Sevan set to reap benefits of having Teekay as a partner

Sevan Voyageur is one of three FPSOs that will be acquired by Teekay Marine in the deal.

History of rescue deal reveals clues as to future game-plan

Barry Parker – New York

DEVELOPMENTS at Sevan Marine are still unfolding, in a story that will continue to evolve. Major news came at the end of September when the company dodged a bankruptcy bullet in a deal, still in the works, with Teekay.

In a nutshell, the capital intensive nature of Sevan Marine's FPSO construction led to a cash squeeze, and it has now begun a restructuring process that will feature a cash infusion from Teekay in return for an equity stake in the FPSO operator.

The typical back-channel story across a wide swathe of capital intensive businesses is that a game of brinksmanship will ensue as vendors and financiers clamour for available cash, and the cash-starved company will threaten bankruptcy unless creditors back off. Reports suggest that investor Jens Ulltveit-Moe, Sevan Marine's chairman, warned of such a move during the week prior to the announcement of the Teekay deal.

In the summer, concerns mounted over cost over-runs on *Sevan Voyageur*, an FPSO being upgraded prior to entering service in the UK area of the North Sea for E.ON Ruhrgas. Acknowledging the need to fund the unit's $45m construction shortfall, Sevan sought to restructure debt following a disappointing spin-off of the company's drilling unit, and its failure to raise $275m through a share issue. After a lengthy dialogue with holders of its bonds, Sevan had reached a deal with holders of five bond issues — two aggregating $370m and three aggregating NOK2.2bn ($375m) — on deferring interest payments until at least end-September. In Sevan Marine's highly leveraged structure that also includes bank debt, bond holders ranked behind "senior secured" bank lenders. In the summer of 2010 a $230 bank credit had taken a previous credit facility.

By the end of September, 2011, as the standstill agreement on bond interest was expiring, the crisis was heightened by additional rumblings of up to $100m of additional costs, bringing total costs up to $290m: above budget for *Sevan Voyageur*. These rumours were vehemently denied by the company through the unusual medium of a formal stock exchange announcement. Still, trading in the company's stock had been suspended as the company came up against the end September deadline.

The rescue deal, as reported, has the Vancouver-based Teekay acquiring an unspecified number of newly issued Sevan Marine shares, taking over three FPSOs, including the *Sevan Voyageur*, where financing for the upgrade would come from Teekay, and co-operating with Sevan on future FPSO projects. Considerable uncertainty surrounds the exact deal, though at least one statement insisted that Sevan Marine would continue to operate as a listed company on the Oslo Bourse. Shares analysts offered little in the way of comment, other than reiterating that Teekay would own the three FPSOs, *Sevan Voyageur*, currently being upgraded at the Nymo yard in Eydehavn, near Arendal, *Sevan Piranema*, four years into an 11-year charter to Petrobras, offshore Brazil, and *Sevan Hummingbird*, on a contract with Centrica in the UK North Sea, recently extended through end September, 2012.

From a business standpoint, analyst Egle Domataite at Terra Markets in Oslo told Lloyds List: "Strategically, Sevan FPSOs suit Teekay well in terms of increased presence in the North Sea and Brazil, where the market outlook for floating production units is seen as strong in the coming years." A mid-August, 2011 Teekay Offshore presentation cited 123 potential FPSO projects, "50% in Brazil and the North Sea", while a new Douglas Westwood report estimates that $68bn will be spent on floating production over the next five years.

"This so-called 'offshore loading' offered an opportunity for a newcomer without capital, as the oil companies were willing to give long-term time charters for newbuildings"

Jens Ulltveit-Moe, chairman, Sevan Marine

Both history and financial structuring might offer some clues into a future game-plan. In the spring Ulltveit-Moe's Umoe Shipping and Energy acquired a roughly 6% shareholding in the company. Ulltveit-Moe has achieved successes in buying into industrial companies at cyclical lows, most notably Knutsen OAS in the mid-1980s, and more recently Unitor, sold in 2005. The Knutsen OAS purchase is significant because it occurred at a time of technical change. In the words of Mr Ulltveit-Moe: "This so-called 'offshore loading' offered an opportunity for a newcomer without capital, as the oil companies were willing to give long-term time charters for newbuildings." Three decades after the Knutsen acquisition, the Arctic is on the verge of growth phase, much like offshore loading was in the 1980s. Sevan's cylindrical units, with sloping sides at ice draught, are touted as having advantages over conventional, vessel-shaped FPSOs in sub-Arctic and Arctic conditions. The ability to break ice in all directions is also an important plus for icy waters where floe-drift directions can shift quickly.

That a behemoth such as Teekay could take advantage of such a possible technological game-changer is not lost on Sevan. Carl Lieungh, Sevan Marine's chief executive, talked about the benefits of working with a strong industrial partner — in implicit contrast to a purely financial vulture investor, or worse, a committee of banks and/or bondholders running the company which sometimes happens after a bankruptcy. Ms Domataite cited the advantages of a strong technical partner in managing projects, and added: "The evident cost overruns on construction and operations is a different issue, but perhaps in Teekay, this will be improved and procured better." ■

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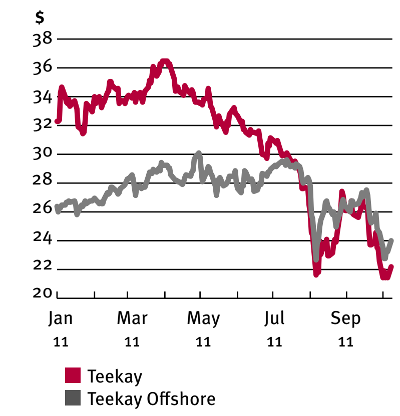
TEEKAY AND TEEKAY OFFSHORE
Adjusted closing share price



Source: Yahoo Finance

Teekay has the financial clout and market scope for deal

TEEKAY, with a fleet of five floating production, storage and offloading vessels — three in the parent and two in Teekay Offshore — has the financial resources and market scope to join forces with Sevan Marine.

Teekay president and chief executive Peter Evensen had described operation of FPSOs in harsh environments as a core competency for Teekay, which had indicated in August that it was "selectively bidding on additional FPSO project and acquisition opportunities". With the Sevan Marine deal, expansion can be effected on a wholesale basis.

Four of the Teekay group's existing FPSOs are working in the North Sea: two in UK waters for BP and CNR, and two in the Norwegian shelf for Statoil and Talisman; one is working for Petrobras in Brazil's Campos Basin. Teekay Offshore Partners, one of the daughter partnerships, owns two FPSOs — *Cidade de Rio das Ostras*, the unit currently on to Petrobras, and *Petrojarl Varg*, on to Talisman in the North Sea, "dropped down" from the "parent" Teekay Corporation in 2009 and 2010 respectively.

Teekay , in materials prepared prior to the Sevan transaction, touted its potential to drop down a further four FPSOs to the Teekay Offshore — with its stated objective of " generating revenues from a diversified portfolio of medium term (3-10 years), fixed-rate contracts with major oil companies".

Teekay is contractually obligated to offer an additional FPSO, *Petrojarl Foinaven*, working for BP west of the Shetlands, to the daughter company by mid-2012, according to an omnibus agreement between the parent and Teekay Offshore.

Teekay chief executive Peter Evensen has described FPSO operations in harsh environments as a core competency.

One of two upcoming Teekay FPSOs, an aframax conversion at Sembcorp's Jurong yard, to be named *Petrojarl Cidade de Itajai*, will enter into a nine-year firm period time charter contract to Petrobras with additional options in mid-2012. Teekay is partnering with the Odebrecht Group in this project, seeking a stronger foothold in Brazil. In the North Sea, a $1bn unit to be delivered in the first quarter of 2014 from Samsung has been contracted to BG for at least six years — or, possibly, a minimum 10-year term, with charterers agreeing term prior to end of 2012 — for work at its Knarr Field.

Mr Evensen, describing this deal, said: "Our sponsor, Teekay Corporation, was recently awarded a significant new North Sea FPSO contract also with BG. This is positive for our future cash flow growth as the newbuilding FPSO unit should become eligible to be acquired by Teekay Offshore once operations under its charter contract commence in early 2014." The intra-company omnibus agreement specifies that the newbuildings must be offered to the daughter company within a year of their charters commencing.

Strategically the Sevan Marine deal effects consolidation in a fragmented sector of FPSOs for hire, advancing two players from the back of the ownership leagues into a position within the top five. The deal also supports Teekay's financing strategies. A hallmark of Teekay's financial engineering has been its ability to create value through its family of yield-oriented "daughter" partnerships, which create value for holders of partner-units and for the parent, which maintains the lion's share of partnership equity.

FPSOs, tied to multi-year charters of three years or longer, are ideally suited for partnerships, because of their stable and predictable cash inflows. With such charters on their books, the daughter companies have, in turn, been successful in raising equity, and have sourced bank debt in difficult markets, enabling them to buy assets from Teekay Corporation. Most recently, Teekay Offshore raised $20m of equity in a July private placement (to partly finance construction of shuttle tankers).

In an acknowledgement that Teekay does face financial risks, the rating agency Standard & Poor's put the credit rating of Teekay — presently "BB", near the high end of sub-investment grade category and various rated instruments — into its CreditWatch. Such reviews are routine events when acquisitions are announced. S&P, in its explanation, pointed to both the Sevan Marine transaction, and to the weaker tanker markets, which have negatively impacted Teekay's profitability.

The S&P announcement was made prior to reports that Teekay Corp was pursuing a deal to acquire Maersk's liquefied natural gas ships, worth about $1.5bn, along with Marubeni .

Teekay will be acquiring three FPSOs. The arrangement surrounding *Sevan Piranema* — working for Petrobras, offshore Brazil — is ideally suited for the daughter entity.

Sevan Voyageur, which will go into a five-year charter with options once the upgrade of its gas compression equipment is completed, would likely fit the partnership template.

Unlike the unit's previous contracts, the upcoming Ruhrgas charter does not carry "reservoir risk", an incentive built into a previous contract. *Sevan Hummingbird* has ongoing re-charter risk in which the Centrica contract can be extended at six-month intervals, and would not be workable in the partnership context.

One FPSO not included in the acquisition, *Sevan 1000*, will be licensed rather than time chartered to operator Eni, with a 65% stake. for production at the Goliat field off the coast of Hammerfest, in the Barents Sea.

At mid-year, Teekay Corporation said that its consolidated liquidity totalled $1.9bn, of which $850m was at the parent. At the parent level, some $200m has been carved out for a stock buy-back programme, a tool typically used to bolster share prices by companies having large war chests but lacking solid core business projects.

With numerous floating production projects on the horizon, Teekay Offshore Partners reckoned its total liquidity to be $294m, at mid-year, split between $158.6m in cash items and $135.4m in revolving credit facilities available to be drawn down. ■

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Teekay's *Cidade de Rio das Ostras* is working for Petrobas in Brazil's Campos Basin.