is in 2016 and it relates to the Petrojarl Varg which has been stationed on the Varg field in the North Sea since its delivery in 1998. The charterer Talisman which Repsol has recently agreed to buy has a series of three-year options which must be declared 12 months in advance.

Given the stable production of oil and gas on the field as well as new drilling which Talisman took place in last year, we would expect the option to be exercised as was the previous three-year option.

Although the current oil price environment will likely delay new FPSO project tenders, Teekay Offshore was fortunate to book a lot of new business in 2014 which I talked about earlier and this will ensure our growth pipeline is well-stocked for the next several years.

On Slide 11 we've detailed the expected impact of low oil prices on our offshore logistics businesses which encompasses shuttle tankers, floating accommodation units and ocean-towing vessels.

Starting with our shuttle tanker business, all of our 33 shuttle tankers are currently employed on either time charters or contracts of affreightment known as COAs.

Similar to FPSOs our shuttle tankers are crucial to our customers' oil production requirements because if our shuttle tankers don't show-up on the field on time, then the field may be forced to shut down and halt production which is very expensive for oil companies.

Unlike the offshore service vessel or anchor-handling sectors where there's surplus tonnage pressuring rates down, the shuttle tanker fleet is currently enjoying high utilization which helps maintain upward pressure on rates when our shuttle tankers do come-up for renewal.

In addition with a very strong spot tanker market at the moment, if a shuttle tanker were to be put off hire due to a problem at the oilfield, we can trade the ship profitably in the spot tanker market. Looking at Teekay Offshore's fleet in particular our shuttle tanker fleet is almost entirely sold-out for the next few years with very few vessels up for renewal in the short term.

Our first floating accommodation unit has now delivered and our second and third FAUs deliver in late 2015 and 2016 respectively. We do expect some of the potential FAU tenders that we were working on to be delayed.

However, we expect many of them will come to market later this year as expect especially if the field work has already been approved or it is related to necessary regulatory work that cannot be deferred.

So low oil price should lessen the number of new units ordered and could possibly force some older units to scrap bringing the supply demand dynamics of this market back in line. Our first FAU is scheduled to commence its three-year contract during the 2nd Quarter of this year and we’re currently involved with tenders for our second and third unit.

We believe our new high-spec, low-cost units are well-positioned for remote and harsh weather applications because they’re safer and can operate at lower operating costs which give us a competitive advantage over older units.

If however we’re unable to contract these units - the second and third prior to delivery - we have an option with the shipyard to delay the delivery of these units for up to one year. Our long-haul ocean-towage business is comprised of six ships we’re recently acquired which have begun delivering and the four new buildings which come to us in 2016.

Rates have remained relatively constant over the past number of years and we don’t expect 2015 to be significantly different based on continued strong utilization of this small niche fleet.

Our ALP management team is very experienced in this market and they’ve already been marketing and building a book of contracts in advance of the partnership taking delivery of these on-the-water vessels. In fact our first two on-the-water deliveries have already been contracted to tow a drilling rig across the Atlantic Ocean.

Turning to Slide 12 I will review our financial results for the 4th Quarter of 2014 as compared to the 3rd Quarter of 2014. For our reconciliation of distributable cash flow to net income, please refer to Appendix B of our earnings release.

Starting at the top of the statement, net revenues increased by $6.4 million primarily due to an increase in earnings on our FPSO units due to year-end incentive-based revenues, higher utilization in the shuttle tanker fleet, the Suksan Salamander FSO operating for a full quarter and scheduled dry-dockings of the Navion (Taga) and Stena Sarita having taken place in the 3rd Quarter.

Partially offset by the settlement of outstanding claims with the charterer of the Voyageur Spirit in the 3rd Quarter and the unscheduled off-hire of two vessels in our shuttle tanker fleet. Vessel operating expenses decreased by $7.3 million primarily due to lower repair and maintenance costs on the FPSO units.

Time charter expense increased by $500,000 mainly due to an increase in spot-in chartering of shuttle tankers. Maintenance capital expenditures decreased by $700,000 mainly due to the sale of the Navion Norvegia to our 50/50 joint venture with Odebrecht which will convert it to an FPSO unit to serve on the Libra field.

General and administrative expense increased by $6-1/2 million primarily due to the business development fee paid to Teekay Corporation during the 4th Quarter related to the acquisition of the Petrojarl 1 FPSO unit, higher business development costs to support our FPSO tendering activity and a pension valuation adjustment recorded during the 4th Quarter.

Our share of distributable cash flow related to our equity-accounted joint venture net of estimated maintenance capital expenditure reserve is consistent with the prior quarter.

Interest expense including realized losses related to amounts paid to settle derivative increased by $3 million primarily due to the refinancing of two revolving debt facilities at a higher interest rate during the 4th Quarter and due to the drawdown of a $50 million debt facility related to the delivery of the Suksan Salamander FSO.

Income tax recovery increased by $2.2 million primarily due to a lower tax provision on our Norwegian entities. Capitalized distributions related to equity financing of new buildings and conversion costs increased as a result of the new units issued in the 4th Quarter to fund installment payments paid on our new buildings and conversions.

Non-controlling interest share in distributable cash flow increased by $2.3 million mainly due to an increase in revenue from a 50%-owned shuttle tanker the Stena Sarita due to her scheduled dry-docking in the 3rd Quarter and total distributions increased due to the issuance of 6.7 million common units during the 4th Quarter.

As a result our coverage ratio improved to 0.91 times during the 4th Quarter compared to 0.89 times in the 3rd Quarter. Wrapping-up this section on Slide 13, we provided an update to a slide we presented last quarter.

Including the six long-distance towing and vessels to be acquired by ALP, Teekay Offshore's total committed growth CAPEX now stands at approximately $3.6 billion which will drive further distribution increases for the next three years. Thank you all for listening and operator I'm now available to take questions.

Operator: Thank you. Ladies and gentlemen if you would like to ask a question, 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 press Star 1 to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal for a question. Please standby. And we'll move to our first question from Michael Webber from Wells Fargo. Please go ahead.

Michael Webber: Hello again, Peter, how you doing?

Peter Evensen: I'm doing fine, thanks.

Michael Webber: Just wanted to jump-in and talk about Petrojarl 1 first. That was the drop that kind of caught us by surprise as the implication is now it's going to be scrapped so it seems like a nice piece of business.

The rate is pretty firm on it but I think (you've been) talking to the idea that another asset could go onto that - the larger asset - would go onto that field after the initial charter's finished so I guess the idea is being, you know, the payback period extends through the life of the charter so you're really getting, you know, a new, you know, ten years of option value on that asset I would imagine after the charter.

I'm just curious as to how you think about either when you're upgrading that asset, do you build-in specifications to allow it to go other places in Brazil and then I guess how do you think about that option value? This is an interesting deal that we don't see a lot of. I'm just curious how you think about the back end of that return profile because it's wide open.

Peter Evensen: Sure, well we were also pleasantly surprised. We've been marketing the unit for two years and while we were marketing it in Asia as well as the North Sea and Brazil, we really were looking and hoping that it would go to some benign water which it has now in Brazil.

And so this unit has been reemployed 10 times so it is shown that it can be moved from field to field. What we like about QGEP is that and I think this is interesting is that we were competing against a new building and they wanted the written-down value of the Petrojarl 1 because it was more competitive.

I think in a low oil price environment you're finding that oil companies like the idea of cheap but nice existing units rather than have to go to the new build and that's a function of what's happened with the lower oil price.

So yes, we invested a little bit more money to make it available for the next 15 years or 10 years beyond the contract because it could stay on the Atlanta field much longer. It's a big field and there's various places it could move around or what we think could also be very likely is it could find a home on a lot of these Petrobras' fields, not the presalt fields but the more conventional field.

And because we'll have put on some equipment to be able to take-on heavier oil, that actually sets-up quite well for a lot of the oilfields in Brazil that are heavy oil so we're actually quite encouraged about that contract and as you say it was a nice upside.

Michael Webber: Got you, okay, no, that's helpful, especially the part around the heavier oil. Around your shuttle tanker fleet I'm just curious, when you kind of look at the age profile there and the environment we're in now, I'm curious as to whether this weakness pulls through or pulls forward any thoughts around replenishing that fleet.

And whether in this environment or whether you've been bought to the idea that maybe on a go-forward basis the North Sea shuttle tanker fleet could be smaller is guess over the next 10 years or you don't necessarily replenish the entire fleet.

Peter Evensen: Well, we've actually been waiting to renew our shuttle tanker fleet as we wait for technology to come in. Given that the North Seas has become an ecozone, I think we have been working and our team has been spending time on what the new generation of shuttle tanker will be.

Part of that process is we go out and talk with customers so we have actually I think we're in a good position because we have actually deferred the replacement and that gives us the chance to consider more fuel-friendly options, the option of having dual-fuel diesel electric so we can do LNG or fuel oil and we can optimally size our ships.

I think you'll find that the new generation of ships won't be the million barrel but will be somewhere around 750,000 barrels and that's what we're hearing from our customers so we actually think we get we are setup pretty well for a fleet renewal in 2018-2019 and so I actually like the idea that we don't have ships rolling-off.

In fact we ships reaching 20 years so we can replace them with much newer ships which is similar to the technological change you watched us do on the LNG side.

Michael Webber: Right. When would you expect to start seeing a capital qual association with replenishing that fleet even with the smaller assets?

Peter Evensen: I see that in 2018-2019.

Michael Webber: Okay, that's when, okay, that's the start of the capital. All right.

Peter Evensen: And so then we'll and that'll lead to distribution growth when that comes but obviously we don't order unless we have an extension of our contracts that we have but a lot of our COA contracts are like the field contracts so that gives us the opportunity to put in new shuttle tankers and if it saves our customers money, then we can provide value to them.

Michael Webber: Right, great. Just two more and I'll turn it over, one around FAU chartering. You went through it in the deck. Just curious what you would need to see to start exercising those options. Obviously you need charters in the first two. I'm just curious whether you would pull the trigger on any options, maybe one or two of the options without actually getting contracts in the next two FAUs.

And then you mentioned the flexibility around the delivery schedule of those two new builds. I'm wondering whether the same flexibility is built into the option stream.

Peter Evensen: Yes, I would say that we would be more cautious now because our customers are more cautious now so I think these units setup well for both the North Sea but we've been focusing much more on Brazil and Mexico and so the advantage of dealing with Brazil and Mexico is that you get long-term time charters as we have on the first unit, three year with an option for another three years.

Whereas a lot of the work in the North Sea is seasonal work and so what we like about the floating accommodation market is it has higher IRRs but you can take utilization risk. We think that our (savand) design is cheaper to produce than semi-submersible and so we think we're setup well.

But I have to be as I said yesterday on the Teekay Corp. call, customers are being quite cautious now and so we will in turn be cautious on not being too long units.

Michael Webber: Fair enough. Just one more and it seems kind of counterintuitive. There was I think it was a 400 million pound wind farm tender that went out in the U.K. I think it was a couple of days ago. I don't know if you guys have a wind farm installation business that's been I don't want to call it dormant but it hasn't certainly been a highlight or a focal point for the past couple of years.

I'm just curious as to whether or not you guys would be involved in that and in what sense and is it feasible that that could be a contributor to growth over the next year or two? I'm just curious as to where that stands and whether you guys would participate in something like that.

Peter Evensen: We have actually shut down our wind farm project and so we're not actively spending any time on business development there.

Michael Webber: There you go. All right, well, that's it. Thank you very much for the time.

Peter Evensen: Thank you.

Operator: Thank you. Once again ladies and gentlemen if you would like to ask a question, please press Star 1 on your telephone keypad and we will move to our next question from Martin Roher of MSR Capital Management. Please go ahead.

Martin Roher: Thank you and thanks for this presentation Peter, it was excellent. The question I have is on the Knarr project. You're now showing $80 million of distributable cash flow once it's up and running and at the analyst day in September you showed $70 million. Is that difference due to lower financing costs on the debt side?

Peter Evensen: Wow, Marty, great catch and you're absolutely right. I think we have a better sense and we're able to take away some of our buffers and so we're now comfortable saying that - some of our buffers - and so now we can confidently say that we'll make $80 million.

Martin Roher: Can you share with us the approximate cost of that debt financing?

Peter Evensen: Vince, can you add something on the debt financing?

Vince Lok: Yes Marty, it’s not a precise number but I guess it’s with I guess with the lower swap rates on that we’re probably looking at in the, you know, 4 to 5% range.

Martin Roher: Terrific, thank you very much, appreciate it.

Peter Evensen: Thank you.

Operator: Thank you. Once again ladies and gentlemen, please press Star 1 to ask a question. We see no further questions from the phone lines at this time. Please continue.

Peter Evensen: Okay, thank you all very much for listening today and as you hear our near-term focus is on getting the Knarr on contract and then therefore getting the distribution growth to all of our unit holders. Thank you very much for listening today.

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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