TEEKAY OFFSHORE PARTNERS' FIRST QUARTER 2019 EARNINGS RESULTS CONFERENCE CALL

Company: **Teekay Offshore Partners LP**

Date: **Tuesday, 30th April 2019**

Conference Time: **12:00 UTC-5**

Operator: Good day, and welcome to Teekay Offshore Partners' First Quarter 2019 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, press star zero on your touchtone phone. As a reminder, this call is being recorded.

Now for opening remarks and introductions, I would now like to turn the conference over to Ingvild Saether, Teekay Offshore Group's President and Chief Executive Officer. Please go ahead.

Jan Rune Steinsland: Before Ingvild begins, I would like to direct all participants to our website at teekayoffshore.com, where you will find a copy of the first quarter 2019 earnings presentation.

Ingvild and I 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 2019 earnings release and earnings presentation that are available on our website. I will now turn the call over to Ingvild to begin.

Ingvild Saether: Thank you, Jan Rune. Hello everyone, and thank you for joining us on our first quarter 2019 earnings call. With me today I have Jan Rune Steinsland, CFO of Teekay Offshore Group. Starting with slide 3, our large and diversified portfolio of forward revenues stands at approximately 5.4 billion at the end of Q1 2019. This provides significant cash flow stability to Teekay Offshore, and this is before including any contract options or upside from oil price and productions tariffs on certain FPSO contracts. On top of this stable portfolio, we have additional upside earnings from redeployment opportunities towards spot market and improving market fundamentals. I would also like to underline the relatively low counterparty risk from working with a very strong customer base.

Turning to slide 4, in the first quarter 2019, Teekay Offshore delivered solid results, both operationally and financially. We generated adjust EBITDA of $188 million and the underlying business is basically performing in line with the fourth quarter of 2018, which was a very strong quarter. The reduction in adjusted EBITDA of $101 million from the prior quarter is primarily driven by the absence of the $91 million Petrobras settlement realized in the fourth quarter, as well as a decrease of $6 million of a non-cash item. We entered into a new six-year contract in our CoA segment this quarter, which confirms how our CoA portfolio continues to create value for our customers with flexibility and uptake security. The floating pipeline.

During the first quarter we agreed to a contract extension for up to three years on the Piranema Spirit FPSO with Petrobras as previously announced, and we saw significantly improved results from our towage segment, driven by very high peak utilizations from our contract for the Kaombo Sul project in Angola. The project employed our vessels for approximately 380 days.

We also made good progress on the extensive 2019 financing and refinancing program, including closing in April a new important $440 million long-term debt facility that will be used to finance our four LNG-fueled shuttle tankers currently under construction at Samsung. We also yesterday closed a $100 million FPSO refinancing.

I will now turn it over to Jan Rune to go over the financial results.

Jan Rune Steinsland: Thanks, Ingvild. Turning to slide 5, adjusted EBITDA of $188 million was up $28 million compared to first quarter 2018 from higher earnings in all six business segments. Compared to fourth quarter 2018, adjusted EBITDA is down $101 million. As Ingvild mentioned, this is primarily driven by the recognition of $91 million of revenue related to the Petrobras settlement in fourth quarter 2018. Adjusted for this and a non-cash item in the FPSO segment, we are basically in line with the fourth quarter.

Our FPSO segment recorded adjusted EBITDA of $94 million, down $14 million from the fourth quarter. $6 million of the decrease was attributable to lower amortization of non-cash deferred revenue relating to the Piranema Spirit FPSO unit, and it is the last quarter we have this non-cash item included in our P&L. The timing of certain maintenance bonuses, especially related to the Libra FPSO in the fourth quarter 2018, accounts for the majority of the remaining decrease.

Our shuttle tanker segment adjusted EBITDA came in at $67 million, basically in line with $69 million in the previous quarter when we remove the impact of the Petrobras settlement related to the Hi-Load DP unit that is in the shuttle segment.

In our FSO segment, adjusted EBITDA of $23 million was down $2 million, primarily explained by positive contract demand on the Randgrid FSO in the fourth quarter and fewer calendar days in the first quarter.

Our long-distance towage segment generated adjusted EBITDA of $4 million, which improved by $5 million over the last quarter, driven by a 96% fleet utilization this quarter.

I will now turn the call back to Ingvild to cover our operating performance in more detail.

Ingvild Saether: Thank you, Jan Rune. Turning to slide 6, we continue to focus on securing charter contract extensions and new contracts for existing FPSO units. The contract extension with Petrobras is for up to three years for the Piranema Spirit FPSO. This extension came out of Petrobras triggering their contractual extension option, and allows production on the existing Brazilian field out to as late as early 2022. Petrobras has a termination right with a ten month advance notice that gives them flexibility based on what they decide to do with the field. The new contract is expected to improve adjusted EBITDA by $25 million in 2019 compared to decommissioning the unit and going into lay-up mode.

We continue to monitor and work with Alpha in their efforts to list the remaining conditions precedent to close our conditional seven-year charter arrangement for the use of the Varg FPSO for the Cheviot oil field development. We are concerned about the delay in getting all conditions lifted and timing is becoming an issue. The Ostras FPSO arrived in Namibia in March for lay-up while marketing it for both new contracts and a potential sale. Lastly, we notice that operationally we had a strong quarter with 99% commercial uptime for the units on contract.

Looking at slide 7, our shuttle tanker segment delivered strong results this quarter with 99% uptime for the TC and CoA shuttle tankers. In our CoA segment, which makes up about 30% of our shuttle fleet, we signed a new six-year contract with BP for the Lancaster field that will occupy 0.3 of a vessel with rates in line with our recent fixtures. Our fleet continues to have high and consistent utilization, confirming the tightness in this segment. We are making good progress on our new buildings and launched our first new building, the Aurora Spirit, in late March 2019. The remaining vessels continue to be on time and on budget and we are looking forward to their delivery later this year throughout 2020 and the last vessel early in 2021. Total remaining Capex for the six-vessel new build program is estimated at $664 million at the end of first quarter.

We have received two innovation awards for these ground breaking vessels. The environmental footprints from these vessels are reduced by 50% compared to the vessels they are replacing, measured in CO_2 equivalent emissions, and bunker volume and cost is also reduced by 50%.

Turning to slide 8, our FSO segment continues to generate strong and consistent results, reflecting high uptime. In April we sold the Pattani Spirit FSO for $16 million.

Moving to slide 9, we saw very strong operational and financial performance from our towage segment, which has returned to profitability this quarter. This was a result of our large contract for Total's Kaombo Sul project in Angola, with five vessels performing mobilization and field installation services for 380 days. While earning visibility is generally low in this segment, we expect to generate positive EBITDA for the full year 2019.

I will now turn it back to Jan Rune to go over our recent financings in more detail.

Jan Rune Steinsland: Thanks, Ingvild. As you can see on slide 10, we've had a very busy quarter and we made good progress on our extensive 2019 finance and refinancing program. As previously announced, we secured financing on favorable terms for our first four shuttle tanker new builds with Canadian and Norwegian export credit agencies and commercial banks. The facility carries an interest rate of LIBOR plus 2.25%, with a tenor up to 12 years and average profile of 18 years. And we are actually drawing the first $80 million under this facility today. We have also continued to work on the financing for the remaining two vessel new-builds, and we expect to close a sale and leaseback transaction in the second quarter.

We are also progressing the refinancing of the $450 million outstanding balance of our shuttle tanker revolving credit facility with commercial banks. The new terms are at LIBOR plus 2.50% with a tenor of five years and, probably most importantly, this refinancing reduces our annual amortizations from about $100 million per year to about $54 million per year. The deal was substantially oversubscribed and is expected to close in May, subject to customary documentation that is also progressing well.

And lastly, we have agreed with commercial banks terms to refinance the Piranema, Voyager and Varg FPSOs with a $100 million revolving credit facility. We will be making a $35 million balloon payment on the existing financing today and we will draw $100 million of the new financing either today or later this week. The new facility will be reduced to $45 million over a three-year tenor, bearing LIBOR plus 3.00%.

Ingvild Saether: Thank you, Jan Rune. Turning to slide 11, we can see an improved offshore market. The increase in global oil prices has resulted in increased free cash flow for E&P companies and this is supporting renewed interest in investment in offshore production and logistics.

Turning to slide 12, you can see the increased activity is translating into new projects. In the FPSO market, contract awards this year could be higher than at any time in the past five to seven years. In the North Sea, it's typically smaller fields where redeployments offer an attractive value proposition to the customers. In Brazil it is typically new buildings with high production capacity. Each of these new units for Brazil requires an investment of between $1.5 and $2 billion, with up to 25-year contracts.

Turning to slide 13, with growing offshore oil production we also see growing demand for shuttle tankers to move this production to shore. Several fields generating demand for shuttle tankers are currently in development in the North Sea and Brazil, with another 16 potential field developments being sanctioned by the end of 2020. In addition to the growth in demand, there is also replacement demand as approximately 40% of the existing DP2 fleet is retiring by 2025. The shuttle tanker market has always been very industrial in nature. Most vessels are on long-term contracts and no real spot market. With limited new builds to be delivered over the next few years, we continue to expect relatively strong demand and rates for our shuttle tanker segment.

Turning to slide 14, to conclude this presentation I want to take the opportunity to remind you of our top business priorities in 2019: maintain safety standards and operational excellence, secure FPSO charter extensions and redeployment, increase profitability in existing business, execute contemplated finance initiatives, and strengthen balance sheet through delevering. All of our new assets are operating well, with high uptime and to the customers' satisfaction. As our customers are increasing their investment budgets in our core markets, being the North Sea and Brazil, we are quite optimistic about the opportunities that we expect to see for Teekay Offshore, the recent extension of the Piranema FPSO being one of those opportunities. As you all can see from the material, there is quite a lot going on in Teekay Offshore!

Operator, we are now available to take questions.

Operator: Thank you. If you would like to ask an audio question, please signal by pressing the star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star one to ask a question. We will pause for a moment to allow everyone an opportunity to signal for questions.

We will take our first question from Michael Webber with Wells Fargo. Please go ahead.

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

Ingvild Saether: Good morning, Mike.

Michael Webber: Ingvild, I wanted to start off with – I wanted to actually go chase some financing questions on the transaction we saw this morning, but I kind of first want to start off with your comment around the Varg, which kind of cryptically commenting the timing is becoming an issue. Can you expand on that a little bit in terms of the different factors in play and what some of the repercussions around that may be?

Ingvild Saether: Yes, we have been talking about the Cheviot project for Varg for the last 12 months and we have been working hard even longer to do all the preparations for that project, and it's still a project that we very much would like to do. We have all the executions planned ready for that. But as we talked about in the last couple of quarters there are still some financing conditions that need to be lifted for us to proceed, and we know that Alpha is still working very hard on that but when we say that timing is becoming an issue, we need to see that fall into place in the next very short while.

Michael Webber: Right, I mean, is the implication there that you continue to market, you'd market it elsewhere, I guess? Maybe kind of frame up the context around the alternatives there and I guess, yeah, just help us frame the context there.

Ingvild Saether: Yes, the –

Michael Webber: So marketing it elsewhere, I mean –

Ingvild Saether: The base case is definitely that we want to do the project and we are in daily and very close dialogue with the yard and the yard suppliers and with everyone involved in this project. But at some point you need to get it over the finishing line and start the actual execution. We have a project team standing by and the yard has a big project team standing by, and we need to get started. So that is really what I mean when I say timing is becoming an issue and that we need to get the execution underway, and unless we are able to satisfy all the conditions, then at some point we will need to start to look at other alternatives for the assets.

Michael Webber: Okay. Alright. No, I appreciate that. And maybe just turning to the refinance work, there's a number of updates in here, but I noticed you don't actually lay out the entirety of, I guess, what the maturity schedule looks like today. So maybe inclusive, I guess, of the FPSO refinance that closed in April and maybe then with and without the shuttle refinance that needs to – I guess maybe with and without the shuttle refinance that needs to happen in May. Can you give us a ball park on what your total amortization and maturities would look like in 2019 versus your cash flow?

Jan Rune Steinsland: That was a more global question than I had prepared.

Michael Webber: Well just the balance sheet. If you – if we – I assume you get the shuttle tanker deal done, right, what's your commitment then or your obligation for the rest of 2019?

Jan Rune Steinsland: Well, I think I'll just highlight that the shuttleCo revolver has been a burden for us. It's been $600 million, that is amortizing over six years with $100 million each year, and we're now cutting the $100 million back to $54 million, so that's a gain of $46 million per year or $13 million per quarter and that's a significant contribution. So I think that's the main message.

And I think on the four new builds, we have a profile there of an average of 18 years, so that's close to the lifetime of the units, which is 20 years, and so we have a very good match there. And that's been in general an issue for us as a very capital-intensive industry, that we have long-lived assets and we have also relatively long contracts and then we have financings that we have to – that are amortizing quicker or that have shorter tenors. So all of this is stretching out and improving matching between asset lifetime and financing.

Michael Webber: Sure, sure.

Jan Rune Steinsland: And then there's lots on the move, so I think to go into what the total 2019 amortization will be, I don't really have that on hand but – so I'll have to go over that another time.

Michael Webber: I guess you turn the debt obligation for the company for the rest of 2019, even if we – I mean we can include the shuttle refinance or not, right, but that's not a particularly nuanced or overly detailed question, just a vague number would be helpful.

Jan Rune Steinsland: Yes, well we'll come back to that on another opportunity to give you more overview of it when we've finalized our financing and refinancing program for the year. So we'll disclose more of that in the coming earnings calls and, as I mentioned, we have other things that we will close in the second quarter too. So we'll provide a picture of that later on.

Michael Webber: Follow up offline. Okay. And I guess, the deal this morning with Brookfield taking Teekay's remaining GP stake, their warrants and their remaining equity, pushes them closer to the 80% threshold. Does that impact the way you guys go about handling the refinance works that you'll give us a full picture on I guess at some point at a later date?

Jan Rune Steinsland: No, this transaction is quite new to management, so we have not taken any of the various motivations that Brookfield might have had for doing this transaction into account in any of our financing work.

Michael Webber: Okay. Alright guys, thanks for the time.

Operator: Thank you. We will take our next question from Fotis Giannakoulis with Morgan Stanley. Please go ahead.

Fotis Giannakoulis: Yes, hi guys and thank you. I want to follow up on Mike's question. Pretty much trying to understand what kind of cross-businesses you have with Teekay Parent, what kind of functions are performed by Teekay Parent and if you will have to unwind completely this relationship and take on these functions. What would be the monetary impact for both sides?

Ingvild Saether: Thank you, Fotis. Well, we are already 18 months into the – since the transaction deal, original deal with Brookfield took place, and in this period we've had a – we buy some shared services from the Teekay Group and, at the same time, we have been building up some more of the standalone functions, like we have Jan Rune for instance being hired as the CFO. So over that time we have built TOO to be more as a standalone company and have the ability to operate on a standalone basis.

Going forward, I expect that we will continue that kind of separation, but there might still be some shared services together with the Teekay Group and we know that that will be available if we should choose to do so.

Fotis Giannakoulis: And if it's going to have any impact on your G&A? I understand that Teekay Parent has guided a reduction of its parent G&A. I was wondering if this will have any impact on your G&A.

Jan Rune Steinsland: So as Ingvild says, we're transferring certain services that we're today buying from Teekay Corp to the in-house. We don't see an increase in overall G&A based on that process.

Fotis Giannakoulis: Thank you, that's very helpful. And going a little bit more in the segment, we see you reported a very strong improvement on your anchor handlers in the towage business. Can you give us a little more color on that? How do you expect to be the run rate, EBITDA for this segment? And how important is this segment for you? Is there a possibility that you will divest this segment and redeploy this capital in the shuttle tanker business or the FPSO business would seem to be more – to have a greater importance for you.

Ingvild Saether: Yeah, I think the Kaombo Sul project that we just did in the quarter really plays to the strength of ALP, because there the customers require multiple vessels for different operations, such as towage and field installation, and we were able to use up to five vessels at the same time and for a total of 380 days. And there are basically not many companies out there that can do such an extensive job with the towage vessels, the specialized towage vessels with the DP and very high bollard pull capability. So we saw that then the towage segment went from -1 in Q4 to +4 in Q1 and that is in a market that is still quite, I would say, well still at best at the very early stages of recovery. So that points to some of the upside that we can see in this segment.

I don't think that we will see the same strong results in the rest of the quarters of the year, because it was driven by this big project, but I think it speaks to the upside that we will have from this segment when the market returns and activity's picking up.

Whether this is a core segment for us or not, I think we talked a bit about it last quarter as well. This is a niche segment and with very specialized vessels, and at the moment we don't think we would get anywhere close to the value of these vessels if we were selling them. So we are excited about this segment. Whether it will be core in TOO for the longer term depends on how the markets develop.

Fotis Giannakoulis: Thank you very much. One last question. Can you remind us what is the outstanding debt on the UMS and if I'm not mistaken this is due for repayment in the third quarter? Is there going to be any extension on that loan?

Jan Rune Steinsland: Yeah, there is some $40-odd million outstanding on the Arendal Spirit and, as you say, there is some maturity coming up during the year and, yes, we'll have a look at that.

Fotis Giannakoulis: Okay, thank you very much.

Operator: Thank you. At this time there are no further questions. I will now turn the conference over to Ingvild Saether.

Ingvild Saether: Thank you, and thank you all for joining us today on this first quarter call for Teekay Offshore.

Jan Rune Steinsland: Thank you.

Operator: Ladies and gentlemen, thank you for joining today's conference call. The call has now concluded. Please disconnect your lines and have a great day.