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The MARITIME EXECUTIVE

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INTERVIEW: U.S. Coast Guard
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TEEKAY:
Vertical
Integration
with
FPSO

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BY JOSEPH KEEFE

Teekay Shipping Enters the FPSO

HIGHLY REGARDED TANKER OPERATOR SHAKES UP OFFSHORE PRODUCTION

The news last September that a bidding war had erupted for the North Sea Floating Production Storage and Offloading (FPSO) specialist Petrojarl ASA made for interesting reading. The story dominated the marine financial market news sector for more than a few weeks and as the stakes rose, it was apparent early on that Petrojarl would soon have new owners. So when the dust finally settled, the news that Petrojarl had yet another principal was not necessarily eye-popping stuff. Instead, the big story was that the world's dominant tanker operator, Teekay Marine Services, with its purchase of the majority of Petrojarl's stock, had entered the FPSO game.



Game



TEEKAY PETROJARL ASA
INSTANTLY THE LARGEST OPERATOR OF FPSO VESSELS IN THE NORTH SEA, TEEKAY NOW HAS UNDER ITS COMMAND FOUR SUCH VESSELS WITH A COMBINED PRODUCTION THROUGHPUT OF ALMOST 340,000 BARRELS PER DAY AND A CRUDE OIL STORAGE CAPACITY OF MORE THAN ONE MILLION BARRELS.

IN THE BEGINNING

The bidding war for Petrojarl ASA was lively, and eventually saw the price of the company's stock climb by about 65 percent in less than a month's time. The radical increase in valuation reflected the booming oil market and the premium that the industry had placed on the control and availability of FPSO vessels. During this period, Teekay increased its ownership stake from 22 percent to 37 percent and then again to about 40 percent. Rival suitor Prosafe held a 30 percent stake in Petrojarl, but ultimately could or would not increase its position to match the 50 percent ownership achieved by Teekay on October 18, 2006.

Seeking to increase their fleets of rigs and oil-production vessels as high oil prices spurred producers to spend more on exploration and production, both Teekay and Prosafe were seen as anxious to get their hands on Petrojarl's fleet. Eventually, Petrojarl's board recommended that the shareholders accept Teekay's offer. Once the Vancouver-based Teekay Shipping had achieved the 50 percent share mark, it was all but over and it effectively declared victory in its battle for control of the Norwegian oil production services firm.

Nevertheless, Prosafe declined to sell its 30-percent stake in the company and confirmed that it would remain a significant shareholder—a situation that still exists today. With Teekay, the Canadian-based, U.S.-listed tanker group in charge, Prosafe's continued investment should be a safe bet. At the time of the acquisition, Teekay Shipping had already established a solid reputation as a major player in the maritime industry. Its assets carry about 10 percent of the world's maritime oil traffic and Teekay has also expanded into the liquefied natural gas (LNG) shipping sector through its subsidiary unit, Teekay LNG Partners.

THE NEW NORMAL

Because over the past twenty years Teekay has made its reputation as an owner and operator of high-quality tank vessels that provides safe transport of petroleum on a worldwide basis, its decision to enter the FPSO market sector was clearly not a casual one. The company never does anything without considering the worst-case scenario and then planning for those consequences. According to Graham Westgarth, president of Teekay Marine Services and interim CEO of Teekay Petrojarl ASA, the plan to enter the FPSO market had been batted around internally for the last two or three years. "It is Teekay's ambition to be a leading service provider to the oil and gas industries," says Westgarth. The company's real reasons go far beyond that slick mission statement.

As the decision process went forward, Westgarth admits that Teekay knew that it lacked some competencies in key, core areas of the FPSO game, but says that it more than made up for those shortcomings in other areas. That is not to say that this is Westgarth's first experience with

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Graham Westgarth, president of Teekay Marine Services and interim CEO of Teekay Petrojarl ASA

FPSOs—far from it. During his final five years at Maersk, Westgarth served as general manager of a fleet of forty vessels, during which time he also established and managed the A.P. Moller FPSO operation in the UK sector of the North Sea. And while Teekay's prior experience as a whole was firmly rooted in marine matters, rather than the subsea/offshore fields, Graham adds, "Technically, we are ready." Beyond this, Petrojarl ASA, one of the real pioneers in the FPSO markets dating back to the 1980s, was already known for superior operating competence; hence there was instant synergy between the two partners.

Still a relatively small player in a growing field of vessels and players, the impact of Teekay's arrival has yet to be felt across the broad expanse of this sophisticated and relatively new (in terms of the maritime world itself) business sector. If Teekay has its way though, that could change very soon. Graham Westgarth gave a hint of where Teekay eventually hopes to go with its newest venture when he told MarEx in March, "It's about getting closer to our key customers. It's about the potential for vertical and horizontal integration of our services to others." His choice of words is telling and the previously one-dimensional world of

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face." All of the Teekay Petrojarl FPSOs are of double hull construction.

For the time being, Westgarth says that the Petrojarl arm of Teekay will be run as a separate entity, but plans for rebranding are currently underway. Although Petrojarl has had more than one other owner and many of those only got into the game for short-term profits, Teekay, according to Westgarth, is in it for the long play: "Unlike previous operators of this tonnage, we've taken a long-term view. As such, Petrojarl is amenable to the Teekay way for doing things." And doing things over the long haul has always been a good thing for the tonnage and companies



FPSO management will probably soon learn exactly what they really mean.

TEEKAY PETROJARL ASA

Instantly the largest operator of FPSO vessels in the North Sea, Teekay now has under its command four such vessels with a combined production throughput of almost 340,000 barrels per day and a crude oil storage capacity of more than one million barrels. Westgarth calls Teekay's initial foray into the world of FPSOs a "second-tier operation" in terms of numbers and capacity, but "first class" in terms of quality. The average age of its FPSO fleet is about fourteen years, a little older than what Teekay is usually comfortable with, especially when one takes into consideration the average age of the company's combined fleet, with newbuildings factored in, is less than eight years old. Westgarth dismisses any concerns over this, however, when he says, "Age is not as much of a factor in the FPSO market. Upgrades happen here more frequently because, for example, after the expiration of a five-year charter, a particular vessel may have to be sent elsewhere to hook into a different inter-

that Teekay has acquired. Perhaps even more importantly in today's marine markets, this long-term outlook is also good for the employees.

THE FPSO MARKETS

Worldwide offshore oil and gas production is growing rapidly and if the U.S. Congress can ever agree on the conditions under which the offshore U.S. markets can also be exploited, this sector of the market may be poised to explode.

On April 10, Dahlman Rose & Company, a self-described boutique investment bank specializing in the marine shipping and energy industries, announced that it was the first investment bank to initiate coverage of the floating production sector and eight Norwegian FPSO companies. Furthermore, the release stated, "Dahlman Rose believes that FPSO companies present strong opportunities for investors seeking long-term growth." This statement was probably music to Graham Westgarth's ears, as it sounds ominously like the Teekay way of doing things. Others, especially Teekay's newest competitors may find it slightly less comforting.

According to Dahlman Rose analyst Omar Nokta, “Deepwater oil and gas production is increasing as a percentage of total worldwide production and is expected to grow substantially during the next few years. Onshore oil and gas reserves have been largely depleted and incremental reserve replacement and production growth will increasingly be sought in deep waters off the continental shelf.” Dahlman Rose goes on to say that oil and gas production in deep waters has been restricted by a lack of infrastructure and occasional harsh weather, but the advent of the FPSO has, to a certain extent, changed this variable.

Dahlman Rose, and Teekay as well, believe that a robust, long-lasting FPSO cycle has just begun—investors will see “outsized returns,” according to Dahlman Rose. Furthermore, as MarEx went to press with this issue, Dalmon Rose reiterated its buy rating and \$62 target for Teekay Shipping (NYSE/TK). Teekay’s stock was trading in the \$55 range on April 12.

The bullish outlook for FPSOs is rooted in the fact that brown water reserves are dwindling rapidly. As oil exploration firms venture into deeper waters, the area where many believe the lion’s share of undeveloped reserves are located, they will increasingly turn to FPSOs and shuttle tankers as the logical solution for production and transport of crude oil supplies. With crude oil prices showing no signs of abatement, the development of smaller offshore fields remains attractive. Dahlman Rose analysts, in fact, predict that as many as 90 new development projects requiring floating solutions will arise in the next five years.

As many as fifty of the new projects may require FPSOs. Thus, with only one hundred or so FPSOs in the worldwide fleet and perhaps half that total under construction, demand for this type of tonnage

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will likely remain strong. Graham Westgarth points to this particular aspect of the business as a key reason for Teekay’s entry into the market. “The quality of earnings is very good and the day rates for FPSOs are too,” he said. Given the statistics, it is hard to argue with him.

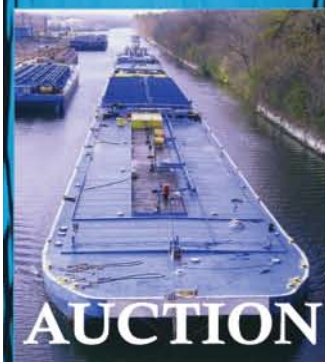
INTO THE FUTURE: THE TEEKAY BUNDLED SUITE OF SERVICES

As a player in the FPSO markets, Teekay is not yet one of the biggest, but it is certainly the most intriguing. Primarily known for its crude oil tankships, Teekay has steadily increased its penetration into both the offshore and natural-gas sectors. Its control of more than half of the world’s shuttle tankers should give readers real insight into where Teekay eventually wants to go. Beyond this, the company’s solid financial position gives it easy access to the capital required to make other moves.

Graham Westgarth was frank in his assessment of Teekay’s intentions in March: “We are actively involved and always looking at further expansion.” He also made it clear that Teekay would eventually be the offshore industry’s “turn-

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key" provider of production, storage and transportation of crude oils in the deepwater markets. With two-thirds of the puzzle already in place, an enviable quality record and existing petroleum transport relationships with the world's oil majors on which to build, it would be a real gamble to bet against additional moves into the FPSO game by Teekay. Indeed, as long as crude oil prices continue to trade in today's range, further consolidation in the industry is almost certain.

Teekay's worldwide reputation is unquestionably solid, but Graham Westgarth perhaps puts it best when he says, "It's not one thing that we do—we're professional and quality-driven on an international scale. Quality is bundled into everything that we do. And, we like to win." Westgarth refused to be more specific about Teekay's future plans, but he did say that real opportunities were presenting themselves in Brazil; he did not rule out an aggressive entry into U.S. or Australian waters, either.

Whatever Teekay decides to do down the road, it is almost certain that the vertical integration of all of its assets and business units will come into play when the timing is right. It is a simple model and one that any number of companies might want to follow. Trying to do that without the financial might and existing assets of this industry giant would be a daunting challenge. But, as Graham Westgarth likes to say, "The higher the hurdle, the better for Teekay." FPSO industry insiders will soon find out just how high Teekay sets the bar.

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