



TEEKAY OFFSHORE PARTNERS' THIRD QUARTER 2018 EARNINGS RESULTS CONFERENCE CALL

Company: Teekay Offshore Partners LP

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Operator: Welcome to the Teekay Offshore Partners' Third Quarter 2018 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 one to register for a question. For assistance during the call, please press star zero on your touchtone phone. As a reminder, today's call is being recorded. Now for opening remarks and introductions I would like to turn the call over to Ingvild Saether, Teekay Offshore's Group President and Chief Executive Officer. Please go ahead.

Tim Cowan: Thank you, Operator. Before Ingvild begins, I would like to direct all participants to our website at www.teekayoffshore.com where you will find a copy of the third quarter 2018 earnings presentation. Ingvild will review this presentation during today's 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 third quarter 2018 earnings release and earnings presentation available on our website. I will now turn the call over to Ingvild to begin.

Ingvild Saether: Thank you, Tim. Hello, everyone and thank you for joining us on our third quarter investor conference call. With me today I have Jan Rune Steinsland, our new CFO of Teekay Offshore Group who joined us in early September and we also have Tim Cowan, he was our Interim CFO until September 1st and he will be available for the Q&A session.



Please turn to slide 3 of the presentation. I will review some of Teekay Offshore's recent highlights. In the third quarter, the partnership generated total cash flow from vessel operations, or CFVO, of approximately \$167 million, up from \$162 million in the prior quarter. The increase was driven by stronger results in our shuttle fleets, a full quarter contribution from the Petrojarl I FPSO and our third shuttle tanker new building for East Coast Canada and lower operating costs.

We refinanced our 2019 bond maturities and our \$200 million promissory note with a new \$700 million bond maturing in 2023, which closed in early July. The new bond takes out 2019 maturities and significantly improved Teekay Offshore's debt majority profile as highlighted in the appendices of this presentation.

Earlier this week, we announced that we reached a constructive settlement agreement with Petrobras for a total of \$96 million related to the previously terminated contract on the HiLoad DP units and the Arendal Spirit accommodation unit. Additionally, in October, we entered into a conditional seven-year charter agreement with Alpha Petroleum for the Varg FPSO for the development of the Cheviot oil field. I will cover both of these transactions in more detail later in the presentation.

Finally, in October, we were awarded our second large-scale towage contract to perform mobilization and field installations services for Total's Kaombo Sul project. This includes towage assistance for the FPSO from a south-eastern shipyard followed by field installation in Angola, which will employ five of our towage vessels for total of 300 to 350 days. This contract award follows the successful completion of a contract of similar scale for Total's Kaombo Norte project earlier this year.

Turning to Slide 4. The CFVO of \$167 million was up \$43 million or 35% over the same period last year, driven by the contract start-up of growth projects. Our FPSO segment CFVO of \$82 million was up 21% over the same period last year, benefiting from the first two quarters of contributions from the Petrojarl I FPSO following start up in May 2018 as well as the full quarter from the Libra FPSO which contributed only partially in the prior period following the start-up in November 2017. The increase was partially offset by lower charter rates from contract extensions on the Voyageur Spirit and Ostras FPSO units.

Our shuttle tanker segment CFVO of \$67 million was up 8%, benefiting from the start-up of our three East Coast Canada shuttle tanker new buildings. The increase was partially offset by the delivery of two DP 1 shuttle tankers last year and increased scheduled dry docking



days during the most recent quarter. Our FSO segment, where the cash flow rose over 290% year-over-year to \$22 million, benefited from the contract start-up of the run rate FSO on the Gina Krog oil and gas field in the North Sea in October 2017.

Turning to Slide 5. I will review the details of our settlements agreement with Petrobras. Earlier this week, we announced that we completed an important settlement agreement in a constructive manner with Petrobras. The agreed settlement amount of \$96 million is relating to a previously terminated contract for the HiLoad DP unit and the Arendal Spirit accommodation unit. The HiLoad contract was terminated by Petrobras in 2014 and the Arendal Spirit was cancelled in the spring of 2017.

Of the \$96 million, \$55 million is receivable unconditionally in the fourth quarter of 2018, \$22 million is to be received by the end of 2020 and the remaining \$19 million is to be received by the end of 2021. As a result, we expect to recognize revenue of approximately \$91 million in the fourth quarter of 2018, which represents the present value of the future expected settlement amount.

The agreement also contains incentives for Petrobras to enter into new contracts with Teekay Offshore, on the Arendal Spirit, the Ostras FPSO and/or the Piranema Spirit FPSO. 40% of charter rates related to the new contracts on these three assets can be used to offset the deferred \$41 million receivable in 2020 and 2021

Concurrently, we also reached a settlement with Petrobras related to the Piranema FPSO and have agreed to a 2% reduction in charter rates over the contract period or approximately \$11 million. This was disclosed previously and was accrued for in three prior periods, primarily in 2016 and 2017.

Over the past decades, we have built a strong partnership with Petrobras who has grown to become one of our largest customers. With these settlements behind us, we can now turn our full attention to working together to deliver offshore production and logistical solution services for the fast growing Brazilian offshore market.

Turning to Slide 6, I will review the details of our recent conditional seven-year charter agreement with Alpha Petroleum for the use of Varg FPSO for the Cheviot oil field development. With the signing of this new agreement, we now have moved into a new stage of the project compared to where we were during our last earnings call. The customer is now



funding project ramp up and other work that needs to be completed prior to the Varg FPSO moving to Singapore.

We will do the required upgrade and life extension work at the Sembcorp marine yard in Singapore, which will be fully-funded by the customer in advance. This means we are able to redeploy one of our most significant assets on a new field opportunity with minimal, if any, of our own capital being required to fund the same.

It is important to point out that there are still conditions precedent relating to Alpha's financing which, according to Alpha, are progressing in accordance with the plan and are expected to be in place by the end of the year. Although these conditions remain we are already mobilizing our project team, preparing the unit for sail-away from Norway, and have signed the contract with the Singapore shipyard with the same conditions precedent.

Turning to Slide 7. With the addition of the conditional award of Varg FPSO, our large and diversified portfolio of forward revenues stands at approximately \$5.8 billion. This provides significant cash flow stability to Teekay Offshore and this is before including any contract extension or offsite from oil price and production tariffs on certain FPSO contracts.

On top of this stable portfolio, we have additional upside to potential earnings from contract extensions, redeployment opportunities and improving market fundamentals. This includes the Ostras FPSO, Piranema Spirit FPSO and Arendal Spirit, which I mentioned previously Petrobras is incentivized to employ. It also includes our towage segment, which as I mentioned in my opening remarks, was just awarded its second large scale towage contract for Total's Kaombo Sul and where there is significant upside from higher utilization.

Turning to Slide 8. During our earnings call in February this year we highlighted TOO's 2018 priorities and I'm pleased to report that we are making good progress on these priorities, including maintaining high safety standards and operational excellence with high fleet utilization and uptime; delivering our remaining existing growth projects that have started cash flowing over \$200 million of annual CFVO; securing charter extensions on the Voyager Spirit and Ostras FPSO units and redeploying the Varg FPSO on the Cheviot project where we hope we are in the final stages of effecting the contract; further strengthening the partnership's balance sheet through delivering as existing growth projects have delivered; and lastly refinancing our upcoming debt maturities, most notably financing our 2019 bond maturities with a new \$700 million bond in July 2018. We look forward to continuing the

pursuit of near and longer-term objectives with the ongoing support from our two sponsors, Brookfield and Teekay Corporation.

And in closing, we are encouraged by the increase of activity in the industry and we are seeing more opportunities coming in our core markets. With market leading positions, operational excellence and strong and supportive sponsors, we believe Teekay Offshore is well positioned to benefit from the expected strong demand for offshore production, storage and transportation.

Operator, we are now available to take questions.

Operator: Thank you. If you would like to ask a question at this time, please signal by pressing star one on your telephone keypad. If you are using a speaker phone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, that's star one to ask a question.

And I will take our first question from Michael Webber of Wells Fargo Securities. Please go ahead

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

Ingvild Saether: Good morning, Mike.

Tim Cowan: Morning.

Michael Webber: Ingvild, if you could quickly just kind of run through maybe how the actual incentives work associated with the settlement you reached with Petrobras. If you were to extend something or extend a contract would just, would that 40% be just amortized over the life of that contract? Would it be kind of front loaded? Just curious to how that would actually work.

Ingvild Saether: Yeah, so the balance of the settlement with the Petrobras is to be paid in 2020 and 2021. If we enter into a new contract, not an extension but a new contract for either the Arendal Spirit, the Ostras FPSO or the Piranema FPSO, 40% of that new revenue can be offset towards the settlement amount.

Michael Webber: And that is to be spread over the life of that contract?

Ingvild Saether: Correct.

Michael Webber: Okay. With regards to the Varg and Alpha, it's something that's been kind of kicked around the market for a while, so good to see it get finalized. Can you maybe talk through some of the mechanics kind of between now and then in terms of kind of the ideal deployment kind of into the Q2 '21 and how long will the upgrades and installations take and kind of what that asset will be doing between now and then?

Ingvild Saether: Yeah. So, as you correctly say, we have been talking about this project for some time, and we have worked very closely with the Alpha for more than 18 months in maturing the technical scope of work that is needed for employing the assets on the Cheviot field. So, what happens now is that we are preparing to take the Varg FPSO from Norway to Singapore where we will work with the Sembcorp Marine to do the necessary upgrades to allow us to operate on the Cheviot field. So, and that is an upgrade that will be funded fully by Alpha. So, it's really to take the assets from Norway to Singapore, do the planned upgrade at Sembcorp yard and then take it back and do the installation work and being ready for the first oil plan for Q2 2021.

Michael Webber: Okay. That's helpful. And then, it's more of an accounting question, but just trying to make sure I understand within the books, you guys had a loss on debt repurchases of \$55.5 million. It looks like it was in kind of a, it says non-cash accretion expense of \$31.5 million from I guess the delta between the face of the Brookfield note and then the carrying value. Is that effectively just a write-down of the book equity post-sale? Can you kind of maybe walk us through what exactly that was? For some reason, I'm just having a hard time catching on.

Jan Rune Steinsland: Yeah, the promissory note was at \$165 million prior to the transaction and redeemed at \$200 million. So, there is a book loss there of \$35 that is a non-cash item.

Michael Webber: Right. Oh, okay, yeah, because, okay. The function of the deal, it got closed into the \$200K or \$200, okay. All right. I think that's it for me. I will hop out. If I have anything else, I'll hope back in the queue, but I appreciate the time, guys. Thanks.

Ingvild Saether: Thank you, Mike.

Operator: Thank you. We will take our next question from Seth Lowry of JDP Capital. Please go ahead.

Seth Lowry: Thanks for taking my question. Over the summer, you put out a leverage target of four to five times. Can you just comment on if you have any line of sight into getting into that range?



And also, how do you think about that leverage target with the Petrobras settlement and also the Varg contract that may start up a few years out? Are those all-inclusive in hitting that leverage target?

Jan Rune Steinsland: Thank you. Yes, we are currently, depending a little bit on how you calculate the leverage ratio, we are somewhat on the high side of that range that you mentioned, and our target is to get more into the middle of that range. That is a balance going forward of de-levering and pursuing growth opportunities. And we see that near-term we will have some CapEx on the shuttle tanker projects where we will have a total CapEx of \$800, which will directionally move it in the wrong direction on the other side. When that comes into production that will be balanced out. And in relation to the Varg, we see that we are able to find solutions where pursuing growth projects are not conflicting. We're driving down leverage as we have found a solution here where there is an upfront funding by the client and as such, which is from our perspective favourable in terms of the leverage ratio development.

Seth Lowry: Okay. And just to follow up on that, just on capital allocation, as you're entering into the high side of the range, I understand that there is some significant growth opportunities in large projects, particularly in Brazil, I think some of the news publications indicated you were tendering for an interest in some billion dollar projects with really long-term contracts. How do you balance the capital allocation of going after these large contracts considering, one, that your equity cost of capital may not be currently supportive; and two, how do you weigh the returns on those projects versus say, redeploying cash back into shares, which seems to be given what is the current stock price a much higher return?

Ingvild Saether: So, I think the starting point is that it's great to see that market is now offering more opportunities than we have a capacity to invest in. So that means that we can be really focused and selective in the projects that we are going after and we can only focus on the cost of the projects that give us the right return and fits our portfolio. I think with the large FPSO projects in Brazil that you are mentioning, that is really a bit of an industry issue on how do you fund these long-term big infrastructure assets.

And, and I think it's currently challenging for any of the independent suppliers to fund those big projects. So that will be some of the focus to see what structures can be put in place to make it possible to participate in one of those or some of those. When it comes to buying back equity, it's always a balance about the opportunities that you see in the market and the near-term opportunity of buying back equity. And I would say that we will always do that

evaluation, but I would say that at the moment there are really a much stronger market out there with plenty of opportunities to grow the business for the longer term.

Seth Lowry: Okay.

Jan Rune Steinsland: I think I can also add that –

Seth Lowry: [inaudible].

Jan Rune Steinsland: Sorry, I think I can also add that in order to position us directionally better for participating in larger projects going forward, we would put a lot of energy into redeployment of our current assets, both Ingvild mentioned already. The Arendal Spirit, we can drive a higher utilization on the towage fleet when the market is coming stronger. We have redeployment opportunities on the FPSO, and all of that will drive everything in the right direction. And on top of that, you have for some of our FPSO, you also have upside on the oil tariffs that are not captured in the forward revenue of \$5.8 billion.

Seth Lowry: Sure, that makes sense. And just one more from me. I think I would echo Brookfield's comments during the debt rating process that the capital markets don't quite get or fully grasp your story. So, I guess is there any near-term catalyst you can point to improve investor communication, like either cleaner KPIs for equity holders or additional metrics, guidance at Investor Day or any kind of longer-term goal-setting from your five-year plan with Brookfield?

Jan Rune Steinsland: I think, I can share with you that we are generally looking into how we are reporting, what metrics we're using, and realizing that we are still an MLP, but we are not operating as much as net MLP as we were some years back in terms of yield pricing and dropdown opportunities. We will also then see if we can move to a more non-MLP metric set for reporting and we might move already within the next few quarters on that.

So, what, also with the second half of your question on how to communicate with the market, we are strengthening an organization in Norway, or say on the European Continent, with a finance function there now. And we will continue to work with the organization in the Teekay family and as such we are, we will have a much stronger footprint both Europe and the U.S. and Canada on the investor relation work, and we are looking into how to employ that going forward.



Seth Lowry: Okay. Great. Congratulations on all the progress you've made in the past year and I'll turn it over.

Jan Rune Steinsland: Thanks.

Operator: Thank you. We will take our last question from Max Yaras of Morgan Stanley. Please go ahead.

Max Yaras: Hi. Yes, thank you. I'd like to ask a bit more about the Varg project economics. If you can give us any kind of idea on returns or EBITDA generation. And then also, if you could talk about the upfront CapEx component. So to that will be paid for by Alpha. Is that all paid for upfront or over the life of the contract? Just any more colour you could provide on that.

Ingvild Saether: Yeah. So, if I start with the last part of your question first, so Alpha will fund the capital requirements as we go along in the upgrade project in Singapore. So, it will be funded upfront and paid over the life of the contract. At this stage, it is premature to discuss the specific regarding the cash flow impact to TOO. We are very focused on seeing the conditions listed and we will of course update the market and provide more details once this test been achieved. So I think we need to come back on that.

Max Yaras: Okay, fair enough. And then you announced a new towage award. Just wondering if you could give kind of any colour on what the towage market is looking like or opportunities past that award?

Ingvild Saether: Yeah, so you might recall that we had a large scale contract with our towage fleet in Q2 that consumed about the 300 vessel days and that was towing the FPSO for the Kaombo Norte field that Total is operating. And now they have a second FPSO that needs to be towed, which will be done in late Q4 beginning Q1, which will be an equally big project for our towage group. And I think we are one of very few who could do that Total job with 5 vessels working at the same time. And it's a great recognition of the job that we did on the first project that we were now being awarded the second project.

In general, the towage market is probably a bit behind the other markets in the market cycle. So, we have this year seen fairly low utilization and rates that are not very exciting. But we are seeing some more activity in that segment and it's really great for us to have these big projects that will consume so many days over a quarter. So probably a bit later in the cycle,

'19 will also probably be a year that is better than 2018, but not as good as we hope it will be on average.

Jan Rune Steinsland: And I can add that while we still see a relatively low overall utilization on towage, we are from time to time sold out, so that's promising, and we think that we will in not too long get out of the cash burning situation and turn this into a cash contributor.

Max Yaras: Perfect, thank you.

Operator: It appears there are no further questions at this time. Ms. Saether, I'd like to turn the conference back to you for any additional or closing remarks.

Ingvild Saether: Yeah, thank you. So, it has been a great quarter for Teekay Offshore. All the hard work by our teams around the world has given us significant wins this quarter, and we are also very optimistic about the improving fundamentals. I also would like to use the opportunity to thank Tim for his contribution as the interim CFO up until September 1st and in particular in all the hard work in getting the bond refinancing in place.

So, thank you all for calling in today and have a great day.

Operator: This concludes today's call. Thank you for your participation. You may now disconnect.